Managing Mergers and Acquisitions:

Perspectives from Human Resources

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Stefan Wuorinen, Brian Burgess, and Patrick Wright present a wide range of considerations and strategies to bolster acquisition success by expanding the influence of human resources on the processes. Using insights drawn from interviews with Fortune 500 Chief Human Resource Officers, they examine the role of HR in acquisitions and provide practical advice for increasing its effectiveness.

For decades, there has been pervasive evidence that mergers and acquisitions (M&A) often fail to meet their expected financial targets. Although researchers have suggested that many of the factors which contribute to suboptimal acquisition outcomes are "people issues," acquisition planners frequently under-consider the people question. The human challenges of M&A are a core concern for human resource (HR) professionals, though they are often granted little influence in acquisition planning. We interviewed Fortune 500 Chief HR Officers to better understand common M&A HR challenges and to develop a set of recommendations for increasing HR's effectiveness during acquisitions. The collective insights of our participants provide an extensive list of considerations that can help to facilitate firm integration, manage people issues, and improve acquisition performance. The most critical points include creating a clear vision for the acquisition, managing cultural differences, prioritizing the retention of key talent, and clear communication between organizations. Our interviewees also suggested that a holistic understanding of the business strategy would make HR practitioners valuable contributors to strategy from early in the acquisition process.

"The people side of the acquisition is always the toughest, and we read all the articles about why they fail, but it seems that companies don't learn from their mistakes. It's always a new leadership team looking to lead an acquisition… we put good leaders on due diligence or integration team, and it seems like there is a lack of education. It seems like every company makes the same mistakes and we all make the same mistakes every time."

Mergers and acquisitions are common means by which businesses increase the scale and scope of their operations. Both research and practice, however, suggest that more than seventy percent of acquisitions fail to meet their financial targets. While our understanding of the conditions in which acquisitions are likely to succeed has improved, acquisition returns continue to underwhelm, leading researchers and practitioners to examine the less obvious factors by which companies navigate some the most challenging parts of M&A – notably, avoiding losses in human efficiency. Decreased human efficiency, increased employee turnover, and the loss of institutional knowledge are difficult transaction costs to model in a financial plan, making it all too easy to overpay for acquisitions. Firms can readily evaluate the expected return on investment in an acquisition, but the human costs are more pernicious variables. Choosing the right deal is only half the battle; success also requires effectively integrating the target firm.

"The people side of the acquisition is always the toughest."

Experienced financial executives and human resources (HR) officials agree that many acquisitions fail at the integration phase, and often because of 'people issues.' Indeed, the largest obstacle to success may be retaining talent while aligning the vision, incentives, and cultures of two firms. HR plays an integral role, communicating and aligning the shared goals of otherwise disparate organizations and mediating relations between M&A strategies and actions. Yet research suggests that senior HR officials and Chief Human Resources Officers (CHROs) are frequently omitted from pre-integration planning despite evidence that their early involvement significantly improves acquisition performance. Our interviewees confirmed that, even now, Fortune 500 HR officials find that their early participation is undervalued.

Our goal, then, is to gain a better understanding of the challenges that HR officials face during acquisitions and to provide tools with which they can get a seat at the bargaining table. Although these tools should be generally useful in bolstering acquisition performance, every acquisition is unique, and we can offer no panacea for the idiosyncrasies of all. Instead, we shine a spotlight on the difficult questions that HR must address during integration. In so doing, we find that involving HR early in the M&A process is critical to a balanced acquisition strategy.

In 2019, we interviewed eight CHROs and three members of HR acquisition teams from ten Fortune 500 firms. All participants had extensive experience with M&As and had recently (within the past three years) played integral roles in large acquisitions. They shared their collective experience with over 200 acquisitions in industries ranging from biomedical to technology to consumer goods. Although we focused on the acquirer's perspective, some of our participants had also experienced an acquisition from the target side and provided us with additional insight. We have focused on the most common challenges our participants faced and used their knowledge and successes to devise methods by which firms can improve their integration planning.

