Chapter Two

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The aim of this chapter is to explain the process of arriving at this particular research topic. In the quest for explaining the process, we try to understand various terms used frequently in merger and acquisition research, and study important works of authors associated with the field.

2.1 Conceptual Definitions

Merger and Acquisition literature is laden with usage of terms like merger, acquisition, takeover and amalgamation. Many authors use these terms/classify them differently. A few arduously distinguish between each, whereas others use them synonymously. For example, Weston, Chung and Hoag (1996) recognize two forms of combinations- mergers and acquisitions (tender offers). Machiraju (2003) on the other hand uses merger as a broader term and considers acquisitions and takeovers as two of its type. Other works in the area classify combinations as mergers, acquisitions (takeovers) and hostile takeovers (tender offers are considered as one of the modus operandi for hostile takeovers). In the following paragraphs, we try to study and understand these terms with help of definitions provided by various authors/ sources.

2.1.1 Mergers

Investopedia.com\(^4\) defines merger as, ‘a merger involves the mutual decision of two companies to combine and become one entity; it can be seen as a decision made by two “equals”. The combined business, through structural and operational advantages secured by the merger, can cut costs and increase profits, boosting shareholder values for both groups of shareholders. A typical merger, in other words, involves two relatively equal companies, which combine to become one legal entity with the goal of producing a company that is worth more than the sum of its parts. In a merger of two corporations, the shareholders usually have their shares in the old company exchanged for an equal number of shares in the merged entity.’ At answer.com\(^5\), merger is defined as, ‘the statutory combination of two or more corporations in which one of the corporations survives and the other corporations

\(^4\) http://www.investopedia.com/university/mergers/mergers1.asp.

\(^5\) http://www.answers.com/topic/merger.
cease to exist’. According to Machiraju (2003: 1), ‘merger is a broad term and it
denotes the combination of two or more companies in such a way that only one
survives while the other is dissolved. A merger is an investment in a future growth
opportunity. In merger proposals plant is ready and market acceptance, clear and well
established. When two companies differ significantly in size, they usually merge’. 
Weston, Chung and Hoag (1996:4) define merger as, ‘any transaction that forms one
economic unit from two or more previous ones’. Mc Carthy (1963: 16) defines merger
as, ‘the combination of two or more business entities into a single economic
enterprise. To be more exact, however, the only type of business combinations that
should be designated as mergers are statutory mergers or consolidations, i.e., when
one or more companies are merged into another or into a new corporation in
conformity with the statutes dealing with such transactions in the states of their
incorporation’. According to De Pamphilis (2001:5), ‘mergers can be described from
a structural or industrial-operational perspective.. From a structural standpoint a
merger is a combination of two firms in which only one firm’s identity survives. A
statutory merger is one in which the acquiring company assumes the assets and
liabilities of the target company in accordance with the statutes of the state in which it
is incorporated. A subsidiary merger of two companies occurs when the target
becomes a subsidiary of the parent’.

2.1.1 Acquisitions

Investopedia.com⁶ defines acquisition as, ‘a takeover, or acquisition, is characterized
by the purchase of a smaller company by a much larger one. This combination of
"unequals" can produce the same benefits as a merger, but it does not necessarily have
to be a mutual decision. A larger company can initiate a hostile takeover of a smallestr
firm, which essentially amounts to buying the company in the face of resistance from
the smaller company's management. Unlike in a merger, in an acquisition, the
acquiring firm usually offers a cash price per share to the target firm’s shareholders or
the acquiring firm's shares to the shareholders of the target firm according to a
specified conversion ratio. Either way, the purchasing company essentially finances
the purchase of the target company, buying it outright for its shareholders’. At

⁶ http://www.investopedia.com/terms/a/acquisition.asp.
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answer.com, acquisition\(^7\) is defined as, ‘the act of one corporation acquiring a controlling interest in another corporation’. According to Machiraju (2003:2), ‘the traditional acquisition is the negotiated acquisition in which a willing buyer and willing seller negotiate the terms under which an acquisition or merger occurs... Acquisition refers to a situation where one firm acquires another and the latter ceases to exist... A firm that attempts to acquire or merge with another company is called an acquiring company. A target company is a firm that is being solicited by the acquiring company. The assets of the dissolved firm would be owned by the acquiring company. The shareholders of the acquired company are paid either cash or given shares in acquiring company’. Mc Carthy (1963: 16) defines acquisition as, ‘a number of so-called mergers involving exchanges of capital stocks legally are acquisitions, particularly where there are large number of shareholders involved. In such non-merger cases, one company “acquires” the voting stock of another solely in exchange of its voting stock. Acquisitions, in a legal sense, may also be effected for cash or cash equivalent, such as debt securities’. According to De Pamphilis (2001:5), ‘an acquisition occurs when one company takes a controlling stake in another firm, a legal subsidiary of another firm, or selected assets of another firm such as a manufacturing facility’.

