The role of HR in successful M&A integration

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This article looks at the integration process typically following mergers and acquisitions, but which is also highly relevant in other restructuring initiatives such as integrating formerly independent business units of large corporates, as well as charities and public sector agencies. Many such projects are currently under way or are imminent, but still scepticism prevails among analysts and stakeholders about their likely success, as the overall track record shows a huge number of failed initiatives. Whole armies of legal and financial experts, as well as strategists and specialists in brand management, business process re-engineering, and other fields employed pre- and post- deal do not seem to guarantee the success of the projects.

From our experience in integration projects as consultants as well as employees, we have seen the "soft" side of the deal usually creating the toughest problems. The line "our people are at the very core of the future success" features in most CEO's Sunday speeches, and much lip service is paid to "culture and values", but when you look more closely, you see that little action is actually taken to put these words into effect.

Post-deal integration capabilities are a major success factor in the post-crisis economy

At the back end of the economic crisis we are already seeing an increase in M&A activity. Companies emerging stronger from the difficult times seize the opportunity to increase market share or acquire new capabilities by buying weaker competitors. Also, a lot of consolidation activity in search for efficiency gains can be observed, as public sector organisations and charities try to adjust to tighter budgets.

So, much is to be gained from successful integration projects and organisations managing them will have a real opportunity to improve their competitive position.

Human Capital aspects are both crucial and often neglected

It seems obvious that the Human Capital aspect of integration needs to rank high on the agenda, particularly in knowledge-based industries where gaining capabilities in a new field is one of the goals of an acquisition. Nevertheless, we recently observed a software company acquire an IT consultancy to broaden its range of services, only to lose scores of consultants and managers as soon as the integration process started. In one of its subsidiaries half the workforce of 100 left and set up a branch for a competitor across the road.

The interesting point in this example: people were not scared off by the vague threat of being acquired, but stayed on for months after the acquisition was announced to see what would happen. The drain only started after the integration efforts were under way, so it is clear that the acquiring company had it in their own hands to retain valued employees and their crucial intellectual capital. Something seems to have gone wrong in this integration project, depriving the company of a big chunk of its prize.

In another example, integration managers did not have the luxury of a lengthy period of time. When a German raw materials firm acquired a US-based competitor, many IT experts left the company despite dire prospects on the job market. They knew there was a corporate IT unit in Germany and assumed they would lose their jobs very soon anyway. German HR, not used to the aggressive American way of hire-and-fire, were caught offguard and it was only after some delay they got the message out that no lay-offs were planned. As things turned out this was not the same kind of disaster as our first example, but it still caused problems and could have been easily avoided by appreciating local culture and some pro-active communication.

Losing employees you would like to retain is only the most immediate and obvious effect of getting the Human Capital aspects of integration wrong. Other issues we have seen resulting from poor management of the "soft" side of integration are as follows.

- A paralysed workforce performing poorly over a long period of time, because they expect major layoffs, but do not know where the axe is going to fall.
- Unclear responsibilities.
- Loss of direction, as objectives set pre-integration are questioned or become obsolete.
- Learning and development grinds to a halt for too long, because people do not know which capabilities are expected of them in the future. This is particularly dangerous, as the new situation will often require the workforce to acquire new skills.
- A surge in spending as managers grant favours such as promotions, expensive training courses, or company cars, in a rush, as they fear they will soon lose the power to do so.
- Lack of communication and collaboration between people from the two parts of the merged company. This applies to whole departments, but also to people who are merged with others in one department post-integration. A broad mix of misunderstandings due to cultural differences, fear, dislike, power games or just different systems and processes used for communication and knowledge sharing can build up barriers to collaboration.

- Outright sabotage meant to make "the others" look bad or just out of frustration.

Dangerous entrenchment

One particular practice to be avoided at all costs is the consolidation of the old positions. Justified by excuses along the lines of "before looking at integration we need to get our own house in order", some HR functions focus their energies on entrenching their current positions to make changes which they perceive as unfavourable more difficult. This is certainly not the normal approach of HR, nor is it restricted to HR. Nevertheless, some vigilance is required to spot and possibly stop things such as:

- large investments in HR that fail to consider best practices from both parts of the new organisation
- agreements with unions, works councils, etc on behalf of only one of the merging parts. This is a particularly tricky field, in an international context, where the acquiring firm does not understand the full implications of such deals in a different country.
- large-scale changes of employment contracts
- new or extended long-term contracts with service providers
- roll-out of new policies, processes, and systems that do not consider the requirements of both parts of the merged organisation.

