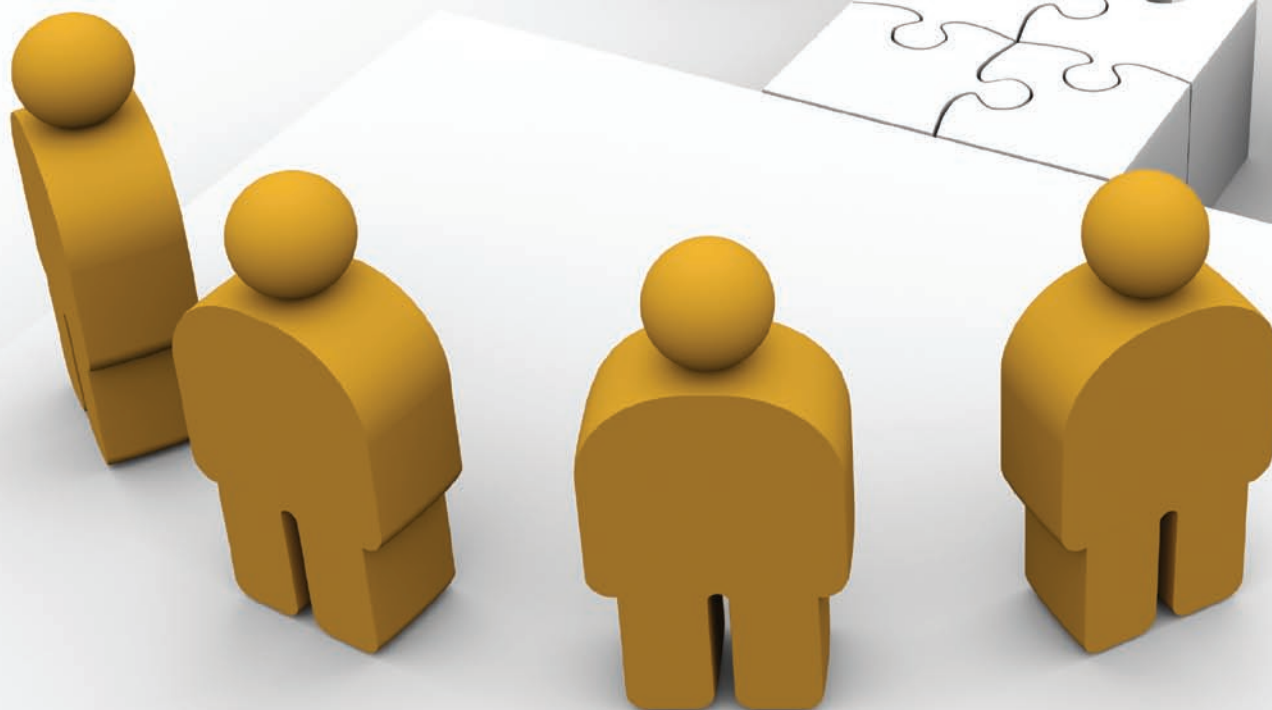
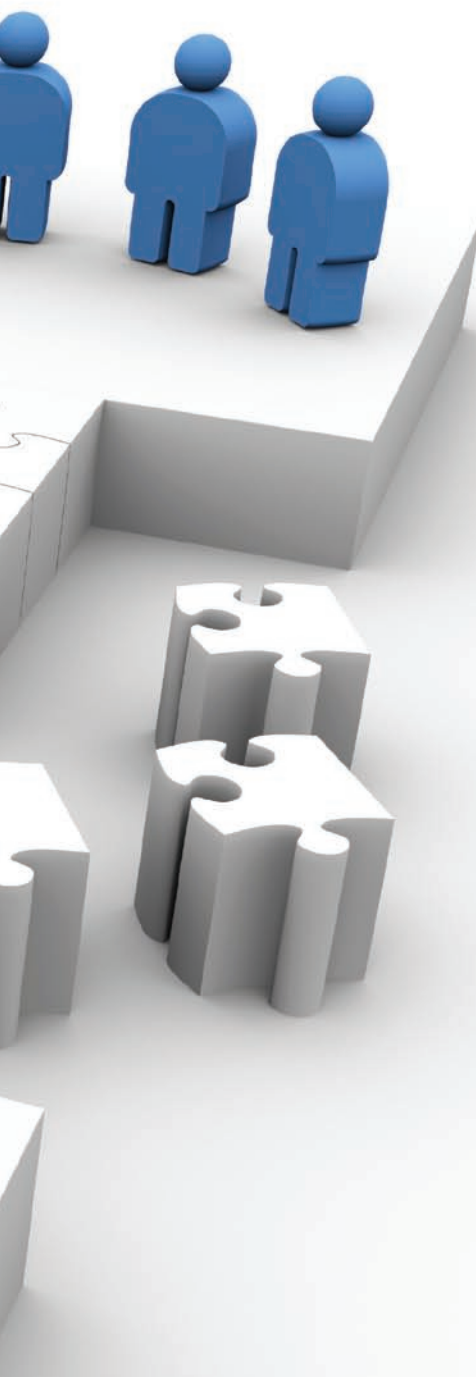