2.1.2 Takeover

Many authors do not distinguish between takeovers and acquisitions.

Machiraju (2003: 2); however, distinguishes between acquisitions and takeovers. He defines takeovers as, ‘a market route for the acquisition of a company. If management of a prospective selling company is unwilling to negotiate a transaction with a prospective buyer, the buyer attempts to accomplish the acquisition by a takeover bid, offering to buy shares of the seller directly from the shareholders of the seller’.

2.1.3 Tender Offer

Weston, Chung and Hoag (1996:4) say, ‘in a tender offer, one party- generally a corporation seeking a controlling stake in another corporation-ask the stockholders of the firm it is seeking to control to submit, or tender, their shares of stock in the firm’.

\(^7\) http://www.answers.com/topic/acquisition.
2.1.4 Amalgamation

Machiraju (2003: 2) defines amalgamation as, ‘the blending of two or more companies into one, the shareholders of each blending company becoming substantially the shareholders of other company which holds blended companies’. The Institute of Chartered Accountants of India (ICAI) uses amalgamations as a broad term to describe two types of combinations. According to accounting standard 14 of ICAI amalgamations fall into two broad categories. In the first category are those amalgamations where there is a genuine pooling not merely of the assets and liabilities of the amalgamating companies but also of the shareholders’ interests and of the businesses of these companies. Such amalgamations are amalgamations which are in the nature of ‘merger’ and the accounting treatment of such amalgamations should ensure that the resultant figures of assets, liabilities, capital and reserves more or less represent the sum of the relevant figures of the amalgamating companies. In the second category are those amalgamations which are in effect a mode by which one company acquires another company and, as a consequence, the shareholders of the company which is acquired normally do not continue to have a proportionate share in the equity of the combined company, or the business of the company which is acquired is not intended to be continued. Such amalgamations are amalgamations in the nature of ‘purchase’. Wikipedia\(^8\) provides an interesting distinction between mergers and acquisitions, ‘although they are often uttered in the same breath and used as though they were synonymous, the terms merger and acquisition mean slightly different things. When one company takes over another and clearly establishes itself as the new owner, the purchase is called an acquisition. From a legal point of view, the target company ceases to exist, the buyer ‘swallows’ the business and the buyer's stock continues to be traded. In the pure sense of the term, a merger happens when two firms, often of about the same size, agree to go forward as a single new company rather than remain separately owned and operated. This kind of action is more precisely referred to as a ‘merger of equals’. Both companies' stocks are surrendered and new company stock is issued in its place. For example, both Daimler-Benz and Chrysler ceased to exist when the two firms merged, and a new company, DaimlerChrysler, was created. In practice, however, actual mergers of equals don't

\(^8\) http://en.wikipedia.org/wiki/Mergers_and_acquisitions.
happen very often. Usually, one company will buy another and, as part of the deal's terms, simply allow the acquired firm to proclaim that the action is a merger of equals, even if it is technically an acquisition. Being bought out often carries negative connotations, therefore, by describing the deal euphemistically as a merger, deal makers and top managers try to make the takeover more palatable’.

In this study we use the term acquisition to describe a situation where one corporation acquires a controlling interest and management control in another corporation. The term merger is used broadly to signify combination of two entities. Thus, in this study an act of combining two organizations after an acquisition will also be referred to as merger. This is necessitated; as in many cases like this, acquiring organizations choose to refer to the combination process as merger. Usage of any other term by the researcher, may lead to conveyance of thoughts and actions that are diverse from those intended by the employees of the researched organizations.

2.2 Mergers-Types

Mergers and acquisitions are categorized into four major types on the basis of product and market in which the acquirer and acquired company operate before the merger.

2.2.1 Horizontal Merger

Involves two firms operating and competing in the same kind of business activity and geographical market. Example: Acquisition and merger of Times Bank by/with HDFC Bank.

