

Strategic business partner: Rhetoric or reality? The role of human resources in mergers and acquisitions

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ABSTRACT

The role of Human Resources in Merger and Acquisition transactions can have a critical impact on deal outcomes. However, although current rhetoric acknowledges the importance of Human Resources in M&A transactions, insufficient evidence exists to suggest that Human Resources directly influences business strategy or transaction performance outcomes. Factors such as Merger and Acquisition success and failure rates, merger motives and merger types and transaction climate provide significant insight into the reasoning for the predominantly operational and executional role of HR in M&A deals.

Introduction

Over the past few decades, Merger and Acquisition (M&A) activity has significantly developed internationally, with M&A transactions becoming a critical strategic tactic for organisations in the quest for growth, diversity and shareholder return. These transactions have significant implications not only for the economic, financial, legal and political success of an organisation, but also for the human equation – Human Resources (HR).

Despite the growth and increasing sophistication of global merger and acquisition activity, research indicates that transaction success remains an elusive deal outcome. One of the primary reasons for the reported high failure rate of M&A transactions can be attributed to the lack of consideration of Human Resource issues before, during and after the deal. Economic, financial, legal and technological factors, identified as the most significant issues impacting deal success, can no longer be considered the only critical success drivers of M&A transactions. It is now widely argued, evidenced and recognised that HR factors can have a critical impact on M&A outcomes, and that M&A success hinges on the effective and successful management of Human Resource issues. Cultural integration, change management, people and processes, communication and leadership are some of the human resource elements which can significantly effect M&A results. Although current rhetoric acknowledges the importance of Human Resources in M&A transactions, insufficient evidence exists to suggest that Human Resources directly influences business strategy, organisational performance or creates a competitive advantage in an actual deal situation. The reality is that Human Resources generally plays a support role in M&A deals, with a focus on executional and integration issues, rather than as a strategic influencer. However, it is becoming widely acknowledged that the exclusion of Human Resources as a strategic business partner from the all stages of a transaction can significantly influence deal outcomes and ultimately deal success.

The scope of this paper is to provide critical insight into the perceived and actual role of Human Resources in M&A transactions, and the impact of Human Resources of merger motives and merger types, and transaction climate on the role of HR and transaction outcomes. The paper also aims to identify the issues associated with understanding and measuring the impact of HR in M&A transactions.

The key themes and issues to be investigated are Merger and Acquisition success and failure rates and the main causes of failure for transactions. The measurement methodologies of M&A success and failure will also be examined, merger motives and resultant merger types, and the implications for the role of Human Resources in transactions will also be examined. In support of the issues discussed, preliminary findings from primary investigation into the role and impact of Human Resources in an Australian case study of a M&A transaction will be explored. In support of the issues discussed, preliminary findings from primary research in the M&A transaction of National Foods and King Island are discussed. This case study is a work in progress and is one of two currently being investigated. Findings are not conclusive or significantly developed at this stage, but provide some insight into the issues examined in this paper. Overall, the paper aims to substantiate the significance for business outcomes of the role of Human Resources in Merger and Acquisitions, and identify the actual role and impact of Human Resources in transactions.

Context

Merger and Acquisition activity has created and developed an increasingly complex corporate landscape over the course of the 20th and early 21st centuries. In the past three decades Merger and Acquisition transactions and related down sizing and divestiture activity has progressed at a steady rate in most developed economies. The total value of deals announced globally in 2003 was US\$1,009 billion, and mid year figures for 2004 has placed total value at US\$557 billion (KPMG and Dealogic, 2004).

The key strategic motivations driving Merger and Acquisition activity are the drive for domination of transnational markets and the push of global competitiveness, as well as speed to market. Organisations seek to 'buy' rather than 'build' customer bases, distribution channels, brands and technology. Economic and legal deregulation, changing social and political policies are also factors facilitating the rate of M&A transactions.