We began by asking participants to describe the most and the least successful acquisitions in which they had participated and the processes which had led to that success or failure. Their responses allowed us to identify certain themes common to either successful or unsuccessful acquisitions. We then investigated how participants perceived the role of HR in each phase of the acquisition process. We focused particularly on target identification, due diligence, negotiations, and integration. Our conclusions demonstrate the value of HR in M&As and suggest ways that HR can facilitate more profitable acquisitions.

Insights from Our Interviews

There are many reasons why M&As fail to create the expected synergies between organizations. Our participants cited poor due diligence, poor strategic fit, bad financial planning, and legal issues as possible causes. However, they considered people issues of various kinds to be far more common contributors to acquisition failure. While integrating the best qualities of each organization makes perfect sense on the surface, the value that integration creates must exceed the loss which results from learning time, employee stress, and conflict. Decisions such as which information system or organizational command structure to use can be rife with employee related concerns.

People issues tend to fall into the broad categories of retaining high quality talent, navigating cultural differences, and creating a shared vision and goal. When firms stumble in any of these areas their acquisition success may decrease. Research shows that executives tend to prioritize tangible aspects of the deal far above culture and other human issues. We have identified the challenges that were most commonly mentioned in our interviews, scrutinized the nuanced issues within them, and devised solutions informed by our interviews and by academic research. Both the challenges and our solutions are interdependent. Nonetheless, all the challenges, individually and collectively, impede the alignment of the vision, goals, and values necessary to bring workers from two disparate companies into harmony.

> "A lot of the issues in the integration, honestly, are people issues - I would say that's 75 percent of the issues."

The Lack of a Clear Vision

Many of our participants described the lack of a clear vision or purpose for the acquisition as a core cause of problems. It is critical that leaders have a clear vision for the post-combination organization and its culture and purpose even before the deal is made, and this vision should be continually updated as integration progresses. Since firms often pursue expansion opportunities fiercely, our participants suggested that executives looking to expand can develop "deal fever" or looking "off to the next shiny thing." Our interviewees told of CEOs who were "driven by the hunt," showing little interest in developing and supporting acquisitions that are already underway. In consequence, these organizations often failed to clearly articulate a vision of the organization after the acquisition. Our participants were nearly unanimous on the necessity of having a coherent strategic purpose and a clear vision of how the integration will unfold. As one put it, "if you are too broad in what you are trying to accomplish, you complicate the integration process." In short, lack of vision creates ambiguity, leaving workers struggling to create support systems for poorly defined goals.

> "It's all about management of tension and resources."

Creating a clear vision is both an operational and a human problem and failure can cause members of both organizations to pursue incompatible or inconsistent goals. If the merging firms are to align their goals, strategies, and decision processes, their leaders must present a clear vision. If they do not, the resulting uncertainty can lead to greater friction, stress, and cultural conflict as employees fill the leadership gaps with best guesses or rumors, some of them malicious, and align their behavior and attitudes accordingly. HR systems can only be beneficial to the extent that they support the objectives of the firm. Only by understanding the goals of the acquisition can HR leaders emphasize the right policies. Tightly integrated organizations, for example, may require HR practices which focus more on commitment than those used for 'bolt on' acquisitions or those aimed at harvesting the physical resources of target firms.

"It's all about management of tension and resources. If you don't know where managers are diverting resources and don't have a management team that is laser focused on particular outcomes, it will be invisible to you most of the time, but people will have divergent interests. The more focused you are on a small set of outcomes, the more predictable your outcomes will be."

Creating a Clear Vision

Because the failure to articulate clear goals for the merger can cause the whole process to fail, our interviewees suggested several ways to improve vision.

Ask the Hard Questions: If a vision is to guide the myriad human tasks that make acquisitions succeed, it must be clearly defined at every level – business model, operational, financial, legal, human, etc. By developing clearly defined plans, leaders reduce the risk of acquisitions motivated largely or entirely by deal fever. Before launching any acquisition, executives should have clear answers to the following questions and more (in accordance with the individual qualities of each acquisition).

