

Managing Human Resources
in
International Mergers and Acquisitions¹

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2004 Congress, ETH, March 2004

¹ A much longer version to appear in H. Scullion and M. Linehan (eds.) *International Human Resource Management: A Critical Text* (London: Palgrave/MacMillan, 2004). Adapted from the book, R. Schuler, S. Jackson and Y. Luo, *Managing Human Resources in Cross-Border Alliances*, (London: Routledge: 2004). Based upon earlier works: R. Schuler, "HR Issues in International Joint Ventures," *Journal of International Human Resource Management* (February, 2001): 1-50; R. Schuler and S. Jackson, "HR Issues and Activities in Mergers and Acquisitions," *European Management Journal* (June 2001: 59-76).

MANAGING HUMAN RESOURCES IN INTERNATIONAL MERGERS AND ACQUISITIONS

"It's clear that you cannot stay in the top league if you only grow internally," says Vasella. "You cannot catch up just by internal growth. If you want to stay in the top league, you must combine."

- Daniel Vasella, Chairman and CEO of
Novartis (Herper 2002)

International mergers and acquisitions represent the end of the continuum of options companies have in combining with each other. Representing the least intense and complex form of combination is licensing. Next come alliances and partnerships and then joint ventures. Mergers and then acquisitions conclude the combination options. In a merger, two companies come together and create a new entity. In an acquisition, one company buys another one and manages it consistent with the acquirer's needs.

During the past two decades, cross-border acquisitions have exploded. According to W. T. Grimm's *Mergerstat Review*, there were only 197 cross-border acquisitions in 1985, and by 1999 there were 957. In the United States, for example, cross-border acquisitions of U.S. companies accounted for 19 percent of all takeovers during 1999. This compared to only 6 percent in 1985. Despite all the challenges associated with IM&As, recent studies suggest that the combined firms are often valued more highly than the uncombined firms would have been succeed in created (Seth, Song, and Petit, 2002). Thus, longer-term, the future appears to be ripe for a continuation of international

merger and acquisition (IM & A) activity, even though a temporary cooling off of the economy is also nearly inevitable.

Many companies seem to be confronted with the need to do mergers and acquisitions, yet the odds of doing so successfully are relatively low. These odds can be increased, however: firms that have gained more experiences and that take a systematic approach to learning from experiences in their deal making are more likely to be successful (Arndt, 2002; Ashkenus, DeMonaco and Francis, 2000; Fendt, 2002). As part of their systematic approach to completing successful IM&As, managers pay attention to HR issues that exist throughout the stages of international mergers and acquisitions. On the other hand, with there being more IM&As overall, there are more inexperienced executives, too. Inexperienced executives are less proactive, tend to underestimate HR issues and therefore not to involve HR or only late in the process (Levinsohn, 2002; Fendt 2002)

The key HR issues that arise in IM&As vary somewhat depending on the specific circumstances or type of IM&A under consideration. Some mergers are “mergers of equals.” Examples of these include the merger between Citicorp and Travellers forming Citigroup; and between Ciba-Geigy and Sandoz forming Novartis. Other mergers take place between firms that are clearly unequal—at least in total size and market value. Similarly there are various types of acquisitions, e.g., those involving acquisition and integration such as those typically made by GE, Siemens and Cisco Systems; and those involving acquisition and separation such as between Unilever and Bestfoods.

There are also friendly acquisitions and hostile acquisitions, although cross border hostile acquisitions are relatively rare (Evans et al., 2002). Acknowledging the different types of mergers and acquisitions is necessary in order to understand the many different HR issues that arise in IM&As. For example, a merger of equals often compels the two companies to share in the staffing implications, whereas a merger of unequals results in the staffing implications being shared unequally (Kay and Shelton, 2000). In this chapter, we can barely briefly touch on the HR issues associated with the different types of IM&As (for a more complete discussion, see Schuler, Jackson and Luo, 2003).

In addition, the HR issues to be addressed in IM&As may differ depending on the objectives behind the deal.

Among the numerous reasons for companies to merge or acquire are these:

- To Promote Growth
- To Manage Technology
- As a Response to Government policy
- To Take Advantage of Exchange Rates, Which Can Affect:
- As a Response to Political and Economic Conditions
- Reduce Labor Costs and/or Increase Productivity
- To follow clients, e.g.
- To Diversify and Manage Risk
- To Achieve Greater Vertical Integration

- As a response to shareholder and/or analyst pressure for growth, innovation, internationalization, etc.

In recent years, people-related reasons have become more common and with industrialized countries' dramatically aging population until 2020, this motive is likely to increase in significance: for example, engineers and scientists are in high demand worldwide and as this demand will go up, the supply will go down (Prognos 2001). In industries where intellectual capital is critical to business success, as it is for semiconductor and optical networking firms, technically skilled employees are seen as more valuable than the company's product. Some banks even make dollar estimates of the value of a firm's employees, e.g., by applying metrics like price-per-engineer. When Broadcom bought chipmaker SiByte, it can be said to "have paid \$18 million per engineer" (Creswell, 2001). Of course, such deals can only be successful if the employees in the target firm agree to stay after the deal is completed. Retaining talent after any merger or acquisition can be difficult. It may be even more difficult when employees in the target firm are expected to shift from working for a well-regarded domestic firm to working for a foreign-owned company, which may have less status or prestige or is simply unknown.

