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| MBA 609 – Organization Behaviour |
| The Human Factor of Mergers & Acquisitions |
| HOW TO RETAIN KEY PEOPLE POST-INTEGRATION |
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# Introduction

“You don’t have to be a psychiatrist to realize that marriage based solely on money rather than personal chemistry has little chance of success. The same axiom applies to business mergers…” [37]

Studies support the idea that mergers and acquisitions are disruptive life events in employees and often lead to stress and uncertainty. This can cause lower productivity, and some people’s mechanism to cope with the additional stress will simply be to change employer, resulting in turnover [1]. Even though most organizational behavior literature stresses the importance of human factors as key successes for M&A's, these factors are too often neglected, which could explain why many M&As do not yield the expected results.

This research is centered on the most challenging aspect to successful M&A’s; the Human Factor [Post, Maryann]. Literary research identified the key pillars that need to be properly addressed in order to enhance the satisfaction of employees, which can result in lower turnover: motivation, compensation, culture, identity and communication. Solutions are proposed to retain key talent post-merger, as well as keep them m in order to increase the potential success rate of M&A. Major aspects to enhance staff retention via motivation are the reward structure, communication strategies, process change management strategies, and ways to ensure proper culture merger and employee identity building.

# Problem definition: Why M&As fail to generate expected synergies

Research suggests that 70% of acquisitions failed to deliver the expected financial results [2]. This can be attributed mostly to departure of key executives, cultural incompatibilities and shortfalls in projected performance [2]. It seems that even simple M&A negotiation has an impact on staff turnover on the target company [3]. It can be noted that there are 5 major employee concerns causing stress during a merger activity: loss of identity, lack of information and related anxiety, survival obsession, lost talent and family repercussions.  These concerns can lead to psychological hardships and loss of productivity [4], and some individual’s way of coping with the additional stress will be to avoid the stressor and leave the new organization.

Most organization behaviour literature and studies focus on the human aspect of M&A's [1], and suggest that a substantial number of merger failures can be traced to neglected human resource issues [1] [5].

M&A’s generates a significant amount of stress on employees [1], and post-merger productivity has been observed to fall below 1 hour per day [2]. Differences in top management styles also have a negative impact on post-acquisition performance of the acquired firm [6], and rights of employees are often neglected [7].

From the due diligence process typically focused on financial compatibility, to human resources who is typically only involved in post-merger to execute a strategic transition plan [5], M&A’s can benefit from a broader focus on the human aspect. According to Mercer Survey on Corporate Trends, the success of M&A’s relies on keeping key talent for the long-term [8].

# Motivation and Retention of Key People

## Identifying Key people and top performers

When a parent company purchases another company, it naturally acquires all the assets, liabilities and equity of the smaller company. Many variables must be considered during mergers and acquisitions. Human capital is one that is particularly complex as it is challenging to determine how to best manage this asset when making purchasing decisions. Companies do not actually own their employees so it can be difficult to predict related outcomes since employees have the option to terminate their employment at any point if their contract is not enforceable. Strong performing companies invest in developing knowledge, technology and/or relationships with channel partners. These core competencies are what make human capital valuable, which is a significant contributor of superior returns in successful firms [9]. This is supported by several studies which document not only that post-acquisition performance is greater [10] but also that shareholders benefited from favourable market responses [11] when target management is retained.

Logically, the first step is identifying the key people that form your value-creating human capital. Especially when time is scarce, which is a usual case in merger and acquisition scenarios, defining a company’s talented employees must be done quickly and efficiently.

**Executives**

A study of 188 completed and 32 uncompleted mergers in the U.S. between 1994 and 1998 analyzes the retention of target CEO’s to several factors in order to provide insight to hypotheses; some being whether CEO retention is positively correlated to target firm performance, relative size of target firm, and target CEO salary in the position just prior to the merger. The results show that the “total compensation of the target CEO prior to the acquisition is larger in deals in which the target CEO is retained (approximately $3.1 million versus $1.8 million). The target firms in deals in which the target CEO is retained are more profitable (higher ROA). The relative size of the target firm to the acquiring firm is much larger in deals in which the target CEO is retained” [9].