- **How will the acquisition add value to the company?** One respondent advised "before you look at the financials, consider what that merger would represent from a business model perspective." Each form of value requires its own support systems, whether it be intellectual and physical capital, human capital, stronger research and development, or product or market diversification. Integration teams therefore require a clearly defined plan in order to develop the support systems necessary for a fruitful integration.
- **What will the identity of the new organization be?** Firms can divvy up brands, regions, tasks, and customers in many ways. Managers can better plan for integration if they know whether the companies will operate under one brand or two and which group or groups of customers they will serve.
- **What qualities characterize the combined company culture you envision?** Once the team has clearly articulated the new business model and strategy, they should outline the cultural mechanisms necessary to support that strategy, considering which elements of each organization's culture to retain and which to discard.[8] They may need to devise different social climates and systems for different areas of operation. By detailing and systematically updating these goals, they will facilitate the use of suitable training procedures (such as role-plays) and of incentive systems that support the desired culture.
- **What will happen if we are wrong?** Given that a firm must evaluate a multitude of factors for each acquisition, it is unlikely to perfectly predict everything that happens. In considering every contingency the acquisition team will necessarily validate (or disprove) its own assumptions about the acquisition. The CHRO and the acquisition team can contribute valuable knowledge by asking hard questions, discussing scenarios in which plans go awry, and devising contingency plans for everything from replacing lost talent to the failure of a new business line.

Be Decisive: The team should consider the answers to the above questions with a view to how the acquisition might limit other opportunities. Choosing any one direction often incurs an opportunity cost. Many of our participants mentioned that the CEO and the top management team must not be afraid to make tough decisions. In some cases, the toughest decision is a cautious one which provides for internally consistent systems and communication in support of a coherent strategy. In short, if the firm can effectively execute a well-defined cautious plan, it may find greater success than it would with a more audacious plan, poorly defined and poorly executed.

"What I have found is that it can be very easy to kick the can down the road…When you're merging companies, people avoid making decisions early… the power differentials suggest that one person will have control. If you create the expectation that both groups will have equal power, you are going to cause problems. It is better to have those conversations about who will be in charge early on and let those who need to heel, heel."

Cultural Obstacles

Our participants also cited cultural challenges as one of most common causes of acquisition failure. Organizational culture is here defined in terms of policies, practices, values, basic assumptions, and decision-making structures. If not carefully managed, cultural differences between the firms tend to damage M&A returns. Their effects generally range from marginally positive to vastly negative. By using inclusive language, the transition team can stymie the magnification of cultural differences, halt the growth of stereotypes, and discourage the use of disparaging language.[8] As the team works to align two companies whose differing concerns cause them to speak fundamentally different languages, conflict may nonetheless arise.

> "If you create the expectation that both groups will have equal power, you are going to cause problems."

Our participants consistently described cultural challenges and conflicts as early signs of trouble. While most research to date has considered cultural issues only at the organizational level, the HR executives we interviewed cited difficult early interactions with the target firm's top management as symptomatic of cultural challenges to come. They observed that both initial and ongoing conflict between top management teams is likely to spread, with the conflict spilling over to the rest of the organization, undermining cooperation and instead creating a competitive environment. These cultural issues presage greater challenges, as disagreements between unhappy employees slow performance and workers begin to leave the company. In successful mergers, our participants observed that managers at the target company were enthusiastic about the deal. While interactions between the two firms were not free from conflict, they were characterized by congenial collaboration and a common willingness to facilitate cultural and strategic change.

One interviewee described an attempted integration in which the managers of the target firm formed a coalition to express their rejection of the acquisition. Passive aggression was commonplace, and it was clear that the target firm's employees were not in favor of selling their company. The interviewed executive described how the acquiring team arrived at an integration planning session to find every member of the acquired leadership team wearing a wristband that read "Protect this House." Rather than contributing to a smooth transition, managers in the target firm were actively working to protect their territory from the changes necessary for integration. This example illustrates both the cultural challenges which top management may face and the risks of acquiring a company whose employees identify strongly with their existing organization and are determined to protect its culture. Although the tension arising from such a situation is obvious, strong evidence reveals that even some of the world's most reputable businesses will blindly proceed with an acquisition regardless.

Navigating Cultural Obstacles

Culture plays an important role in the success or failure of an acquisition. Our respondents suggested several ways to manage culture and increase the probability of success.