Next, we describe a simple three-stage model of the IM&A process and use it to outline several HR issues that arise during IM&As. This model provides the foundation for developing propositions regarding how effective human resource management can contribute to IM&A success.

THREE STAGE MODEL OF MERGERS AND ACQUISITIONS

Exhibit 1 summarizes the HR issues to be addressed in three stages of the IM&A process. The three stages shown are (1) pre-combination; (2) combination and integration of the partners; and (3) solidification and advancement of the new entity (Evans, et al., 2002; Habeck, Kroger and Trum, 1999). These three stages are applicable to most of a firm's business functions (finance, marketing, distribution, IT, manufacturing, etc.), but we highlight here only the issues that are most closely associated with managing human resources.

Insert Exhibit 1 About Here

Stage 1

The pre-combination stage includes all of the activities that occur before the IM&A is completely legally. Thus it includes the process of determining the reasons for becoming involved in a merger or acquisition (as a buyer or a target), searching for possible partners (whether domestic or international), evaluating the alternatives, selecting and negotiating with a specific partner, and planning for the eventual implementation of the deal. In many respects, these activities are quite similar to those conducted during the Formation Stage of an IJV.

The activities in stage 1 establish a foundation for stages 2 and 3. For example, in order for Stage 2 to be effective, it is important that the partners have already carefully planned

and prepared for it during in Stage 1. According to some estimates, lack of integration planning is found in 80% of the IM & A's that under-perform (Habeck et al; 1999).

A key HR activity in Stage 1 is the performance of a HR due diligence. The HR due diligence process should assess the human capital of an organization. It is, however often carried out by lawyers and financial experts focusing on financial costs and contractual obligations. If HR is involved in this process it will go beyond to give insight in how much a business is supported by its human capital, what culture drives the company and how does it impact on performance, what added value is the human capital capable of creating in a merger and how can it best be released and developed (Daniel and Metcalf, 2001; Devine, 2002).

Stage 2- Combining and Integrating the Companies

The stage of combination and integration begins after a merger or an acquisition is announced and pre-combination activities are completed. The general approach used to integrate and combine IM&A firms can be characterized as fitting one of four approaches: portfolio, blending, new creation, and assimilation.

In the portfolio approach, managers in the two companies retain a great deal of autonomy. Although the alliance creates legal and economic interdependencies, the top management team assumes that the two organizations will continue to operate more or less as they had operated prior to the IM&A. Presumably, the strategic value of the alliance does not lie in the integration of the separate organizational systems, so

differences are “managed” by maintaining segregated organizations. This scenario often occurs when one firm acquires another firm as a pure investor or in order to diversify into another business or region and then allows the acquired firm to operate as a relatively autonomous subsidiary.

The blending scenario arises when top managers intend for the two organizations to come together or merge into a new organization that retains the best aspects of the original partners. In this scenario, the intent is to manage diversity through integration, with members of each organization adapting to the procedures and culture of their alliance partner. The blending approach is perhaps most common in IM&As that occur within an industry and between firms that are believed to complement each other’s strengths and offset each other’s weaknesses.

But surely management style, organization, and market share could have been improved without a merger? "No," Vasella replies. "The merger was the trigger we needed to rethink our focus and re-challenge ourselves. We needed to create a whole new corporate culture. The creation of a new company with a new name committed to innovation gave us a competitive advantage." (Hanes, 1999)

A third scenario arises when the partners agree to create a new firm that is truly different from either of the original partners. As we have already seen, this is typically what partners agree to do when they enter into a joint venture, especially if the IJV is located in a country other than the countries of the parent firms. Creating a new

organization is the goal of some mergers also, although it seems to be less common.

One indication that an IM&A is intended to form a new creation is that the resulting firm takes on a completely new name. Novartis, which was created through a merger of Sandoz and Ciba-Geigy, is one example. Although it is not strictly speaking an international M&A, cultural differences of these two global life science players were important². Having experienced a merger of similar size in 1970 with Ciba and Geigy and having seen that for two decades people tended to blame “those of Ciba” or those of Geigy”, the merging partners set out to do it right this time. They focused strongly on culture from the start and spared no effort to create a totally new culture from day on.