With this in mind, we can conclude that target firms with the following characteristics are more likely to have a valuable CEO worth keeping: high CEO salary, high return on assets and the target firm is as close in size as possible to the parent company.

A high CEO salary is an indicator of performance in that higher wages provides an incentive for managers to develop the specific skill-sets that generate revenue. It is also in the firms’ interest to distribute said revenue to the most performing and valuable people. [12]

Return on assets is a measure of profitability that compares a firms’ operating income to its assets. Naturally, a firm that is more profitable should indicate a CEO that is performing well since the CEO is the embodiment of the company.

The similar company size between the acquirer and the acquired is an indication that the acquired CEO has a more diverse skill-set that mirror the parent company’s necessities in an effective leader. Therefore, the target CEO has more opportunities to create value [13].

**Workforce / Non-Executive Level**

The methods required to identify key employees in the remainder of the firms’ workforce requires a different approach. Christopher Kummer, of PricewaterhouseCoopers, suggests using a two-method combination made up of a document and data based approach, a survey approach or a mapping of social networks. [14]

The document and data method uses organizational charts to quickly identify top management, higher ranks and key roles. Once this is done, each department on the value chain is analyzed, with an emphasis on departments and activities that are closest to the customer since these are the teams that create the most customer-perceived value. Salaries, budgets, profits-generated, and patent value, specifically for the Research and Development function, are then utilized to sort through the candidates and isolate top performers that are the most indispensable to the business. [14]

Surveys are a time intensive type of approach that requires a significant amount of quality participation so that the sample size is large enough to analyze trends and formulate conclusions. Questions must be carefully designed to detect the key people required for the success and the integration of the business while being time efficient and indirect [14].

Social network mapping is an effective way to produce valuable results. It consists of analyzing relationships within the company as well as between the company and channel partners. Frequency of communication, quality of communication and trust are some dimensions to measure relationships [14]. The central theme is that social network mapping attempts to identify the group of people that are detrimental to the efficient operation of the company by examining where the strong connections lie in the effort to maintain those deep-rooted relationships.

## What Motivates Key People & How To Retain Them

Once the key personnel essential for the success of the merger and acquisition integration as well as the post-merger firm’s performance have been identified, it is critical to motivate them, maintain their trust in management and, possibly, provide them with some incentive in order to avoid defection.

### Workforce / Non-Executive Level

**What motivates them?**

Generally, top performing key individuals have a trend to be associated with higher-order, intrinsic, hierarchical needs such as esteem and self-actualization. This is due to the relationship of performance to commitment to the company in that the most committed employees are usually the superior achievers. Kummer explains the association of commitment to intrinsic motivation as “the most effective way of having ongoing commitment of employees is their affective and emotional attachment to the organization, e.g. belief in the goals and strategy of the company.” [14]

**How to retain them**

Where the issue comes into play is that the work environment changes during a merger and acquisition. Employees who were once focused and committed are generating doubts as to their place in the company; “goals, which can be self-generated or assigned by others, become inexistent, unclear, difficult to set and hard to realize.” [14] The first task of retention must be to address these concerns as well as any fears related to job security. They must know that their position in the post-merger company is valuable and future growth opportunities are not hindered by the merger. If this is not done quickly, the inevitable offers made by active head-hunters may be an attractive alternative to remaining with the firm.

What must not be forgotten is to include a type of extrinsic retention incentive to the targeted high performers. A study of 42 organizations around the world who were actively engaged in mergers and acquisitions shows that “…almost two-thirds (62%) of deals completed by participating organisations over the past three years used retention programmes.” [8]. In addition, retention programs are not only seen as a short-term motivation, but also as a contributor to the long-term commitment of key people in the firm; “Executives critical to the long-term success of an organisation are eligible for retention incentives in 70% of the programmes at the time of mergers and acquisitions compared to employees considered for the short-term success of the integration who are eligible in just 53% of the programmes…” [8] When it comes to detailing the retention program, a mix of short-term benefits, such as awards, spot-on bonuses, and increases to base salary, with long-term incentives, such as pension plan adjustments and stock options, should be packaged together depending on the employee’s contribution to the short or long term benefit of the company. [14]

### C Level Executives

**What motivates them?**

In the case of retaining the target CEO of acquired company, the intrinsic and extrinsic motivational factors discussed above remain valid. However, the specific methods to satisfy the CEO’s concerns must be tailored to this special case. The main difference lies in how to intrinsically motivate the acquired CEO since retention is essentially a joint decision by both firms.