M&A success and failure rates

The large volume of local and international research studies available regarding the issue of merger failure and success, despite varying research objectives and methodologies, are consistent in their findings that large numbers of Merger and Acquisition transactions fail to reach potential. Although significant disparity occurs in the research results available, the range of Merger and Acquisition failure rates are commonly placed between 50% - 83% (KPMG; 1999, AT Kearny;1999, Egon Zehnder & London Business School;1987, Watson Wyatt;1999, Deloitte & Touche; 2001). As research studies and surveys are becoming increasingly sophisticated and broader in their measurement criteria, with greater emphasis on analytical than anecdotal measures, higher rates of failure of Merger and Acquisition transactions are being documented. Current empirical research indicates that up to 83% of global Mergers and Acquisitions fail (KPMG, 1999). The Australian market also reflects global trends with a KPMG study of 73 Australian domestic deals completed during the year to September 2000 indicating that only 25% created value (KPMG, 2001).

Various explanations have been offered to as to why such a large percentage of Merger and Acquisition transactions are deemed failures. However, any specific elements of the merger and acquisition process have yet to be identified as the critical success or failure factor impacting on the performance of a transaction. It is more likely that a range of issues and elements are responsible for M&A failure.

The prescriptive literature and empirical research findings provide a wide range of insights into the critical Human Resource success factors impacting Merger and Acquisition outcomes. The empirical research studies are consistent in their identification and analysis of the key factors that contribute to merger and acquisition success. Typically, the most common factors cited as 'keys to Merger and Acquisition success' are communication, cultural integration and fit, integration project planning, due diligence, leadership and talent placement and management. The characteristic reasons denoted for failure are the overestimation of synergy between joining organisations, excessive premiums paid for target companies, inadequate integration planning and implementation. All of these factors are intrinsically linked to Human Resources.

A number of models are useful in the assessment of M&A success and failure factors. Hubbard (1999;13) provides a dual framework for the explanation of merger and acquisition performance, encompassing 'fit' and 'process' issues. 'Fit' issues are those which assess the juxtaposition of the acquirer and the target. The acquirer has limited ability to influence the fit issues, however there are some factors over which control can be asserted. 'Fit' issues are those of size, diversification and previous acquisition experience. Organisational and strategic fit, along with cultural fit and other demographic factors also contribute to matters of 'fit'. 'Process' issues are those surrounding the transaction and implementation process, and include pre-acquisition planning, implementation and negotiations, factors over which, the acquirer can exert a large degree of control. The fit and process model is a comprehensive one, encompassing the two variables that impact success – the background circumstances of the combining organisations prior to the deal (situational or context factors) and the actions of the buyer to ensure transaction objectives and outcomes are realised (managerial behaviour or action) (Hunt et al 1997 ; 62).

In exploring these factors which contribute to merger and acquisition success, it is difficult to distinguish one particular factor that is contingent upon performance. Success or failure is rather an amalgamation of a number of variables. It is still open to debate in the literature and research as to which are the most significant elements that impact M&A success.

Measurement of M&A success and failure

Traditionally, Merger and Acquisition failure and success has been primarily measured using a variable range of economic and financial criteria and measures. These criteria have been utilised to provide absolute measures of Merger and Acquisition transaction success, with the most popular absolute measurement being return on shareholder value. However, more recently, a more comprehensive evaluation criteria has emerged in the assessment of Merger and Acquisition outcomes, with Human Resources issues and elements becoming a key measure of M&A success.

Despite the broader focus and increasing diversity of M&A success criteria, the issue in evaluating the success or failure of M&A transactions based on human resources criteria is problematic in that there is no absolute measure of success. 'Success' or 'failure' will be very different for each organisation, based upon differing variables such as merger motives, strategic objectives and size of the deal. As Buono and Bowditch (1989) found, it is difficult to measure M&A success as the financial and technical issues usually have a 'right and wrong' value assumption, with errors relatively easy to locate and clear cut solutions formulated, whilst 'soft' issues such as behavioural and human issues are not as concrete, and cannot be accounted for in quantitative terms.

