CHAPTER ONE

INTRODUCTION

"...Mergers are more likely to succeed when inspired by a clear goal. Much depends on the quality of management, because melding people who come from different work cultures can be tricky. Indeed, the post-merger scenario, which is largely about people, seldom has received the same commentary or attention. There does not seem to be adequate literature about the human aspects of mergers, although that is the prime focus of the top management. Given the role of employees in bringing about the change so essential for driving the lasting gains from a merger, business organizations can ill afford to neglect the subject."

"Human Face of Merger" – Speech of S.M. Datta, Ex-Chairman, Brooke Bond India Limited (BBLIL) and HLL at the 82nd AGM of erstwhile BBLIL.

1.1 INTRODUCTION

Corporate mergers and acquisitions (M&As) have become extremely common over the last few decades. Mergers, acquisitions, and restructuring have become a major force in the financial and economic environment all over the world. M&As, essentially an American
phenomenon till the mid-1970s, have become dominant global business themes since then. As David Sinclair put it: “It was once thought that states too sophisticated to fight each other would make war through sport. They do not. The real international battle ground these days is the boardroom. The weapon is takeover”.

Closer home, too, corporates are seriously looking at mergers and acquisitions as strategic management tools, which have become ubiquitous. The use and intensity with which corporate restructuring is practised has grown at tremendous pace since the beginning of the liberalization era (circa 1991), thanks to greater competitive pressures and a more liberal environment. There has been a sharp increase in both the number and sizes of the mergers and acquisitions in the last decade: In 2003, for example, India saw more than 650 deals announced whose value totalled more than Rs.20,000 crores.

M&As have been used by executives to expand corporate size, power, and economic wealth. As such, M&As have been viewed as alternatives to internal growth. M&As have represented a quick way to either enter new markets, control markets, or acquire new technologies etc. They have been viewed by finance professionals as ways to improve the effect of taxation on profits, portfolio additions, and relatively an economical way to expand quickly.

Surprisingly, none of the studies even mention the indirect role played by WTO in M&A. In fact, the impetus for such a tremendous increase in
M&As, in general and in India in particular, could partly be attributed to the keenness of the signatory countries to the WTO to play by the WTO framework. For example, a pharma company in India, having core competency in economic production of drugs, finds itself in a vulnerable position as it lacks the R&D muscle and as a consequence the number of patents it owns. In such a case, acquiring a small to medium sized purely research focussed outfit looks mandatory. Many such reasons for M&A could be sighted which definitely support the claim that WTO does play a great role in M&A.

In more mundane terms, a large number of M&As of the 90's are standing examples of WTO rule driven activities. In most of these cases, the manufacturers tried to circumvent the export restrictions, quotas and local content barriers by acquiring small to medium companies operating locally in the country of their interest. (a'la Ford acquiring Mazda, Toyota acquiring Daihatsu)

Corporate restructuring forms like closure, rationalization, expansion, diversification, technological upgradation or restructuring in general when driven by corporate efforts at globalisation initiated due to or in spite of M&As affects HR and its reactions.

Literature review of studies of both qualitative and quantitative categories points to insufficient preliminary insights on the human resources responses front in varied contexts.
The present study essentially focuses on one corporate restructuring context which has not been researched adequately before, even in developed countries' context and which is also of immediate relevance in the Indian context. The M&A process presents infinite possibilities as a laboratory for investigating the HR response, not only because it is a poignant and volatile moment in the evolution of the merging organizations but also because it is intrinsically traumatic for the human beings who go through the turbulent pre-, through and post merger phases.

1.2 DEFINITIONS OF TERMS

An attempt is made here to clarify the meaning of certain terms as assumed in this study for purpose of clarity in understanding.

Although the terms 'mergers' and 'acquisitions' do not describe the same thing, the growing literature in this field suggests that they are homogeneous in nature and typically have the same repercussions for the firms (Schweiger and Ivancevich, 1987). Therefore, the terms 'mergers' and 'acquisitions' are used interchangeably in most discussions. That is also the approach taken in the context of this study, in which the terms 'mergers' and 'acquisitions' will be used interchangeably.