Know Your Culture and Theirs: HR professionals can look at organizational structure, vision, pay structure, and incentive plans to find cultural similarities or differences. Academic researchers have developed many useful survey tools such as the Denison Culture Survey which can help to identify these differences. Participants also emphasized that some cultural differences may be more important than others. For example, moving a company from a control-based HR system, that heavily manages individual behavior, to a system more focused on employee freedoms and commitment is likely to be easier than moving it in the other direction.

Take Culture Seriously: Many of the HR officials in our sample felt that while cultural differences may be only an obstacle to be aware of in some instances, in others they should be a disqualifying factor. Although some acquisitions must proceed for financial reasons and despite cultural differences, significant cultural conflict nearly always leads to an unsuccessful acquisition. It is therefore vital that leaders have a strong understanding of cultural alignment during target identification and due diligence so that they can plan and communicate appropriately in managing cultural challenges.

Change the Pace: The nature of an acquisition will probably determine the degree to which the two firms will integrate. Managers can, however, use the speed of integration to manage cultural issues. Our participants varied widely on how fast and to what degree the target firm should be integrated. Some advised patience and gradual change while others recommended moving quickly and decisively. One interviewee even offered an example in which the team expected cultural differences to undermine merger efforts to such an extent that they chose to incubate the new firm separately until they could build trust over time. Practitioners may want to consider planning a slower integration when faced with serious cultural issues or human capital concerns or when the changes planned for the target firm are extensive.

Talent Retention: Defending the Value of Your Acquisition

When key talent leaves in response to an acquisition, the acquired asset immediately loses value, not only in the obvious sense of decreased performance, but also in the immense loss of knowledge and of social and relational capital. This effect is worsened because it is the most talented workers who are most likely to leave because they have more employment opportunities than their less capable colleagues.

Many studies have examined turnover in top managers during acquisitions and recorded its negative effect on acquisition outcomes in the short term. Now, however, some scholars have suggested that the leadership instability caused by M&As can last up to nine years. Since resignations can be contagious, retaining leaders encourages other workers to remain. Given that turnover among executives of the target firm is generally agreed to be detrimental to acquisition performance, and that the signs of executive turnover are visible early on, mass departures should be viewed as a deal breaker.

Keys to Retaining Talent

Nearly all the recommendations made by the CHROs in our sample related either directly or indirectly to talent retention. Lack of a clear vision, cultural conflicts, poor communication, and so forth can all cause undue stress which drives turnover. However, our participants did suggest some tactics and considerations for retaining talent.

Identify Top Talent: To identify the workers you want to retain you can request a list of high potential employees from the target firm's leaders, conduct interviews and surveys, and even consult acquisition advisors. However, the target firm's leaders may pass on their own bias while outside advisors may lack a fundamental understanding of either firm. It is often wiser to take a trust but verify approach, conducting your own interviews and using personality or leadership tests to ensure that the suggested individuals will fit well into the culture you are building.

Talent Retention May be Worth More than the Talent Itself: Given that the departure of a few workers can lead to turnover contagion and drive broader losses in productivity, talent retention is more important than simply keeping a role filled. The transition team may therefore want to plan on compensating certain people for a value greater than their direct contributions to the company.

Leverage Your Allies: Our participants described several instances in which top talent who chose to remain acted as instrumental allies, using their relationships to communicate effectively and foster integration. Because the target firm's leaders have more information about human liabilities and assets, their support is invaluable. In instances in which the two management teams maintained an amicable relationship, the acquirers received more candid information regarding the target's opportunities and threats while also enjoying the benefit of having champions of the acquisition on the target side. Leaders at the target firm who support the acquisition encourage support among their colleagues and make internal communications more optimistic.

Lock in Key Talent: When executives at the target firm plan to jump ship as soon as the deal is secured, it may be best to back out of the deal. Yet while keeping key executives is generally good for integration, it is less important afterwards. It may therefore be worthwhile to get top executives under contract for a specified period.

Plan for Contingencies: Although retaining talent is beneficial during an acquisition, it is unlikely that everyone will stay. The acquisition team should therefore have a succession plan for key players, a backup scenario for when things do not work out as planned.

> "Communicate, Communicate, Communicate!"