Other problems identified in measuring Merger and Acquisition outcomes is that no deal is the same – each Merger and Acquisition arises out of different business conditions, different goals and projected outcomes. Measures of success can also be contingent on the health of transacting organisations and the complexity. These measurement issues have been highlighted in many research projects and surveys investigating the success and failure rates of Merger and Acquisition transactions. As there is no prescribed formula to evaluate these matters, this often results in subjective measures such as the size of the deal, the time scale involved, geographical scope of the study and the implementation and integration methodology (Egon Zehnder & London Business School, 1987).

A key issue is how to determine measures of M&A success. There is a growing body of empirical research available that records, measures and analyses success and failure rates of Merger and Acquisition transactions. This originates predominantly from the large global consulting firms that have the resources and ready client survey base available to conduct such research. Whilst these surveys are valuable, they differ in focus, scope and methodologies, and their independence, impartiality and accuracy can be brought into question, given that the studies are often used as strategic selling tools for clients, in the quest to sell Merger and Acquisition consulting services.

Despite the growing breadth and complexity of M&A transaction evaluation, there remain several areas where the measurement methodology of Merger or Acquisition performance could be improved. In analysis to date, the measurement of success has been conducted over a relatively short time frame immediately after the Merger or Acquisition. Since it may take many years for the true performance of the organisation to be ascertained, more long term studies need to be conducted. As well as financial issues, employee attitudes and the behaviours of employees (e.g. absenteeism, turnover, performance) also need to be measured to determine the outcomes of integration.

The role of human resources

Despite the prescriptive literature supporting the critical importance of Human Resources involvement in all phases of a transaction for the execution of successful Mergers and Acquisitions, the empirical evidence suggests that there is little actual participation of Human Resources at the strategic level. The body of empirical literature exists indicating that the Merger and Acquisition process and potential success is more a result of providence, rather than the outcome of any planned HR strategy in a transaction. From the time of deal initiation, through to the outcomes, Mergers and Acquisitions have been considered as ‘journeys into the unknown’ (Cartwright and Cooper, 1992), with HR playing a minimal role in the M&A process. Despite the growing understanding of the critical impact of HR strategy and planning from the early stages of an M&A transaction, reality suggests that HR is often only active in the implementation phase, indicating a significant lack of integration of HR and business strategy.

The overall findings of a study conducted by the London School of Business and Egon Zehnder (Hunt et al 1987) found that the Human Resources function is conjectured to have a minimal, if any, role to play in the Merger and Acquisition process. These findings were universal across the survey results, whether the whole Merger and Acquisition process was considered, or particular stages of the transaction (e.g. identifying a target, negotiation, planning, implementation). In response to the survey question “Was the personnel function involved in any capacity”, the majority of buyers surveyed stated that Human Resources was not involved in the process. Two thirds of the sample stated that the Human Resources function had not been involved in any capacity prior to the signing of the deal. The remaining one-third who had involved Human Resources in the final stages of the process regarded the role of Human Resources as ‘marginal’ and restricted to specific issues such as conditions of employment and redundancies. Overall, three clear areas were identified by the London Business School and Egon Zehnder study where Human Resources could play a more influential role – human due diligence, input in the negotiation and planning process and active participation in the implementation phase.

A study conducted by the Conference Board (US) (McShulskis, 1998) found that only 22% of organisations included HR in the initial planning stages of a deal. The Conference Board surveyed 88 senior Human Resources executives whose organisations had undergone a merger transaction. In the study it was reported that less than 33% of Human Resource professionals surveyed stated that Human Resources issues have a significant influence in the planning or negotiation of Mergers and Acquisitions. Between 9% and 13% of respondents claimed that human resources plays no role until after the transaction has taken place, and even then, almost 20% reported that Human Resources issues only play a moderately significant role. However, over 80% of respondents agreed that those issues do only become critical once the deal progresses.

These results reveal that Human Resources is not an integrated component of business strategy, despite the emphasis given to the need for strategic Human Resources in the Merger and Acquisition process.