From the target CEO’s perspective, even though they are losing their title, there are still several factors they may find attractive in being employed by the acquiring firm. Booz & Company`s study concludes that there are three reasons former chiefs remain with the company post-merger. [15] First, the possibility of a promotion to a position in the larger, post-merger, company is seen as a greater opportunity. [15] Second, there could be a reasonable chance of becoming the new CEO of the larger company. [15] Third, the acquiring company usually insists that the target CEO is retained, “…particularly if his or her skill set and leadership are viewed as critical for success.” [15]

**How to retain them**

The role of corporate governance in acquiring firms is ultimately what influences the target CEO to credibly consider any of the three cases above. Firms that shift power from the shareholders to the managers have a greater impact on retaining target CEOs. This is true since CEOs logically value the right to make decisions and any promises made by the acquiring CEO will not be overturned by shareholders. Therefore, it is of great importance that the acquiring firms have governance provisions that protect managerial discretions. [9] Furthermore, firms in which the parent company CEO maintains a high volume of shares, and therefore greater ownership, have the advantageous position of offering credible commitments, whether it be a promotion opportunity or simply decision rights since the acquiring CEO is generally a key player in negotiations. [9]

# Organizational Culture

## Importance of Culture During an M&A

Culture fit plays an important role in the success of mergers. As defined by Langton, “organizational culture is a system of shared meaning held by members that distinguishes the organization from other organizations. Culture provides stability to an organization and gives employees a clear understanding of ‘the way things are done around here’” [16]. As many studies have demonstrated, M&A success can falter based on the lack of capability to obtain the participation of workforce [17].

Different cultures imply different perceptions and behavioral patterns to various social contexts. When two cultures are forced to merge as part of a corporate acquisition, conflicts often arise. As often studied in organizational behavior, conflict can sometimes be an effective driver of change and innovation. However, affective conflict, often associate with high stress situations, can lead to loss of productivity and decrease in employee morale [16]. As shown in the 2009 Post Merger Integration Conference Survey conducted by McKinsey & Company, 70% of respondents conceded that “too little” effort was focused on culture during merger integrations [18]. This is further reinforced by the fact that 84 studies explicitly investigated the impact of culture on M&A’s, which are published in 40 different academic journals [19].

Studies have sought to explain the underperformance of employees post-merger as a result of cultural distance, culture compatibility, cultural fit, cultural change, management style similarity and cultural change. These components of organizational culture greatly affect the impact of change on the employees. Improper integration of two company cultures can lead to great dissonance within the workforce. There is a spectrum of integration to consider as well; mergers can seek total autonomy from the acquired company while others seek total absorption [20]. For example, one of the major cultural changes post M&A in culture has been noted as removal of autonomy. These cultural facets of merger integration can lead to conflict and dysfunctional employee behavior, such as high level of absenteeism and turnover. In extreme cases, this dysfunction leads to failed merger implementation [20]

One important factor to consider during the merger process is the possibility of “culture clash”: two organizational cultures at very different spectrums, expecting very different norms of behavior. Culture clash, in addition to removal of autonomy occurring during a merger, will lead to stress and negative attitudes towards cooperation and lack of commitment, which in turn leads to high turnover rates and decreased M&A integration success.

## Culture Integration

In order to ensure a successful merger, the larger company that is integrated a smaller one should pay close attention to the role culture plays in mergers. Attention should be applied in every stage of a merger, which usually include (1) due diligence; pre-merger and pre-planning stage, (2) planning stage, (3) implementing stage and (4) evaluation, review and reflection stage [21]. Below is a recommendation to follow a culture integration process into four stages, mapped to cater to the M&A context.