First things first

Even if the HR function is fully dedicated to integration, you have to get your priorities right. We observe that HR managers often focus on the integration within HR itself to harmonise policies and processes, integrate IT systems, and find some savings through synergies. This purely internal approach keeps HR practitioners from acting as strategic partners and change agents for the whole business, when this would be needed most. As it does not really consider the new business context, this approach not only makes the achievement of the strategic objectives more difficult, but it often results in policies which create barriers to integration. This often occurs when one pre-merger set of policies are applied to all parts of the new organisation without understanding bespoke circumstances or culture.

In one of our examples outlined above, the acquiring software company did not understand the work-hard-play-hard culture of the IT consultancy, nor was it aware of the way consultants were constantly juggling several projects at a time. Being able to communicate with clients efficiently at any time while travelling across Europe was as important for them as having the freedom to call their families from their mobile phones, when they were putting in extra hours at a client's site. In contrast, the small number of consultants of the software company were travelling far less and had more of a 9 to 5 culture. Applying the corporate policy of taking mobile phones away from most consultants could look like a good idea to save some money only to those who had no idea about the business of the acquired company. For the IT consultants this move not only deprived them of the means to do their job (ie satisfying their customers) well, but also told them that their extra efforts were not appreciated and that they were not trusted either. Little wonder then that many of them left and others made sure they'd reduce travel time.

If HR wants to be a strategic partner and change agent, just looking inside the HR function is not good enough. Instead of asking "how can HR become more efficient through this merger?", HR managers need to focus on the question "how can HR make sure the integration as a whole is achieving its goals?".

Excellent people management contributes to the success of the integration

An excellent HR function has much to offer for successful integration, so there's no need to hide behind the door of the HR department. We don't say that looking at HR policies, processes, and systems has no place in the early stages of an integration project. However, they should be seen as a means rather than an end, and the aim should be to achieve the objectives of the integration project as a whole rather than only efficiency gains within HR.

To begin with, two things need to be clearly understood:

1. **What are the objectives of the integration?** If a company is acquired primarily because of personal client relationships or the unique skill sets its employees hold, the people strategy for the integration looks very different from a case where the major assets of the target firm are, say, mining rights. It is also very important to establish the level of integration that needs to be achieved. Do we want both companies completely mixed up, with employees from both parts working together closely in the same teams, or are we keeping both companies as separate units in a portfolio, where the integration affects primarily the balance sheet and very little collaboration is required?

2. **What is the current and what is the required culture?** Cultural differences determine to a large degree how much integration is possible — and how fast. Actions which go strongly against the culture of one part of the organisation are usually doomed. We can't just act as if some desired future culture was already in place. If culture needs to change, it requires a conscious effort and will take some time.

Based on this understanding there are quite a few actions HR can take to actively support integration. These usually involve removing forces impeding the integration and strengthening forces that help the integration, taking into account the fact that the forces at work are likely to differ significantly between the two parts of the organisation. (see *Figure 1* below).

The integration force field

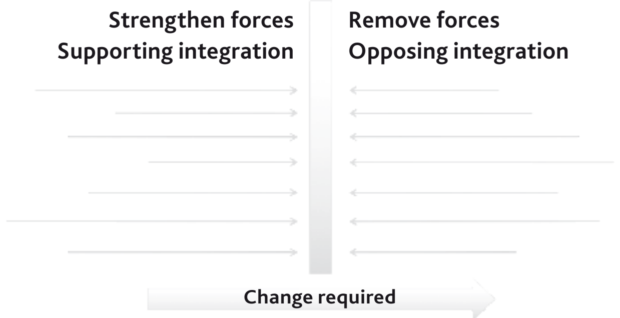


Figure 1

Here are some steps we have found most valuable in various organisations for HR to help integration:

- Determining which elements of the current culture are crucial for future success and protecting them.
- Defining a roadmap for culture change to support future strategic objectives.
- Establishing clear and early communication about the objectives of integration, any impact on the workforce including layoffs, and the reasoning behind it.
- Identifying key employees (individuals or groups) you want to keep and making sure they know they have a promising future in the new organisation. Start to work with them early on defining this future.
- Setting up a process to identify important knowledge or relationships possibly held by people who are about to leave (voluntarily or not). Often there are thousands of small pockets of knowledge not of strategic importance, but difficult to manage without, at an operational level, for example the only engineer able to fix a certain piece of equipment or the only assistant who knows which strings to pull at an important supplier to speed up a delivery. While corporate HR can't do this, you can trigger a process for lower level management to ask their people and plan for timely knowledge transfer.
- Defining which skills will be required for the new operating model of the merged organisation. Identify sources for these skills and plan for knowledge transfer, job rotation, training, and possibly even recruitment at the cost of employees lacking these skills. Be realistic. If the required skills cannot be built up as fast as required, you have to blow the whistle and discuss the impact on business planning.
- Making sure your performance management process supports changed objectives and structure. If things are still in the flow, be open about it and set appropriate objectives for an interim period. At all costs, avoid having objectives set that focus on one part of the organisation only, thus dis-incentivising collaboration. A typical example is a large software company planning to replace one of their products by buying a smaller competitor with a better product. We've seen objectives for development teams and the sales force set up to strengthen the old product even though the decision for the new one is 99% in place.

HR can reap benefits in cost as well as quality

Only as a second priority, but still important, you should look at opportunities to make the HR function more efficient and

The Human Capital Excellence Framework

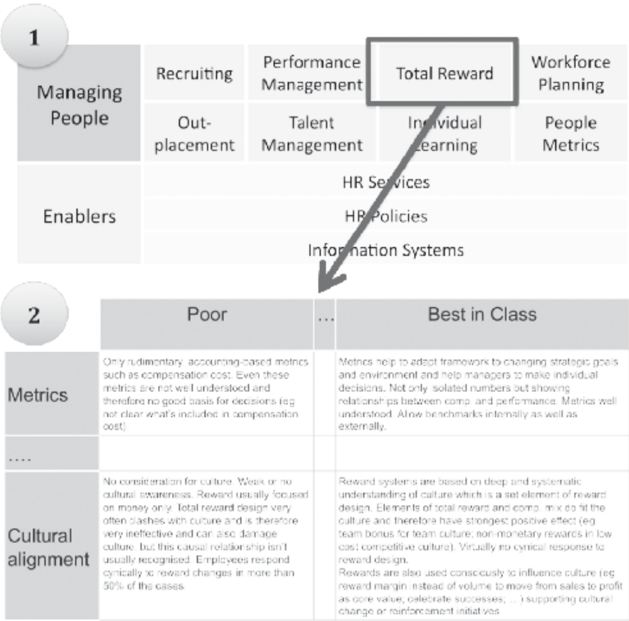
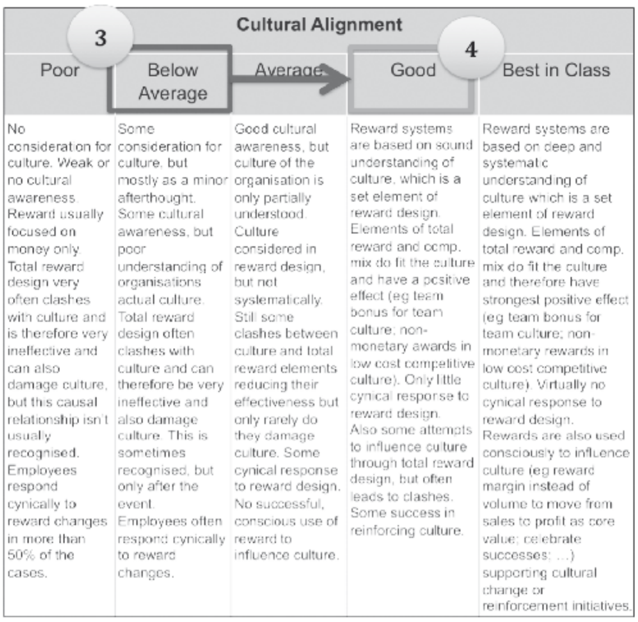