Managing People and Cultural Issues **in Mergers**

A practical guide to integration

By Jim McKay,
with Paula DeLisle and Patrick Huang





M&A IS A RECENT phenomenon for many Asian companies, with major “inter-Asia” cross-border deals originating from Japan, Korea and more recently from emerging markets such as China and India going regional or global. Much like their global counterparts, the intent is to seek new growth opportunities in human, customer, structural and financial capital.

Risk levels and complexity are much higher in these cross-border deals. Acquirers are likely to encounter unfamiliar corporate structures, differing standards in information availability, language barriers, unfamiliar regulations, complex taxation systems, cultural differences and different governance regimes and practices. With these higher levels of risk in the deals, a much more thorough and focused approach to due diligence is needed.

In this article, we offer a practical guide to help manage two of the biggest problem areas in mergers: people and culture. If poorly handled, these can result in employer unrest, talent defection and organizational gridlock, which rapidly result in losing any value of the deal. Therefore, we’ll show three practical steps that HR can take, in sequence, to frame, analyze, prioritize and ultimately resolve these problems – in any merger.

Step 1: Fact Finding

Before HR can be positioned to contribute to the success of a merger, it must do some fundamental fact finding to understand the history of the merger and the decisions made so far. This step consists of two parts: orientation and soul-searching.

Orientation requires meeting with the leadership that put the deal together and asking four big questions, whose answers will shape HR’s priorities, challenges, resources and expectations.

What were the primary business drivers for the acquisition?

Or put another way, why was the deal done? While reasons vary with each deal – buying talent or product, market access, geographical reach or industry consolidation – HR must understand what drove the deal in order to determine how these drivers influence its priorities.

What is the strategy for integrating the acquired firm?

This centers on understanding the level and depth of integration anticipated– from minimal to full integration – once the acquired company is formally owned by the buyer. In minimal integration, the acquired is maintained as a standalone subsidiary, often the strategy when talent is bought or the buyer enters a new geography. In the other extreme is full integration where the acquired company relinquishes its identity and is rolled into the buyer’s operations, often the case in industry consolidations. HR must understand the intended integration strategy in order to assess the people and cultural challenges and complexities inherent in that strategy.

What is the strategy for communicating the deal, integration and changes?

How will the buyer ensure that stakeholders understand the deal rationale, integration strategy and consequent changes? Although many stakeholders are involved (such as existing shareholders, the investment community, customers, vendors, the press and employees), HR’s primary concern will be communicating with the employee population. To do this effectively, HR must understand the business-wide communication strategy and align the employee communications to the overall strategy.

How will the integration be managed?

A trademark of successful integrations is that they are well led and well managed; integration success does not just happen. Although the specifics of each deal determine how the two companies are integrated, HR must know the plan for managing the integration, since this will determine HR’s contribution to the integration and



Step 2: Providing the Framework to Analyze the People and Cultural Issues

The second step requires HR to provide a framework for senior management to understand the people and cultural issues within a broader business context. This is essential for two reasons: it directly shows how the people issues affect the entire organization; and it immediately gets the cultural issue on the table.