1. **Pre-merging stage**

During this stage, the most important thing to do is to evaluate the cultural differences between the larger company and the smaller one; look at the cultural fit between both entities. As shown in the survey conducted by McKinsey & Company in 2009, 41% of respondents believe “lack of understanding of both cultures” should be blamed when cultural differences create difficulties in a merger [18]. In order to get a full-picture, a suggested way is to focus on every dimensions of organizational culture proposed by Yaakov et al : a) approach to innovation and activity, b) approach to risk, c) horizontal relationship, d) vertical-hierarchical contact, e) autonomy and decision making, f) approach to performance and g) approach to rewards [22]. The cultural synergy of the acquiring company and the acquired company must be gaged prior to the merger to evaluate if this integration of cultures is at great risk due to high difference levels [17].

1. **Planning stage**

During this stage, the larger company should decide a) what dimensions of cultures needed to be integrated, b) setting clear goals of integration, c) methods and timing of change, d) making budget for training and other things needed.

1. **Implementing stage**

Obviously, integration is the most important stage in the process of cultural integration. In order to make it successful, there are many techniques that can be used, such as a) creating the atmosphere of cultural integration, b) setting the norms that can be accepted by the parties, c) building trust of each other, d) communication, e) be good prepared of any conflicts arising from different organizational cultures, f) always keep equity. An example of approach that can be implemented in this stage would be to increase organizational commitment through effective communication strategies, outlined later in this report.

1. **Reviewing stage**

What should do during this stage is a) evaluate the actual results with what has been expected, b) find the reason for the difference between results and expectation and c) revise the way to improve cultural integration.

# Identity

Identity is an important factor during mergers, it helps individual employees define “who I am” while organization culture tells “how to do things”. Frequently individuals integrate the organization of their employer in order to help shape their identities. It is not uncommon when individuals meet each other to define themselves with regards to their roles in their organization, and perceptual judgements are performed based on what individuals do for work, and the organization they belong to. For example, a person stating that they work as a garbage collector for the city will not be perceived in the same manner as a person stating that they are a surgeon for a children hospital, or a sniper in the military. Even if the individuals perform the same job functions, just the organization they work for can have an impact on shaping their identities. For example a secretary in an NGO can pride herself that she is contributing to human welfare, whereas a secretary working for the police could perceive that she contributes to the safety of her co-citizens.

Mergers can bring drastic changes in organizations, especially if one company is smaller or less influential (most often the acquired company). The transformation in the acquired organization can break the link between employees and the organization, disrupting their sense of identity. This can generate a sense of insecurity which can translate into stress for the individuals. Steffen Giessner outlines that “alienated employees who feel a loss of identity could place financial and strategic objectives of a merger at risk through lack of drive, reduced performance, and even sabotage”, thus reinforcing the importance of identity during a merger [23] . Therefore it is critical that action be taken to ensure that employees can rebuild a sense of identity with the new merged entity in order to ensure success of a merger.

Once organizations have merged, there are 4 potential outcomes for employee’s new identities: assimilation, confederation, federation and metamorphosis [24]. The difference between these approaches is the status for each company, and the will to integrate. Typically if one organization is much more influent than the other, the less strong organization will be assimilated; one firm is completely absorbed into the other. In contrast, if both organization are of equal sized, a new federation could be created, where both organizations maintain their unique identity. In a confederation, both organizations will preserve their identities, but a sense of common identity will also develop spanning the organizations. Finally, metamorphosis involves both firms dissolving their former identities and creating a new entity that did not exist prior to the merger [24]. Since the federate integration does not really involve changes in identities and confederate integration only implies minor changes to identities, research was focused on how to cope with assimilation and metamorphosis.

As proposed by Ching-Chi Lee et.al, there are four important factors that influence employees’ identity in M&A: a) pre-merger organizational identification, b) procedural justice, c) trust in merger, d) expected utility in merger [25].

Corresponding to the four factors above, in order to help employees build their new identity after merger, the following is recommended:

1. If it is possible, keep the structure of the smaller company stable, in order to make the difference between old and new identity small. This will help employees’ to handle the change in identity. For the employees who will experience a larger change in identity, ample communication is needed to explain the reason for the change. Also, give employees’ enough time to adapt the change from old identity to the new one.
2. Give enough information to the employees and let them join the discussion of how the new norms and rules should be build. This process will give them the right to get the justice that they focus on and also let the people from the larger company get to know what the employees of the smaller company really care about.
3. Carefully explain why the merger has occurred and answer their doubts. If their insecurities are addressed and answered, doubts will be disappeared and trust will be built.
4. Communication is very important to get to know the utility that the employees expected from the merger. Also, management in the new company should propose concrete plans to persuade employees that the merger indeed can raise performance.