Other Advice on Effective Integration

Communication is vital in shaping the expectations of acquired executives and employees. If you do not define and communicate a clear vision, gossip will surely fill the void. By setting appropriate expectations and avoiding misunderstandings, you ensure that employees of the target firm feel they are being treated fairly. Effective communication will ease all the challenges described above. Our participants suggested designating a communications expert to ensure clear, comprehensive, and well-articulated communication and to avoid misunderstandings and ambiguity. They also offered the following advice.

Be Honest and Straightforward: Being candid about who will lead the new organization is critical for success. It is also important to set expectations early. Although these conversations can be awkward and uncomfortable, having them early on clarifies everyone's expectations, letting them know who will lead and who will follow in the ensuing integration. Employees of the target firm will appreciate the honesty and refrain from unnecessary power struggles. While in some cases everyone may still have a role, the top management of the two firms cannot be perfect equals in the new organization; some managers will be placed in lower positions. By understanding how people feel about these changes in power and organizational strategy, the acquisition team can get an idea of who will stay or go and who will make a valuable ally.

Don't Acquire; Merge & Integrate: While being clear about future power structures is very important in conversations among top managers, communicating to the rest of the organization presents a different challenge. Our participants warn against using threatening or domineering language that stresses one organization having more power than the other. They particularly suggest avoiding the term "acquisition" and instead using the term "merger." As one HR executive pointed out, "I think there is a natural tendency to think, 'we're the acquirers, so we must be the better company with the best talent, operations, and culture.' If you go in with your eyes open… learn what we can, and adapt to the target firm's strengths, you will have a better outcome." By consciously building a more cooperative environment and mentality, firms are likely to reap better results.

HR Executives in their Own Words

Communication and Integration

"We had a clear vision and plan. Once we decided on the target company, we moved quickly to organize the due diligence process and it was very structured, and involved the whole senior team including the CEO. I met the senior leaders of the target firm, we talked about people and culture and what is important to them and all these HR types of due diligence as far as what programs they were used to. Every function did this. We did a town hall with the leadership and asked the hard questions, so the preparation was critical. Then, we put an integration plan together and a steering team (integration team) with

people from both sides to help. This has been something we have done in acquisitions moving forward. This is hugely helpful. There was not a lack of clarity for how the new business is expected to operate. When you lack clarity, you're more likely to lose talent. We also focused on retaining the talent we didn't want to lose. We also communicated, communicated, communicated."

The Flaw in Simply Seeking the Best of the Best

"A lot of consultants would suggest integrating the best technology and best talent from each firm. This is a frequent prescription and is often a prescription for disaster. The company we acquired was a large acquisition and you would think we should integrate the best technology from both, but this would disrupt the functioning of 11,000 locations. To make that change so quickly would require showing that adding the new technology would have to add more value than the change and disruption it causes. The best of best mentality is too simplistic because it does not include conflict in the equation."

"When you lack clarity, you're more likely to lose talent."

Why and How to Get HR Involved from the Start

Why Involve HR Early?

Our respondents have found that forming a cross-functional team composed of experts from all areas of the organization, including HR, is imperative for success. Mergers are complex and multifaceted. The team which manages them must therefore cover a range of areas of expertise. HR is valuable because it can identify the human and cultural challenges likely to arise throughout the process and create advance plans to manage them. Our empirical evidence to date also suggests that involving HR early in the process contributes to the acquisition's success. Although HR is rarely involved in target identification – generally regarded as the first stage of an acquisition – the HR practitioners we interviewed feel that they could be of use even at this stage by identifying cultural and HR issues before executives devote any additional effort to the potential deal.

One participant aptly described a common sentiment among the HR executives and officers in our sample:

"I would like to see more compatibility evaluation done during the target identification phase because I know how important those things are if you are going to integrate… but at the point at which I have the information I need to advise the organization in the due diligence phase, we are really far down the path. Then you find yourself in a situation where you are bringing unwelcome news as opposed to moving upstream… I think you would find yourself less in a position of trying to talk people out of something or trying to help people understand how significant these kinds of things are."

Throughout our interviews, we noticed recurring discussion of the importance of asking the hard questions and having a clear vision for the acquisition. The CHRO was often charged with asking these challenging questions in order to clarify the how and why of acquisitions. Participants also reported that these contributions are frequently perceived as naysaying by CEOs, focusing on everything that can go wrong rather than everything that can go right. HR executives should be aware of this perception and evaluate the acquisition from a business perspective as well as a human one. By displaying cogent business savvy, they may be better able to combat deal fever.