2.2.2 Vertical Merger

Integrates the operations of a supplier and a customer. In a backward vertical merger, the customer acquires the supplier. Example: RPG Group’s acquisition of Harrisson Malayalam gave it control over rubber, a major input for another group company Ceat, whereas in a forward merger the supplier acquires the customer. Example: Arvind Mill’s (denim fabric manufacturer) acquisition of Quest Apparels (manufacturer’s of denim jeans).
2.2.3 Concentric Merger

A market/technology extension merger takes place between two companies in a similar field whose sales do not overlap but may expand the acquiring firm’s geographical or product market owing to related market/technology. Example: Acquisition of Kissan Foods by HLL.

2.2.4 Conglomerate Merger

Occurs between firms engaged in unrelated types of business activities. Basic purpose of amalgamation is utilization of financial resources, risk diversification and also a synergy of managerial functions. Example: Torrent group’s acquisition of Ahmedabad Electricity Company.

2.3 Motives of Mergers and Acquisitions

There are various motives for acquisitions and mergers. These extend from economies of scale to managerial motives. Here an attempt is made to evaluate some of these reasons.

*Differential Efficiency*: This theory stresses on differential efficiencies of different management of different companies. Manne (1965) highlights the existence of a positive correlation between corporate managerial efficiency and the market price of shares of that company. If a company is poorly managed the market price of the shares of that company falls as compared to the market price of the shares of other companies in the same industry. This difference in share price of companies, indicates the potential capital gain that can accrue if the management of the company passed into the hands of a more efficient management. The company in question becomes an attractive takeover target for those who believe that they can manage the company more efficiently. Firms operating in similar business are more likely to be acquirers since they would better possess the ability to detect under-performance and will have the know how to turnaround the company.

*Inefficient Management*: This theory is related to the differential efficiency theory. Takeover is seen as an effort by the shareholders of the acquired company to discipline the management of the company. Managers often have problem in
abandoning their old strategies, even when these strategies do not contribute to the growth of the company. When the need to restructure is overlooked by the management, the capital markets through the market for corporate control come to rescue. The shareholders of the target company through the takeover market pass on the control to the more efficient management. The price paid to the shareholders has to be at a premium over current market price (Jensen and Ruback, 1983) to solicit them to sell their shares.

Operating Synergy: can be achieved through horizontal, vertical and conglomerate mergers. This theory assumes that economies of scale exist in the industry and prior to a merger, the firms are operating at levels of activity that fall short of achieving the potentials for economies of scale. There are four kinds of synergies: cost, revenue and market power and intangibles. Cost synergies are again broken down into fixed cost and variable cost synergies. Fixed cost synergies like sharing central services such as accounting and finance, the office, executive and higher management, legal, sales promotion and advertisement etc can substantially reduce overhead costs. Variable cost reduction is associated with increased purchasing power and productivity. Revenues synergies are associated with cross-selling products or services through complementary sales organizations or distribution channels that sell different geographic regions, customer groups or technologies. Intangibles include brand name extensions and sharing of know how. This kind of synergy is realized by transferring of these intangible capabilities from one firm to another.

Pure Diversification: Unlike the stakeholders of a company who reduce their diversifiable risk by holding a portfolio of well-diversified scrips, managers income from employment constitutes a major portion of their total income. Hence risk attached with a manager’s income is to a large extent a function of firm’s performance. Managers invest heavily in organization capital during their tenure with the firm. A major part of this capital may be firm specific, increasing the employment risk of the managers. Managers can thus be expected to diversify their risk by engaging in conglomerate mergers (Amihud and Lev, 1981). Similarly a firm engaged in manufacturing/marketing of a single product, which is in the maturity or decline phase of its life cycle, might like to invest the cash flows into growing businesses. The learning by employees has been developed over time. This learning may also be
firm specific. It makes sense to employ this organization capital in growth businesses instead of letting them get destroyed with the withered business. Market synergies are discussed in the section on market power.