The chart on page 8 (Framing the People and Cultural Issues) provides such a framework. It allows for an organization-wide understanding and analyzes these issues from both a financial and an operational perspective, by segmenting the issues along three interdependent lines: financial, people and cultural.

The financial line represents the underlying cost of employing people – the plans, programs and contractual obligations due to some or all of the employee population. This segment helps identify and quantify all the items that affect the acquired company's cost structure and their impact on the financial statements. It shows the major financial items that arise as a result of employing people, categorized by retirement and retirement-related plans, medical plans and executive contracts (including any accelerated stock gains as a result of the acquisition). Also included in this segment is a line item showing the total cost of employing people by adding all their financial components together (from direct wages and salaries to benefit plans, incentive plans and perquisites).

The people and culture components are wholly interlinked, since people create, maintain and ultimately change a company's culture. The goal in analyzing these two components together is to understand how the acquired

operates, what it does well and what fundamentally drives its performance and productivity. Understanding the similarities and differences in the way the buyer and the acquired do business will enable the buyer to focus more sharply on what needs

the resources it needs to allocate to the effort.

Now, to the soul-searching question, which requires HR to evaluate where it stands in contributing strategically within its own organization:

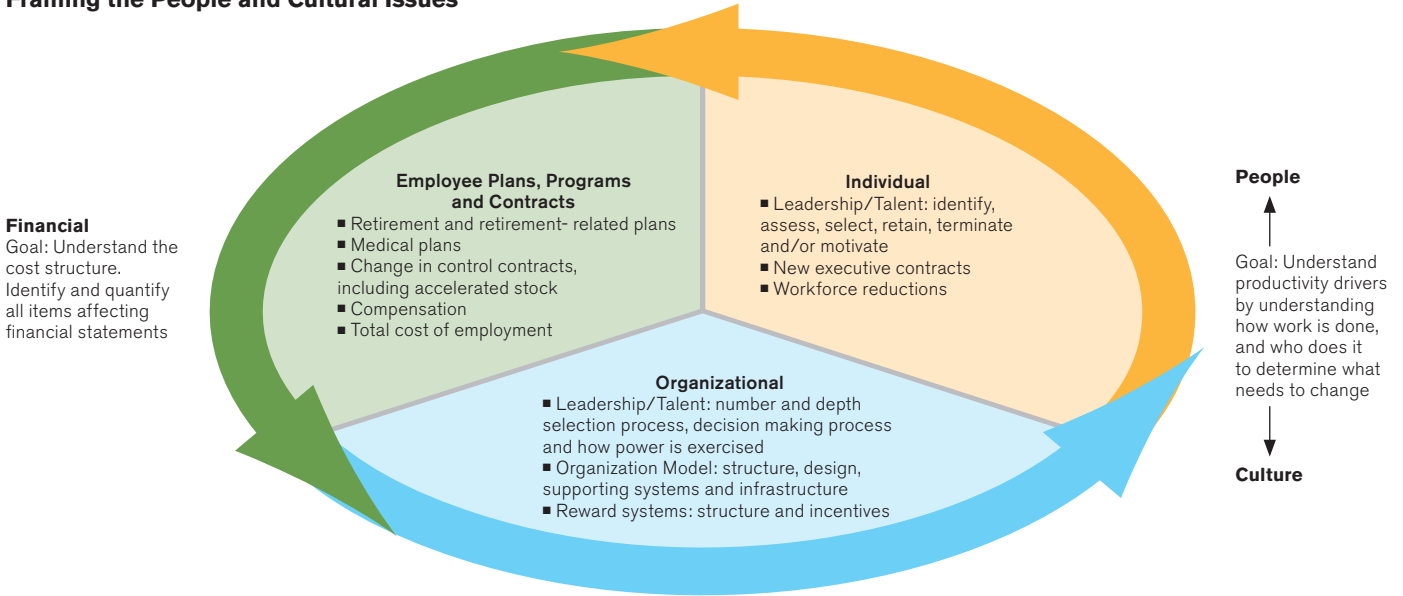
Does HR have the “right” to contribute to organization-wide discussions, or will it have to earn that right?