Nevertheless, it is necessary to point out the specific differences in meanings of these. In a more technical sense, 'acquisition' describes any transfer of ownership, whereas 'merger' describes a transfer of
ownership in which one entity legally disappears into the other, or both entities disappear into a third entity created for the purpose of the merger (Lajoux, 1998). In other situations, the word 'merger' is used to mean the union of two companies of substantially equal size involving a high degree of cooperation and interaction, while the word 'acquisition' refers to the combination of a large company with a much smaller one.

The difference between mergers and acquisitions, however, tend to be much more than technical and semantic in nature. Mace and Montgomery (1962) found when talking with the executives of a target firm that management representatives of the acquiring company always referred to a 'merger' of the two firms, although it was implicit and apparent that the one firm proposed to acquire the other. In the respective situation the negotiating executives of the acquiring company would talk about 'merger' with the management of the company to be acquired, but when discussing this opportunity with their board of directors, they referred invariably to the possibility of 'acquisition'.

In the words of Mace and Montgomery (1962): "There seemed to be an inoffensive quality in the word 'merge' not found in the word 'acquire'. As one executive stated, 'The reasons for the difference are unclear, but managements find comfort in the merging of mutual interests. Being acquired connotes being had!'"
For analytical purposes, it is usual to consider mergers and acquisitions in terms of the extent to which the activities of the acquired organizations are related to those of the acquirer. This kind of classification proposes four main types of mergers and acquisitions (Walter, 1985; Hovers, 1973; Kitching, 1967).

**Vertical M&A** is the combination of two organizations from successive processes within the same industry with an actual or potential buyer-seller relationship. In this context, an organization may choose to acquire a supplier (backward integration) or a firm that could distribute its products (forward integration).

**Horizontal M&A** comprises the combination of two similar organizations in the same industry and often occurs, when the firms involved produce one or more of the same or closely related products or services in the same geographic area.

**Conglomerate M&A** occurs when the acquired organization is in a completely unrelated field of business activity. The rationale usually cited for such acquisitions is that the combination opens entry into an attractive business or industry and spreads the company's risk.

**Concentric M&A** occurs when the acquired organization is part of an unfamiliar, but related field into which the acquiring company wishes to expand. This kind of M&A activity is often referred to as product extension and occurs, when the acquiring and acquired companies are functionally related in a field, but sell product or services that do compete directly with one another.

Napier (1989) suggests that mergers can also be considered as falling into three main types, depending on the degree of integration necessary, if the merger is to achieve its objectives. These types are described as follows:
In extension mergers, the acquiring organization does not intend to change, other than perhaps minimally, the way in which the acquired company transacts its business. This approach is also referred to as 'hands off' approach.

In collaborative mergers, the success is dependant upon the integration of operations ('synergy mergers') or exchange of technology or other expertise ('exchange mergers').

In redesign mergers, the acquiring organization intends to introduce wide-scale changes, whereby the acquired company totally adopts the practices and procedures of the acquirer.

The terms 'post-acquisition' or 'post-merger integration' refer primarily to the art of combining two or more companies - not just on paper, but in reality - after they have come under common ownership. Integration refers to a combination of elements that results in whole entity. Moreover, integration occurs at several levels, e.g. by combining the accounting systems of the two firms or by creating a single legal entity. Other important issues may be the integration of physical assets, product lines, production systems, technologies, or the cultural integration.

1.3 IMPORTANCE OF HUMAN RESOURCES IN INTEGRATION POST-MERGER

The inadequacy of rational economic explanations of merger failure was first demonstrated over almost forty years ago (Kitching, 1967). The study, examining the variance in performance of almost seventy US acquisitions, found that analysis of objective results (i.e. statistical evidence relating financial performance to known pre-acquisition factors of size and type) was insufficient to explain success, without
integration with subjective results (i.e. the reflective experiences of the top executives involved). Kitching concluded that the key to merger success was essentially the way in which the 'transitional process' was managed and the quality of the working relationship between the partnering organizations. The study found that in 81 per cent of failed mergers, 'reporting relationships' were said to be unclear or frequently changed.