# Communication and Processes

## Effective communication strategies During Change Management

One major challenge that has been outlined during mergers and acquisitions is not only the challenge of keeping performance levels high for all employees during the major change in the organization, but also of communicating effectively within new a new structure. [26] Proper communication during times of uncertainty can go a great way in reassuring the workforce of stability to come and can be an asset in stress relief. Proper corporate communication channels in times of disruptive change can reinforce employee confidence in leadership [27].

This brings us to the notion of reinforcing trust during the process of mergers and acquisitions. As previously mentioned, the trust factor becomes very important during a major change within an organisation. The notion of trust will affect how many perceive the organisation and its leadership. One organizational behaviour theory examining the effective functioning of the organization in relation to employee loyalty is the concept of Organization Citizenship Behavior (OCB). This concept was first put forth by Bateman and Organ in 1983 and advanced by Katz and Kahn in 1996 [28]. OCB examines 5 dimensions effecting satisfaction and happiness related to increasing performance: Conscientiousness, sportsmanship, courtesy, civic culture and altruism [29]. An organization that can increase employees perceptions of these factors, can in turn increases OCB, which in turn increases performance efficacy and retention of employees. One key factor of increasing OCB is effective communication practices, as studies suggest that “communication satisfaction is positively and significantly related to OCB” [29]. Open and honest communication is one of the key factors influencing the employee perception of the 5 dimensions of OCB. In other words, the employees must be aware of that these components are important within the organization, the message must effectively be sent from leadership to reinforce OCB [29]. When OCB in reinforced in the employee, their behavior goes beyond what is generally expected in an organization as they desire what is best for the organization at all times, just like a good citizen of a city or country. It can somewhat be equated to patriotism, but towards the organization. Although difficult to reinforce in the merger scenario, increasing perception of the 5 dimensions of OCB during the merger process will help reinforce OCB, and this reinforce loyalty to the organization, reducing the risk of high turnover.

Another interesting correlation to examine between communication and the effect on employee retention is “Organizational Commitment”, the conceptualisation of loyalty an employee has towards its organization. A 1992 study found that employees’ perception of corporate communications were positively correlated with the level of employees’ organizational commitment [30]. A 2011 study provides insight to the strong link between effective communications, organizational commitment in trust. In sum, the relationship between trust and communication is the strongest, followed by the relation between trust and commitment. Therefore, the gap to bridge to increase commitment to the organization is communication: “Trust and commitment do not just happen; they are forged and maintained through effective communication” [27]. Moreover, this is a very important notion to consider, especially in uncertain times [27], thus the importance of having a proper communication strategy throughout a merger and acquisition scenario.

Many recommendations can be applied to communicating during the M&A process, especially when concerned with employee retention. First, it is recommended to follow a strategic approach of planned formal communication throughout the organisation. This means that throughout the merger process, communications must be strategic, frequent, and truthful. If messages are perceived to be true, employees will be more likely to stay dedicated. Remaining truthful through corporate communications will reinforce leadership credibility; which is important as it will be difficult to encourage productivity if the employees become skeptical [26]. Second, it is important to note that not only formal corporate communication must be looked at. The effect of proper informal communication from leadership and agents of change is also important, as denoted by Beslin and Reddin in 2004: “Informal methods of communication provide more specific and more frequent assessments to help make changes or address issues quickly and flexibility” [31].

## Effective information transfer from key employees

An outcome of improper corporate communication leads to a problem noted in the merger and acquisition process: knowledge fragmentation. Pugh defines knowledge fragmentation as “the dispersion of know-how around the firm in employees ‘heads, habits, and hard-drives, with no coherent alignment with new work and processes of the combined entity [32]. The importance or process throughout the merger and acquisition model is found to be in the transferring of information. The more obvious loss of knowledge occurs in the effect of talent flight in M&A’s, where key employees leave the firm due to feelings of uncertainty in their future.