The answer will help HR determine whether it can contribute with its internal resources or should include external advisors to help get the message across.

Patrick Huang, Managing Director, Watson Wyatt in Greater China and Paula DeLisle, Vice President, Client Services, Asia Pacific.

“The challenge is to keep employees engaged, motivated and productive while the complications involved in the merger are being resolved”

Framing the People and Cultural Issues



to change (in either its own organization or in the acquired company), who needs to change, and how and when those changes should take place.

In this chart, the people segment considers people as individuals or groups of individuals and involves the identification, assessment, selection, motivation and retention – or termination – of the top leadership and talent at the acquired company or possible large-scale reductions in the employee workforce.

Meanwhile, the culture segment gets at the specific organizational issues that are unique to every company. Bear in mind that there is no one universal definition of “culture”; the important point is to understand the elements of any definition that most affect the organization’s performance. While the people segment gets at who does the work, the culture part gets at how the work gets done. It shows the process the company uses to select its leaders and identify its key talent, along with how these people exercise decision

making and power. It delves deeper into the organizational model and infrastructure, including reviewing the systems in place that reward people for their work and support the behaviors desired in achieving their performance goals.

Step 3: Making the Right Decision in the Right Order

The reality of mergers is that many issues need to be tackled, often simultaneously, often without the breadth and depth of data that go into typical day-to-day decision making. Given this, it’s critical that HR surface and prioritize issues quickly so that decisions can be made with the best information available, enabling the merger to progress toward its goals. The following table illustrates how to break these issues into three components: immediate strategic priorities, immediate HR functional priorities and the issues that can be deferred for later resolution.

Making the Right Decisions in the Right Order			
Deal Decision Drivers and Influencers	Immediate Strategic Priorities	Immediate HR Functional Priorities	Deferred HR Issues
Reasons for the deal and Goals for Integration	Organization model, structure and design	Transition of payroll and enrollment in benefit plans	Organizational processes that are not critical to integration
Integration strategy and level of integration anticipated	People decisions on key leadership	Employment contracts for key leadership and talent	Performance management and incentive harmonization
Communication strategy for deal, integration and subsequent changes	People decisions on key talent	Broader based staffing and selection decisions	Retirement plan design changes
Integration management	Terminations relating to large scale reductions in workforce	Represented employees negotiations	Broad based compensation levels
Evaluation of HR’s current strategic credibility	Change plan and related communication strategy	Integration of business and employee communications	Ongoing, relevant and consistent communications

The strategic decisions are those with the broadest organizational and company-wide impact. These are:

■ **Organizational**

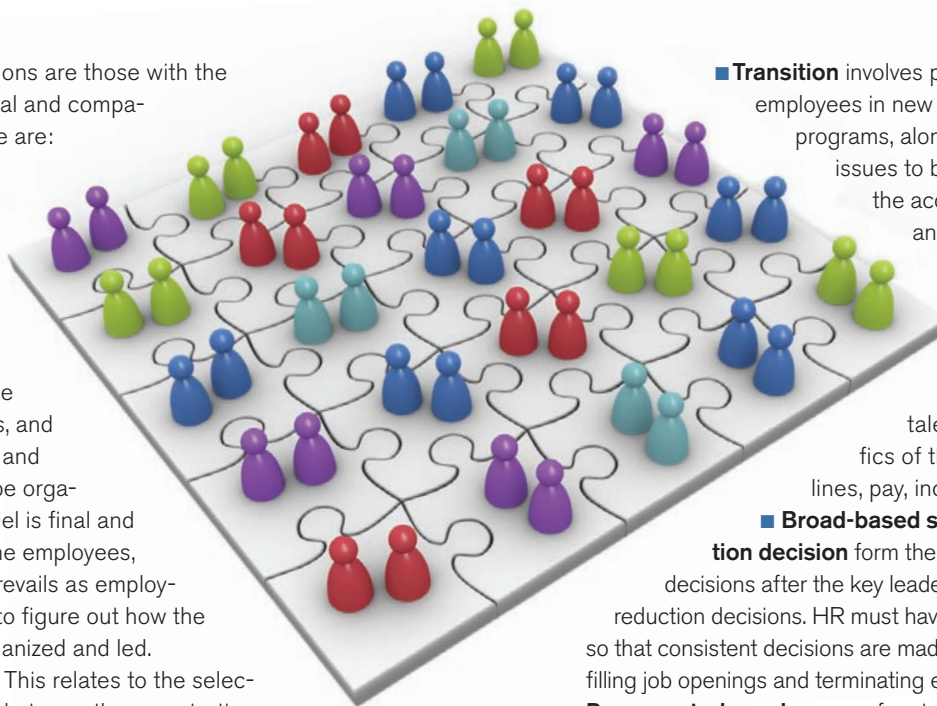
model. This shows how the merged business will be set up to manage its business. It delineates the shape of the new business, and how reporting lines and work teams are to be organized. Until the model is final and communicated to the employees, uncertainty often prevails as employees at all levels try to figure out how the business will be organized and led.