Harry Levinson (1970) first likened the process of merger to a marriage, whereby the compatibility of the partners is crucial to the healthy growth of the new or revamped organization. In the predominant view of decision makers, compatibility is only a matter of ensuring a 'good strategic fit', and the compatibility of management styles and corporate cultures has not received adequate attention of the researchers.

A survey of over 200 European chief executives carried out by Booz, Allen and Hamilton (1985) found that 'ability to integrate the new company' was ranked as the most important factor for acquisition success; 'price paid' was ranked as one of the less important factors. A discussion paper prepared by the British Institute of Management (1986) identified sixteen factors associated with unsuccessful mergers and acquisitions, at least half of which directly relate to people and people management issues:
• Underestimating the difficulties of merging two cultures.
• Underestimating the problems of skills transfer.
• Demotivation of employees of acquired company.
• Departure of key people in acquired company.
• Too much energy devoted to 'doing the deal', not enough to postacquisition planning and integration.
• Decision making delayed by unclear responsibilities and post-acquisition conflicts.
• Neglecting existing business due to the amount of attention going into the acquired company.
• Insufficient research about the acquired company.

Walter (1985) suggests that socio-cultural integration takes between three and five years. Furthermore, he estimates that the cost of culture collisions resulting from poor integration may be as high as 25-30 per cent of the performance of the acquired organization. Davy et al (1988) attributed 'employee problems' as being responsible between one-third and a half of all merger failures.

Mergers and acquisitions, as they represent sudden and major change, generate employee uncertainty. Davy et al (1988) suggest that the only thing certain about organizational acquisition is that nothing is certain. This uncertainty is considered to be associated with lowered morale (Altendorf, 1986; Sinetar, 1987), job dissatisfaction and unproductive behaviour, in that a considerable amount of employee time is spent sympathizing with others or on unofficial job hunting. In addition, mergers and acquisitions have also been linked with acts of sabotage
and petty theft (Altendorf, 1986), increased staff turnover (Unger, 1986), increased absenteeism rates (Davy et al., 1988) and increased concomitant stress (Sinetar, 1981; Schweiger and Ivancevich, 1985).

Besides the fragmented perspective and unresolved expectations, Jemison and Sitkin (1986b) identify the limited consideration of integration issues as one of the major reasons for unsuccessful M&A activities.

Buono and Bowditch (1989) have pointed out that: "because of the myriad questions about merger and acquisition success, attention has begun to shift toward human resource concerns, the cultural ramifications of merger activity, management of overall combination process, and specific efforts aimed at post-combination integration."

(Buono and Bowditch, 1989)

A study by Chakrabarti (1990) has found that post-merger performance depends even more on post-merger integration than on strategic fit, because organizational factors intervene and essentially determine which of the pre-merger potentials are really achieved and which are not.

A study by A.T. Kearney concludes that the post-merger integration phase bears the greatest risk in an acquisition (Habeck, Kroger and Tram, 2000).
This point of view is corroborated by a study of Bain (Duelli, 2000), which revealed that more than half of all merger and acquisition failures are caused by faulty post-merger/post-acquisition integration activities.

A recent study of McKinsey (Bekier, Bogardus and Oldham, 2001) points out that many companies lose their revenue momentum after the acquisition as they concentrate on cost synergies or fail to focus on post-merger growth in a systematic manner. In fact, only 12% of the companies in the sample of the McKinsey study managed to accelerate their growth significantly over the three years following the merger.

Although there is considerable literature from strategy researchers or financial economists in which M&A activities have been analysed from different perspectives, the issue of post-merger integration is still a rather neglected one. Some of these studies have been done in the context of the market for corporate control (Jensen and Ruback, 1983) whereas others have investigated the specific performance or success of the acquiring / acquired company, sometimes also linked to a specific type of acquisition (Seth, 1990; Ansoff et al., 1971; Lubatkin, 1983).

Financial analysts frequently fail to recognise that the merger or acquisition is an important human as well as financial activity. In focussing exclusively on balance sheet explanations of merger failure and the so called “hard” issue, the role of people in merger success is often forgotten or overlooked (Hunt, 1987, Levinson, 1970, Kitching,
This distinction which has developed between "hard" and "soft" merger issues, thus separating the impact of merger on the individual (and the research question "what happens to people?") from its organizational impact ("what happens to the organization?"), has been of little help in extending understanding of merger failure.