Merger motives and merger types

The role of Human Resources in Merger and Acquisition transactions can be in essence, linked to the motives for mergers and merger types, despite the current limited range of academic analysis and evidence to support this position. There are a number of theoretical models, frameworks and empirical research concerning Merger and Acquisition motives and types in

the literature. Most link the strategic purposes for Merger and Acquisitions transactions with resulting Merger and Acquisition type, the integration strategies and approach required, and impact on transaction outcomes.

Merger motives can be summarised into three main categories, as presented in a framework developed by Berkovitch and Narayanan (1993; 347). Berkovitch and Narayanan suggest that there are three major motives for takeover/merger and acquisition activity – efficiency or synergy, agency and hubris. They advocate that these motives exist simultaneously as merger motives within a transaction. Based on empirical evidence, Berkovitch and Narayanan (1993: 347) found that synergy is a primary motive in Merger and Acquisition transactions, based on projected positive economic gains of merging organisations. A more detailed theoretical model of Merger and Acquisition motives is presented by Trautwein (1990). In the model, Trautwein (1990) reviews seven alternative explanations of merger motives- economic efficiency; monopoly theory, empire building; raider; process, and disturbance theory. Trautwein's model is built upon a range of empirical evidence that examines the strength and credibility of each motive.

Although there is a wide range of literature available regarding M&A motives, there is little available regarding the link between M&A motives and the implications and impact for human resources. In one of the most comprehensive examinations of the links between merger motives and Human Resources, Hubbard (2001) has also created a model which links merger motives to pre-acquisition planning and the degree of post merger integration required in a transaction.

Merger types can also indicate the degree of integration required between merging organisations, and are an indicator of how Human Resource issues will be impacted and the level of planning and integration required from an HR perspective (Napier; 1989; 276)

In one of the more evolved models of merger types and Human Resources, Haspelagh and Jemison (1991) explore the impact of the extent and level to which integration is required and achieved in corporate diversification activity. They propose three different types of takeover, all requiring differing degrees of integration and implementation. These transaction types are termed absorption, symbiotic and preservation takeovers. Haspelagh and Jemison found that there were two variables affecting the type and extent of integration. The first variable was the degree of strategic interdependence between the acquirer and the target. If the strategies of the two businesses were closely connected and synergistic, the businesses would need a high level of integration at strategic level. If the two businesses were strategically independent, they could be run as separate operating entities, reducing integration issues. The second variable was the degree of organisational autonomy required by the target.

In reference to the relationship between merger types and HR, Napier (1989) presents a typology of three Merger and Acquisition types - extension, collaboration and redesign. An extension merger occurs where the acquiring firm leaves the acquired firm to continue to operate as is, changing little of managerial or operational practices. Collaborative mergers occur when two firms join to generate gains through the merging of operations, assets or cultures or through an exchange of technology or expertise. Collaborative mergers can therefore be split into two forms – synergy or exchange. A redesign merger involves the widespread adoption of policies and practices of one organisation by another.

Napier (1989) suggests that in determining the type of Merger and Acquisition to pursue, the planning and implementation of HR issues and degree of change required for a successful transaction can be forecasted. For example, in an extension merger, integration may be limited to financial criteria rather than HR issues. In such cases, the impact on HR issues is relatively low and the acquisition remains relatively independent. For other merger types such as redesign, the effect on HR issues and changes to practices can be extensive, often involving widespread change to strategy, planning, policy and processes.

Merger motives and merger types have far reaching implications for Human Resources in a transaction, as the level of integration determined from business strategy and merger motive and type, indicates the impact of HR in the planning and integration phases of a deal and the consequent transaction outcomes. In a further examination of merger types, it is also found that the degree of friendliness or hostility of a deal can have ramifications for the role of HR.

Human Resources implications and outcomes of a Merger and Acquisition transaction have a significant relationship with merger motives with merger types. Merger motives can provide an insight as to the structure or characteristics of a merged entity and the consequent Human Resources implementation requirements and outcomes. Merger types forecast the degree of integration required between merging organisations, and are a guide as to the critical human resources issues involved in the deal and the level of planning and integration required from an HR perspective.