■ **People decisions.** This relates to the selection of the key people to run the organization and the retention of key talent, in conjunction with their “power” and reporting lines. These individuals will fill the job slots in the organizational model and will also be the primary leaders in communicating the merger message throughout the organization.

■ **Workforce terminations.** This relates to large-scale workforce reductions and the need to announce them as soon as feasible, while respecting the legal processes in each country regarding announcing and implementing terminations.

■ **Communicating changes.** The organizational model, people decisions, reporting lines and workforce reductions all have a significant, immediate impact on employee behavior and performance. The challenge is to keep employees engaged, motivated and productive while the complications involved in the merger are being resolved. In any merger, employees at all levels must understand the impact of the merger on two fronts: themselves and the organization. Personally, they need to know: (a) whether they have a job, (b) if so, whether their pay and benefits will change, (c) whom they will report to and (d) whether they will need to relocate. Organizationally, they need to know: (a) what's changing in the way they do the work, (b) what will stay the same, (c) what they will do differently, if anything, and (d) how they will do the work differently. The vehicle to achieve this is a well-planned and flawlessly executed communication strategy that addresses all the changes on a consistent and ongoing basis.

The critical functional issues are HR's direct responsibility. They also are labor intensive, tie up resources in planning and execution and, if not executed with precision, can destroy any hope of HR contributing to the strategic company-wide discussions. These relate to:



■ **Transition** involves payroll and enrolling employees in new or revised benefit programs, along with any transitional issues to be worked through with the acquired organization and/or vendors supplying these existing services.

■ **Employment** contracts for key leadership and talent covers the specifics of their role, reporting lines, pay, incentives and benefits.

■ **Broad-based staffing and selection decision** form the secondary people decisions after the key leadership and workforce reduction decisions. HR must have a process in place so that consistent decisions are made with respect to both filling job openings and terminating employment.

■ **Represented employees** refers to the communications and negotiations with employees represented by unions, work councils or their local equivalent. Due process and timing for these discussions must be respected, especially with any broad-based workforce reduction decisions.

Deferred issues are those that are less important to the immediate success of the deal. Decisions on these can be left until after the strategic and functional issues have been resolved. The tactic employed here involves conducting an inventory of these areas to understand and document what exists and provide an information base for better decision making once these issues rise in the priority list.

Examples of these longer-term issues include broader changes to organizational processes, performance management and incentive systems, retirement plan designs and compensation levels of the general employee population. The communication strategy must be ongoing, relevant and consistent so that employees understand the progression of the integration and how these elements will be addressed.

Summary

Whether in China, India, Japan or other parts of Asia, HR can and must play an important role in the overall merger, since resolving many of these issues requires knowledge and skills in organizational modeling, talent identification, cultural integration, change management and employee communication. With the right HR talent employed in merger integration, many of the people and cultural problems evident in so many deal failures can be mitigated or eliminated completely. **W**

– Jim McKay is Global M&A Engagement Leader, Watson Wyatt Worldwide.