The issue of post-merger integration, which is closely linked with the complex organizational implications of acquisitions, has been rather widely neglected. In addition, some other authors (Shrivastava, 1986; Napier, 1989; Hunt and Downing, 1990; Chakrabarti, 1990; Davidson and Neumann, 1997; Haspeslagh and Jemison, 1987 and 1991; Walsh, 1989) emphasise also the importance of the post-acquisition integration strategy and call for further research in this context. In fact, Ashkenas et al (1998) have commented: "Improving the acquisition integration process, however, may be one of the most urgent and compelling challenges facing business today."

Nearly 40 years ago, Mace and Montgomery (1962) stated: "The values to be derived from an acquisition depend largely upon the skill with which the administrative problems of integration are handled. Many potentially valuable acquired corporate assets have been lost by neglect and poor handling during the integration process."

1.4 CONCLUSION

Mergers and acquisitions have become the principal tools for corporate restructuring. There has been a sharp increase, in both the number
and sizes, of the mergers and acquisitions in the last decade. Closer home, too, corporates are seriously looking at mergers and acquisitions as strategic management tools, which have become ubiquitous. The use and intensity with which corporate restructuring is practised has grown at tremendous pace since the beginning of the liberalization era.

An extensive review of literature indicates that M&A related studies is dominated by strategic, financial and operational concerns. Organizational and human issues that influence the processes, during and post-merger phase, have received inadequate attention. In the Indian context, most of the research is confined to either the study of mergers as an outcome of economic reforms or is seen through the financial, strategic or organizational perspectives.

Literature review of studies of both qualitative and quantitative categories points to insufficient preliminary insights on the human resources responses front in varied contexts. A majority of them point to the wrong handling of the HR aspects as the principal reasons for merger failures.

In essence, though unfortunate, the literature on human aspects of merger is fragmented, eclectic, US dominated, and essentially composed of hypothetical speculation and anecdotal articles. There is a paucity of research in the area generally and a notable lack of empirical research of a comparative nature. The need for research into
human aspects of mergers and acquisitions is all the more acute in India, as can be seen from the comment (more like lamenting?) made by Mr. S. M. Datta as mentioned afore.

Success of mergers and acquisitions is critical from the point of view of overall economy. Though every other aspects of mergers and acquisitions needs to be examined in detail, the productivity of such effort is higher in case of study on human aspects. From this point of view a single most significant factor which can have positive impact on the overall success rate of M&As is the integration of human resources. This is amply evidenced by available data and preliminary research. There is a dearth of relevant empirical studies in the area in India. Hence, this study needs to be taken in the cause of national interest.

1.5 ORGANISATION OF THIS THESIS

Chapter One introduces the topic of research and highlights the importance of the human resources in the post-merger integration. Need for the study is highlighted in the concluding portion of this chapter.

Chapter Two reviews the research in mergers and acquisitions considered in eight broad themes. The major research work in each theme is discussed in detail with a view to identify the research construct – Human Resources responses.

Chapter Three discusses the determinants of HR responses as indicated by the existing literature. The identified set of dependent and
independent variables used in the study are brought together in a conceptual framework which forms the basis of empirical investigation of determinants of HR responses in the merger context.

Chapter Four outlines the main research objectives of this study, the hypotheses. The process for developing the measures for the variables under study and testing them for validity and reliability are explained. The chapter also describes how the field work was carried out & the methods used for collecting data for the purposes of the study.

Chapter Five presents the results derived from the analysis of data in two parts. Part One discusses the results from the Questionnaire Survey and Part Two discusses the results from the Case Study.

Chapter Six summarises the key results derived from the regression of survey and case data. An attempt is made to integrate the survey and case study data results to see if any discernible pattern can be deciphered from the emerging picture.

Chapter Seven highlights the relevance of this study to the scholastic world as well as the corporate world and spells out the road map for better management of HR interventions. This chapter also discusses the limitations of this study and suggests various areas for further research.

The next chapter, Chapter Two, deals with the review of literature.