**Agency Problems:** On one hand literature on mergers and acquisitions points out that corporate takeovers are used as disciplining mechanism by the shareholders of the acquired firm, on the other hand authors also consider takeovers as manifestation of the agency problem. Ignoring the welfare of its shareholders, the management of acquiring company makes value-eroding acquisitions to increase the size of their company and thereby increasing their compensation. The relationship between size and compensation has been signaled by Murphy (1985). Roll (1986) points out that the payment of excess bid premia in a takeover by the management may be the result of hubris. Bids are made when valuation of the target firm by the acquiring firm exceeds the market price of the firm. The bids are abandoned when the valuation is lower than that of the market price of the firm. If however there are no gains in the acquisition, then the theory of hubris says that managers do not abandon these bids because of positive errors in valuation i.e. the overbearing presumption of the acquiring managers is that their valuation is right. Jensen (1986) uses the free cash flow hypothesis to explain takeover activity in certain cases. When a firm generates cash flows and does not have enough projects with a positive net present value, it is prudent to pay the additional cash to the shareholders. This payout of cash is detrimental to the interests of managers, because it reduces the resources under the manager’s control and thereby diminishes their power. The management will also have to go through monitoring of the capital requirements when for future need of funds they have to go back to capital markets to raise new resources. Managers have incentives to grow their firm beyond an optimal size (as pointed above). The reward to middle managers through promotions also generates a bias towards growth to supply the new positions that such promotion based rewards system may require. Acquisitions are one way for the manager to spend excess cash instead of paying it to the shareholders. Therefore managers of firms with free cash are more likely to undertake low benefit or value destroying acquisitions.

**Market Power:** Acquisitions, especially horizontal mergers may also be undertaken to destroy competition and establish a critical mass. This might increase the bargaining
power of the company with its suppliers and customers. Economies of scale may also be generated in the process. Example of this could be VIP’s takeover of Universal Luggage and its thereafter putting an end to Universal’s massive price discounting, which was eating their profits. The HP and Compaq merger also created the largest personal computers company in India. Internationally, as well this move was supposed to put IBM under immense pressure.

**Market Expansion**: Organic route of growth takes time. Organizations need place, people, regulatory approval and other resources to expand into newer product categories or geographical territories. Acquisition of another organization with complementary products or geographic spread provides all these resources in a much shorter time, enabling faster growth.

**Tax Benefits**: If a healthy company acquires a sick one, it can avail of income tax benefits under section 72-A of Income Tax Act. This stipulates that subject to the merger fulfilling certain conditions, the healthy company’s profit can be set off against the accumulated losses of the sick unit. The money saved must be used for the revival of the sick unit. The healthy company, besides saving on tax, acquires additional manufacturing capacities and strength. Tax advantage was one of the reasons that prompted the takeover of Allwyn by Voltas.

Reasons for mergers as enumerated above are all economic in nature and the most commonly quoted ones across various industries. Mergers and acquisitions are a very old phenomenon and have occurred due to these different reasons for over a century now. Renewed interest in mergers and acquisitions in the present context is due to two reasons: first because of increase in number of cross-national mergers and second due to increase in financial stakes involved and the corresponding realization that majority of mergers and acquisitions fail to create value or meet their objectives.

### 2.4 Non-Realization of Gains in Mergers and Acquisitions

Many researchers have tried to explore reasons for failure of mergers/acquisitions. According to Allred, Boal, and Holstein (2005) roughly half of all mergers and acquisitions fail. Homburg and Bucerius (2006) citing work by other authors claim that between sixty to eighty percent mergers fail. The reasons for failure are many.
Earlier researchers, for a considerable period of time blamed, mainly economic rationale or reasons like non realization of anticipated synergies and cost savings, incompatible facilities and technologies for dismal success rate of mergers and acquisitions. Of late, however researchers identified integration related issues as major value destroyers. Elucidating reasons for merger failures, Allred, Boal, and Holstein (2005:24) say, ‘but a simpler explanation is perhaps closer to the real issue — the merged entities did not fit together or the integration could not be made to work effectively’. Jemison and Sitkin (1986) in their seminal work have tried to answer this question. According to them, success of integration is determined by the importance paid to both organization fit and strategic fit in the pre-acquisition phase. However, it is observed that strategic fit is given more importance at the expense of organizational fit in the pre combination phase of merger, thus resulting in unsatisfactory integration and merger performance. Strategic fit is defined as the degree to which the target firm augments or complements the acquirer’s strategy and thus makes identifiable contributions to the financial and non-financial goals of the acquirer. Organizational fit is defined as the match between administrative practices, cultural practices and personnel practices of the acquiring and target firm. Since acquisitions, especially related, require the integration of a variety of organizational activities, issues of organizational fit must also be considered. If during the process of acquisition, organizational fit factors are ignored, the acquisition outcomes are less likely to be desirable.

Integration has been highlighted as a crucial factor in ensuring success of merger. In the following paragraphs an effort is made to understand its meaning and what is it that makes integration (and HR integration) so important.