Pugh further describes the knowledge fragmentation as having three major components: Knowledge blind spots (not knowing how in the organization holds key information), knowledge mismatches (existing processes and documentation do not clearly address the reason for which existing process exist, only outline how processes are to be executed), and finally knowledge jail (abundant documentation and repositories of information of existing processes being merged make it difficult to navigate and compress into one firm’s process) [32]. All three of these factors become key points of new process integration in Mergers and acquisition. When taking this into account with all aspects discussed throughout this report, it is inferably a potential cause of frustration for employees, this a reason for leaving the newly merged firms.

It is therefore recommended to implement a process of include a process of transfer of information surging the M&A process. This process will alleviate stress reactions caused by uncertainty in the future, role overload and by creating reassurances for the employees.  The keys to avoiding knowledge fragmentation are to first identify information that can be crucial to the merged organization by selecting facilitators and sponsors together to prioritize process information. Next step would be to plan how knowledge will be captured. Once a plan is prepared, the firm must discover and formally capture these sets of key information to be able to make sense of it. Once documented, the merged firm must translate the information into useful applications, such as applied process framework. This will allow employees to go back to their new merged work groups with the tools to implement the process. Lastly, the information accumulated must be used to be reinforced [32]. For example, a firm should select specific merger-integration projects in which preselected teams work with the newly combined information. By enacting this type of procedure to communicated and execute process changes during a merger, employees will be able to perceive the organization as more prepared and supportive of the changes, thus increase trust an commitment to the organization. As mentioned previously, two key items in employee satisfaction and retention. Through effective communication planning and continuous message reinforcement, an organization can therefore reinforce organization citizenship behavior and organizational commitment, all while reinforcing trust and reducing stress on employees. This cause will negatively affect employee turnover rates and increase key employee retention.

## Effective process change

Proper communication strategies leads us to the notion of effective process. Procedural changes are all but unavoidable during an M&A. There are some key recommendations that can be applied to make these transitions more acceptable by the employee, to reduce the impact of stressor on them, thus reducing turnover. The first concept to implement during procedural change is the use of transition teams: “Once the merger process begins, teams incorporating members from both companies should be formed and used to bridge communication among employees in both the acquired and acquiring firms. Periodic meetings with middle managers and the executive staff can do much to ease the transition” [33].

It must also be considered that firm size and complexity will affect the success of procedural change within a merged company [34]. The more complex the merged entities are, the more complicated the knowledge transfer. This phenomenon seen by large firm may create more reasons for employees to flee the merger, perceiving the change as overwhelming. This is why it is important for firms in this situation to take some steps to make the change more manageable for employees.

Taking communication implications and firm complexity into consideration, there are a few recommendations to consider when implementing procedural change in a newly defined M&A. First, it is notable that organizational complexity will make greater integration progress and knowledge transfer in the early on stages [34]. This should be considered in pre-merger considerations to properly strategize the integration plan. Task-knowledge transfer is relatively un-impacted by organizational complexity, however conflict may arise when merging teams form different organizations. Management must be prepared for potential affective conflicts and be prepared to communicate through them [27]. Infrastructure support or formalized integration preparation with hardware, software and formalized integration procedures will positively affect the speed at which the company integrates knowledge [34]. This implies again, that proper employee preparation through training will become a key factor in transitioning.

Where process change is concerned, in sum, it is key to be prepared for integration and to prepare the workforce for integration. It is important to provide a structure system throughout integration. This support will assist organizations in

# Conclusion

While examining the human factor of in mergers and acquisitions, some major points can be outlined. Evidently, in many merger scenarios, retention of the entire workforce is not necessarily the goal. However, identification of key people and top talent are paramount to the success of integration. These key people are the source of information, continuity of operations, and motivation for other employees. Special attention must be focused on retaining them in the organization, keeping them motivated. In addition to keeping these employees motivated, it must be considered that their fit in the new organisation will have an effect on their loyalty. This implies that the organization must reinforce their cultural fit throughout the company, as well as ensure the employee identity is reinforced. To tie everything together, the merging organization must take a strong communication approach throughout the process. Formalised communication must be set to reassure employees of what is happening around them, to reduce uncertainties causing high stress. Open communication strategies will help reduce employee turnover.

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