The name Novartis, describing the innovation focus of the new organization and bearing no association with either of the previous names, should be its symbol. No energy should be lost with turf wars. Rather should all efforts be focused on the common project: "(...) is like having a **child**: Each parent looks for resemblances in the eyes and face. But the child has its own identity. Both sides will need to step back a bit and not impose their own **culture** on it." (Smith, 2000)

Finally, in some acquisitions, the buyer clearly intends to take over and control the target. Typically General Electric and Siemens do this with many of their acquisitions (Javidan, 2002) Such experienced integrators use proven integration processes which they regard as critical growth competencies. Consequently, they invest time, people,

² Daniel Vasella: “We [Ciba Geigy and Sandoz] had very different corporate cultures even though we were in the same town, separated only by a river. Companies can have substantial differences even if they are physically very close in proximity. Of course, there are also national differences. For example, one of my colleagues (a German in the U.S.) went with another colleague to a football game. His colleague was coaching and the gentleman's son was shooting the ball and couldn't score. My colleague thought, "What a poor shot!" while the American said, "Great try, Johnny!" I felt that this was such a wonderful example of the difference in attitude that I saw between Americans and Germans: one focuses on the effort and the possibilities for the next time, while the other thinks first about critique.” (Fuld, 2000)

and resources to develop the processes, functions and responsibilities, checklists and full-time integration managers long before IM&As occur (Bogan and Symmers, 2001). The target firm may be an attractive candidate for an acquisition because it has some valuable assets, yet for various reasons it is clear that it cannot survive on its own. In this scenario, the expectation is that the target firm will lose its identity and adopt the management practices of the acquiring firm. In other words, the target firm is expected to assimilate into the acquirer such as what happened when Deutsche Bank acquired Bankers Trust (Atlas, 2002). This is also what happened in Pfizer's hostile take-over of Warner-Lambert. When Pfizer acquired Warner-Lambert, they adopted a few of Warner-Lambert's practices, but observers say that little of the Warner-Lambert culture remains today. Not surprisingly, most of Warner-Lambert's top-level managers left the firm.

Regardless of the specific approach, all acquisitions require some degree of integration of systems and processes in order to achieve key synergies. Successful integration is a key challenge in Stage 2 of IM&As. If the firms don't succeed in integrating their activities, the results are predictable. According to recent studies, poor integration accounts for declining productivity, leadership attrition, low employee morale, and failure to meet financial goals (Bobier, 2000).

Because Johnson & Johnson engages in so many mergers and acquisitions, they have been able to study their own experiences and learn from the successes and failures. This company's research clearly indicates that a systematic, explicit integration process

is at the heart of successful mergers or acquisitions. Furthermore, J&J has learned the importance of tailoring decisions about how to approach the task of integration to take into account the specific strengths and weaknesses of the acquired company. J&J has also learned that Stage 2 should proceed as quickly as possible—the sooner the process begins, the better. Ideally, decisions about the management structure, key roles, reporting relationships, layoffs, and restructuring should be announced within days of signing. Creeping changes, uncertainty, and anxiety that last for months are debilitating and drain value from an acquisition (Bobier, 2000).

Stage 3-Solidification and Assessment of the New Entity

As an IM&A takes shape, it faces issues of readjusting, solidifying and fine-tuning. These issues take on varying degrees of intensity, although not importance, depending upon the approach to integration that the firms adopt. The intensity can be quite high for an international merger of equals that is intended to lead to the creation of a new entity, and failure to address the HR issues effectively is likely to mean that the intended strategy is never successfully implemented. For DaimlerChrysler, Stage 3 lasted more than two years (Muller, Green and Tierney, 2001). During that time, they grappled with all of the HR issues listed under Stage 3 in Exhibit 1.

Like IJVs, effectively managing international mergers and acquisitions requires dealing successfully with many significant HR issues. Each stage of the IM&A process presents new challenges as well as new opportunities to create value by managing people

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effectively. Next, we turn to a more detailed discussion of the HR issues that arise in each of the three stages of IM&As. We will do this in our workshop at the ETH.

Due to space limitations, references are not provided here, but may be obtained by going to my website or clicking on the article entitled: "Managing Human Resources in Cross-Border Alliances," by Randall S. Schuler and Susan E. Jackson. The address is www.rci.rutgers.edu/~schuler/

EXHIBIT 1

Selected HR Issues in the Three Stages of IM&As

Stage 1: Pre-Combination

- Identifying reasons for the IM & A
- Forming IM & A team/leader
- Searching for potential partners
- Selecting a partner
- Planning for managing the process of the IM and/or A
- Planning to learn from the process

Stage 2-Combination and Integration

- Selecting the integration manager
- Designing/implementing teams
- Creating the new structure/strategies/ leadership
- Retaining key employees
- Motivating the employees
- Managing the change process
- Communicating to and involving stakeholders
- Deciding on the HR policies and practice

Stage 3: Solidification and Assessment

- Solidifying leadership and staffing
- Assessing the new strategies and structures
- Assessing the new culture
- Assessing the new HRM policies and practices
- Assessing the concerns of stakeholders
- Revising as needed
- Learning from the process

Source: R.S. Schuler, S.E. Jackson and Y. Luo, *Managing Human Resources in Cross-Border Alliances* (Routledge Publishing, 2004). Used by permission.