2.5 Integration

Integration of two organizations can range from complete absorption to partial assimilation or complete autonomy of the target organization. Thus, the definition is determined by the level of integration and directly relates to the acquiring organization’s objectives. In the most general terms, integration occurs when two distinct organizations become a single new entity on every level. In addition, integration can be divided into subcategories and defined on specific levels (www.corporateleadershipcouncil.com).
**People Integration** — Occurs when acquired employees and existing employees have the same corporate culture, and all employees feel part of a single organization.

**Systems Integration** — Occurs when all employees are connected to a single corporate system, and the system operates smoothly without disruption.

**Production Integration** — Occurs when production processes are assimilated to create a single production method.

**Various other definitions found for integration**

1. *Definitions profiled from various clients by Corporate Leadership Council (CLC), (2003:3).*

Integration is when everyone is connected to the organization, and the organization is achieving maximum productivity without disruptions.

Integration is defined according to the integration production plan and depends on the organization’s objectives for the acquisition. Depending on the acquisition, objectives can include product creation or process improvement.

Integration is when the acquired organization is incorporated into all aspects of the business. It includes the integration of systems, people, and structure.

Integration is when the acquired employees can walk, talk, and use the tools and processes of the acquiring organization without conflict or disruption.

Integration of cultures is when acquired employees feel part of the new organization. From a systems stand point, it is when acquired employees are connected and involved in processes.

Integration is when resistance fades away, processes and systems are smooth, two different cultures become one, and objectives have been met.

2. *Definitions from other sources*

The bringing of people of different racial or ethnic groups into unrestricted and equal association, as in society or an organization; desegregation (http://www.thefreedictionary.com/integration)
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The bringing together of separate elements to create a whole unit. (http://www.answers.com/integration)

Integration is a process of combining or accumulating (http://www.wikipedia.com/integration).

In this study we use the term integration to refer to overall combination of two companies. It includes combination of various facets of merging organizations like strategy, information technology, sales and marketing, production, finance and HR.

Having clarified the meaning of integration, we need to address the question: ‘when does the process of integration actually begin?’ According to Schweiger (2001) preparations for integration process should begin at the time a target is being considered. According to him there are five key elements of the integration process: strategic and financial objectives, transactions stage, transition stage, integration stage and evaluation.

![Figure 2.1](image)

**Key Elements of the Integration Process**

Source: Schweiger (2001)

As, was seen in the section on motives for mergers and acquisitions, any decision to merge or acquire is driven by strategic decisions of growth, expansion and cost saving. Once an organization decides to acquire or merge, search for an ideal target or partner begins. Potential targets are assessed on the basis of publicly available information on various parameters like product lines, markets it serves, financial and legal situation, manufacturing facilities and capabilities, organization culture and structure, key management and employees, and future potential. A positive assessment may lead to establishment of a formal contact with the potential target and
start off the transaction stage. The transaction stage is the period that starts with identification of the target and culminates when there is a commitment to do a deal. This stage is used to conduct due diligence: gather key information that may not be publicly accessible, assessing the culture and key people of the target, and negotiating the price for the deal. Next is the transition stage that begins when the merging partners sign the merger or acquisition agreement and announce the deal. The announcement generates speculation amongst employees and customers regarding the impact of the deal on them. Thus, there is a need to start communicating with various stakeholders. This stage also marks events like creation of an integration transition structure, articulation of integration guiding principles and deciding what to integrate and how. Integration stage begins after the merger is effected and regulatory approvals received. During this stage, organizations are physically integrated depending upon the level and degree of integration desired. It is important to build teams and work units, motivate key and capable people, assimilate acquired employees, and achieve cultural integration during this phase. Finally, it is highly probable for critical decisions to be reviewed during the integration process, making it imperative for the process to be evaluated continuously. Any significant discrepancies found between what was planned / intended and that what was actually implemented can also be corrected with the help of ongoing evaluation.

A firm’s approach to integration will vary based upon two critical dimensions of acquisition (Haspeslagh and Jemison, 1991): acquired’s relationship with the acquiring firm and the way in which value is expected to be created. The first dimension refers to the nature of the interdependence that needs to be established between the firms to make possible the type of strategic capability transfer that is expected. It is called the strategic interdependence need. The other dimension called the organizational autonomy need is associated with the need to preserve the strategic capabilities of the acquired after the acquisition. A combination of both these dimensions helps in understanding specific approaches to integration. Some acquisitions have high need for strategic interdependence and a low need for organizational autonomy. These acquisitions call for absorption approach to integration. In absorption a full consolidation of operations, organization and cultures of both the organizations is required. Other acquisitions have a low need for strategic interdependence but a high need for organizational autonomy. The integration
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approach associated with it is called preservation. In preservation acquisitions the main task of the management is to keep the source of the acquired benefits intact, because deterioration in the acquired company’s way of managing, practices or motivation may endanger success. Other acquisitions have a high need for strategic interdependence and a high need for organizational autonomy. Their integration approach is referred to as symbiosis. In symbiosis, the two organizations first co-exist and then become increasingly independent. Over a period of time, for symbiotic mergers to survive, each firm must take on the original qualities of the other. In holding there is low need for autonomy, but also a low need for interdependence. This approach is applicable when value creation will not occur by removing of boundaries or introduction of a new organizational structure. The reason for M&A in these instances would be to share risk or create value through financial transfer.