“Experienced buyers incorporate mechanisms to resolve people issues very early in the process of due diligence”

The role of people in deal failures

WHY DO DEALS FAIL? Primarily because poor decisions are made by “people”, specifically the senior leaders of an organization.

Before explaining this statement in more depth, let’s recap how a deal is put together. First, a company must make a decision to grow through acquisition and then evaluate potential targets. After that, there are three decisions it must get right:

- The Strategic Fit (it must buy the right business aligned to its intended growth strategy)
- The Price and Terms (it must not overpay, nor agree to terms that limit its ability to succeed)
- The Integration (it must combine the organizations successfully).

All three need to be individually successful for the overall deal to be a success. Here, the saying “companies don’t make, people do” is valid, even though the outside world may never know who really made the decisions in any one deal.

So, how does deal failure materialize? Organizational performance drops, leading to one of two things: revenues don’t meet intended targets, or the expenses in integrating firms are larger than expected. In deal making terms, business goals are not met and synergy targets (for revenue and costs) fall short of expectations.

Given the 70% failure statistic, senior leaders embarking on the acquisition trail need to make decisions that will help them beat these odds. Some of the poor decisions they make, that contribute to the failure rate are:

- They have inexperienced people lead the deal. This shows through in their enthusiasm for doing a deal, which overrides concerns about the strategic fit, the price and major terms and in the decisions as to how best integrate the two firms. The result is that the combined business starts immediately missing its goals because the deal itself was based on emotion and not sound business reasons.
- They decide to proceed with their strategy, without a well developed M&A process to manage through all the stages and without a tested process which covers all the key decision points, in the right order, aligned to the appropriate stages of the deal. This sows the seeds of failure right at the start of the deal. It first shows through when acquisition teams are put together to run the due diligence, but these team members often have no vested interest, nor expertise, in the operational details of integration, and gather superficial “integration” information at best, particularly on the real leaders and talent in the target and how the target actually operates. The result of these superficial integration assessments is that subsequent integration decisions are based on inaccurate information, made in a haphazard and confused way.

- They delay on deciding the “leaders” of the combined organization. The leaders of the combined organization are not named immediately, and failure to make these often tough and emotional decisions, results in a cascading confusion all the way down to the employee population base. This shows through when many integration meetings end as “discussions of issues”, but little decisions are actually made and implemented. The result is organizational gridlock, and business is lost during this confused and “leaderless” time.
- They delay on identifying talent and letting that talent know they are key. This is significantly tied to the leadership decisions above, there is simply no real leadership to identify the talent, speak to them and get them to commit to stay with the combined organization. This most often shows through when sales people leave, or

R&D talent teams defect as a group to competitors. Talent tends to become dissatisfied with answers to their career path questions, and their contractual terms are hastily put together. They defect to competitors who entice them with concrete answers to questions.

- They allow the two companies to lose sight of their market and customers. The buyer has not thought through the best way to get them working as one, and the two businesses don’t know how to work together. This shows through when the integration focuses on “big company” corporate structural decisions on financial and legal reporting, risk management systems, IT systems or performance management changes – all to do with operating efficiently, little to do customers, either with winning new ones and/or retaining existing business. The result is that the combined business becomes distracted from the marketplace. Sales people can become confused about what they are selling, to what customers, and on what terms, or teams put together to land large projects disagree on the approach, timing and pricing of the project.
- They have not planned for adverse reactions to workforce reductions. They have not thought through the implications of large scale reductions, and often terminate employees on a staggered basis, in line with their strategic plans and not the impact on employee behavior.

While these issues may have been identified, the buyers might be slow to act on the issues. If they leave these decisions until integration is in progress then that is too late. They can be prevented however by people who have been through deals before and who can anticipate and prevent many of these issues from arising in the first place.

Experienced buyers incorporate mechanisms to surface and resolve these issues very early in the process, beginning with the due diligence investigations.