Figure 2a: Using the HCEM (Steps 1 and 2)



Cultural Alignment				
Poor	Below Average	Average	Good	Best in Class
No consideration for culture. Weak or no cultural awareness. Reward usually focused on money only. Total reward design very often clashes with culture and is therefore very ineffective and can also damage culture, but this causal relationship isn't usually recognised. Employees respond cynically to reward changes in more than 50% of the cases.	Some consideration for culture, but mostly as a minor afterthought. Some cultural awareness, but poor understanding of organisations actual culture. Total reward design often clashes with culture and can therefore be very ineffective and also damage culture. This is sometimes recognised, but only after the event. Employees often respond cynically to reward changes.	Good cultural awareness, but culture of the organisation is only partially understood. Culture considered in reward design, but not systematically. Still some clashes between culture and total reward elements reducing their effectiveness but only rarely do they damage culture. Some cynical response to reward design. No successful, conscious use of reward to influence culture.	Reward systems are based on sound understanding of culture, which is a set element of reward design. Elements of total reward and comp. mix do fit the culture and have a positive effect (eg team bonus for team culture; non-monetary awards in low cost competitive culture). Only little cynical response to reward design. Also some attempts to influence culture through total reward design, but often leads to clashes. Some success in reinforcing culture.	Reward systems are based on deep and systematic understanding of culture which is a set element of reward design. Elements of total reward and comp. mix do fit the culture and therefore have strongest positive effect (eg team bonus for team culture; non-monetary rewards in low cost competitive culture). Virtually no cynical response to reward design. Rewards are also used consciously to influence culture (eg reward margin instead of volume to move from sales to profit as core value; celebrate successes; …) supporting cultural change or reinforcement initiatives.

Figure 2b: Using the HCEM (Steps 3 and 4)

increase the quality of Human Resource Management (ie increase the value it contributes to the business).

Much has been written about the merits of harmonising HR policies, processes, and systems and reaping synergies through shared service models. So, we do not go any deeper into these points, although appreciate there's value to be found.

However, we want to present the reader with a framework to help HR to emerge from the integration with the best possible blend of best practice from all parts of the organisation. Rather than rolling out existing processes from one business unit to all others, we strongly recommend that you draw on the treasure-trove of experience and ideas across the organisation to build the HR function for the future.

We do this by using a straightforward tool we call the Human Capital Excellence framework, which must obviously be adapted to specific circumstances. Figures 2a and 2b on the previous page illustrate how this framework supports the four steps of the process:

1. Decide which areas to focus on. Ideally, you'd want to look at all elements of people management (not restricted to what happens inside the HR department), but with limited time and resources you may have to make a choice.
2. Define "what good looks like". In each focus area, you look at the six dimensions: strategic alignment, process and adherence, roles and capacity, metrics, systems, cultural alignment and describe the ideal state as well as poor performance and some steps in between (five levels overall is usually enough). While this definition may be based on generic best practice, it is crucial that your analysis supports your organisation's strategic goals within your given cultural and business context.
3. Determine the current state in each part of the organisation and set realistic objectives for the level you need to achieve in a given field. Again this is bespoke to your context and you shouldn't waste energy by aiming at top performance in each field.
4. Help each part of the organisation to achieve the targeted level and monitor progress on the scale of your framework. Where HR functions or whole business units are merged after the integration, make sure that you use the capabilities of each part in their respective strong fields of the framework.

This is a process that can create real long-term value for any organisation and even more so for organisations in a post-merger context, where people management capabilities often vary a lot. Using the respective strengths from both merged companies not only makes the best out of a unique opportunity, but also makes it easier to gain buy-in from both sides as the process is transparent, capability-based, and focused on future business requirements.

Summary: three stages

So, our core message is that the HR function has a lot to contribute to a successful integration project, if they show they are concerned with the business needs and don't hide behind policies. To create the best value, it is important to get the priorities right:

1. Avoid creating new barriers to integration by any HR activities.
2. Support the business in achieving strategic integration objectives.
3. Improve the efficiency and quality of the HR function by using internal benchmarking to find and utilise best practice in each field of people management.

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