"I would like to see more compatibility evaluation done during the target identification phase."

How To Get HR Involved Early?

Be an HR Business Partner: When asked about the circumstances in which HR is likely to be involved early, our participants repeatedly gave one simple answer: HR executives will be invited to the strategy table to discuss upcoming acquisitions if they know the business and can contribute to conversations about financials, operations, and more. These early conversations are generally concerned with *what* and *why*. Understanding the competitive landscape and the differences between potential acquisition targets lends the CHRO credibility in turning strategic discussions toward the *how* of HR.

Be a Skeptical Yea-sayer: Many of our interviewees' recommendations for strategic discussions concerned avoiding the use of prohibitive language. "Just saying you 'can't do that acquisition because it's a culture mismatch,' is not helpful for two reasons. First, because the measure of success is typically financial results, HR executives must link culture to those results. For instance, if financial success requires that the two companies collaborate on innovation to create new products, culture clashes which prevent or interfere with that collaboration would be detrimental to financial success. Lee Dyer, one of the first academics to study the link between HR and strategy, often told HR executives "Never say no to a business leader unless you can provide an alternative way to achieve the same goal." Similarly, some of our participants recommended that when HR professionals point out problems, they should also suggest solutions, proposing a more effective way forward. While we contend that sometimes mounting cultural challenges should be considered good cause to back out of a deal, it is important to recognize that CEOs may not agree. It may be more effective to suggest adjustments that will ease the way ahead. One participant suggested, "Given these potential challenges, we need to ensure that we have strong allied leadership in the target firm, or we may want to take integration a bit slower so we can listen more and give them time to adjust."

Have A Concrete Game Plan: HR is often accused of being too soft on the details because it does not provide hard metrics that link human behaviors to financial performance. If HR professionals propose that HR should be involved but do not provide a concrete plan for their involvement, they only perpetuate this stereotype. Before proposing any involvement, HR officials should lay out their tactics and goals. Some valuable goals are: ensuring that there are no outstanding HR-related financial concerns (e.g. pension plans, law suits, etc.), identifying cultural differences that will require management, identifying the top talent and potential allies, and determining who is likely to stay and who is planning to jump ship. Tactics which may be useful include: interviewing key personnel, utilizing employee selection tools, conducting HR audits, measuring culture and climate, identifying differences in policies and practices, and more. Armed with a concrete plan of this kind, HR managers are more likely to be accepted as valuable contributors.

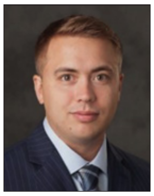
Conclusions

Mergers and acquisitions will continue to be an important tool for growth. CEOs may focus on the development of new strategic capabilities that will come of combining the firms. CFOs may focus on the increased revenues or decreased costs produced by eliminating redundancies. But achieving these strategic and financial synergies depends upon people.

Research has shown that only a minority of mergers achieve their financial goals and that the rest often fail because of fleeing talent, culture conflicts, and a lack of employee engagement, in short, people issues. If firms are to mitigate these risks, they must first identify them and develop strategies to head them off. We found that HR executives are often tasked with solving these problems in the integration phase of M&A but are not necessarily included in identifying and evaluating potential acquisition targets. By involving HR earlier in the process, firms could avoid these problems rather than asking HR to clean up in the wake of poor acquisition decisions. HR executives can help decision makers to articulate their vision more clearly for a successful merged entity. They can identify potential cultural obstacles before they arise and either propose ways to address them or advise discarding the firm as a viable target. The expertise of HR can also be used to better assess talent and manage culture and relations during the potential merger.

To enact a successful merger, integration teams must have a clear understanding of the combined strategic capabilities, the financial models, and the human capital necessary for building those capabilities and delivering those financials. Now that most organizations understand the importance of HR expertise in the integration phase, it is time that they make best use of HR in the target identification and evaluation phase. We and the HR professionals we interviewed believe that firms that involve HR earlier in the process will be able to entirely avoid many of the people problems that portend failure, and instead reap far greater success.

Author Bios



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