M&A climate

In addition to Merger and Acquisition motives and types, the degree of hostility or friendliness can have a significant impact on the HR issues, strategies, plans and priorities that arise out of a transaction.

In a small sample of the literature available regarding merger motivations and types, the degree of hostility or friendliness in a merger and acquisition deal has been examined in the context of Human Resources consequences. Buono and Bowditch present a brief analysis of the degree of friendliness or hostility that is involved in a merger and acquisition transaction, and propose these transaction dynamics as an indicator of the level of organisational and human resources issues involved, the types of integration issues that are likely to emerge, and the role and impact of Human Resources in such environments. (198;65). Pritchett (1985) expands this concept and suggests that the amount of resistance or opposition to a merger and acquisition transaction can significantly effect the HR issues involved and the role of HR. In one of the most comprehensive considerations available regarding the nature of a transaction and the outcomes for Human Resources, Pritchett has created a framework of merger and acquisitions providing four categories as to the degree of hostility or friendliness of a deal – cooperative/adversarial continuum, organisational rescues, collaborations, contested situations and raids. Pritchett's classification of Merger and Acquisition Climates also contains 'the incline of resistance', indicating the intensity of opposition to a transaction and the amount of resources required to execute the transaction (funds, skills, time). According to this model, which will be examined in greater detail below, an organisational rescue is the most cooperative relationship whereas a raid is the most hostile and adversarial in nature.

Case study findings

Preliminary research concerning an Australian M&A transaction between two organisations in the Fast Moving Consumer Goods industry, supports the proposal that Human Resources does not act as a strategic business partner from the outset of a M&A transaction.

The two transactions selected for this study are National Foods and King Island , and Southcorp and Rosemount. The case studies were chosen on the grounds of Australian ownership, industry, and the motives for the merger and the types of merger.

The research aims to are to examine the actual role of Human Resources in M&A transactions and the impact of HR on successful outcomes. These findings are being tested against the rhetoric of the current literature which suggests that HR is a strategic business partner, able to influence, drive and deliver deal success. The research will provide insights into the role of Human Resources in Australian M&A transactions, in a growing stream of enquiry, which is at present, predominantly focused on international case studies, literature and research.

Preliminary findings regarding the National Foods and King Island Dairy transaction are interesting. National Foods is one of Australia's largest food companies, with core activities in milk and dairy foods. The King Island Group is a manufacturer, distributor and marketer of speciality cheese products and an analogous range of gourmet foods to the Australian Market.

National Foods acquired the King Island Company in February 2002 for \$92 million as a part of its strategy of growing its portfolio of successful dairy brands and moving into higher value added sectors of the market.

Merger type had a clear impact on the role of HR in the transaction. As the transaction was a horizontal deal, the level of integration was indicated by the resultant outcomes of deal

synergies realised. Due to the nature of the horizontal transaction, the integration plan involved a 'split' integration model, preserving the marketing and selling functions of King Island, and keeping them separate to National Foods, whilst fully integrating other functional areas such as distribution, manufacturing, human resources, and finance, in the anticipation of significant operational synergies and savings. The implications for HR were that of restructuring and culture.

Human Resources was involved in the post-transaction strategy and implementation, and was seen as integral to the integration execution. Despite not being involved at the early stages of the deal in the strategic business process, careful planning and attention to Human Resources issues were contributory to the financial success that the merged entity has experienced in the past year. Some of the key Human Resources issues for the transaction were the integration of two distinct cultures (corporate vs. boutique, family style business) and the communication process. The role and impact of Human Resources in this transaction so far supports the suggestion that HR does not act as a strategic business partner in the early stages of the deal, but plays a role in the integration stages of a transaction. However, the impact of HR issues and the way in which they were managed in the integration phase, have contributed to the growing success of the merged entity.

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