Figure 2.2
Types of Acquisition Integration Approaches

<table>
<thead>
<tr>
<th>Need for Strategic interdependence</th>
<th>Weak</th>
<th>Strong</th>
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<tbody>
<tr>
<td>Preservation</td>
<td></td>
<td>Symbiosis</td>
</tr>
<tr>
<td>Holding</td>
<td></td>
<td>Absorption</td>
</tr>
</tbody>
</table>

Source: Haspeslagh and Jemison (1991)

According to Galpin and Herndon (2000), in case of overall integration as happens in case of absorption, all areas and processes are merged and consolidated. All management decisions for the acquired business (or function) are integrated into the parent company’s processes, with appropriate ‘best practice’ knowledge transfer and revisions. Moderate integration, on the other hand, leads to merger of certain key functions and processes like marketing and sales. Strategic planning and monitoring is centralized as an element of parent company’s processes, but day to day operations remain autonomous. In minimal integration selected corporate and staff functions are merged and consolidated, primarily to achieve staffing synergies and cost-efficiencies; whereas, all strategic and day-to-day operating decisions remain
autonomous and decentralized, with agreed upon requirements for reporting to the parent (acquiring) organization.

In general, there are a few areas that need to be concentrated upon to achieve successful integration. Spelling seven rules for successful post-merger integration, Habeck, Kroger and Tram (2000) say that problems occur in seven areas: 1. Vision: Merger partners lack a clear idea of what the merger or acquisition has taken place for. Stated rationales may many a times be different from real reasons and key is to remain focused on the latter. 2. Leadership: Companies reluctance to assign leadership tasks, leads to chaos and eventually generates into survival of the fittest battle. This results in wastage of time and resources and causes de-motivation amongst the workforce. 3. Growth: Though growth is initially identified as motive for many mergers and acquisitions, organizations focus too much on cost synergies, loosing long term focus on sustainable growth. 4. Early wins: Companies believe that employees will naturally see into the benefits of merger. This is often not true; employees from both sides are initially suspicious of the merits of the merger. If early wins like quick tangible results can be shown and communicated to the employees, they might acknowledge a brighter future for themselves and their organization. 5. Culture: The propensity to ignore cultural differences and refusal to believe that change is inevitable also leads to dereliction of important integration related issues. 6. Communication: A communication strategy using different media and close involvement of leaders and staff may help in diminishing uncertainties faced by latter. 7. Risk management: Various risks like stakeholders risks (like erosion of investor confidence, loss of key employees and customers), execution risks (addressing areas like IT, ability to meet milestones) and the risk to very benefits of merger should be recognized and resolved.

DePamphilis (2001) says that integration should be viewed as a process that consists of activities that are either sequential or continuous and non ending. Main activities are: pre merger planning, addressing communication issues, defining the new organization, developing staffing plans, functional and departmental integration, and building a new corporate culture.

In this section attempt was made to understood the meaning and importance of integration, and study its various elements and types. Looking at the gamut of
activities that need to be carried out, one can assume that any merger or acquisition decision will be followed / accompanied by development of an integration strategy that would encompass integration of all functional areas with the aim of maximizing merger benefits. Further, it was also noticed that authors mentioned above have cited the importance of employee related facets of integration as integral part of overall integration process. Hence any integration strategy is bound to set the direction for HR integration and have a strong bearing on it. The components of HR integration process like communication, culture building and leadership introduced as part of holistic integration, though critical, are not exhaustive. To make good this little gap, in the following paragraphs we will look at the meaning of HR integration, its various components and the important role it plays in ensuring merger success.

2.6 HR Integration

HR integration is the process of assimilating employees of acquired / merging organization/s into acquiring / merged entity. According to Bajaj (2007) HR integration process includes two sub-processes. First sub process enables integration of people through culture building exercise, communication, and facilitation of learning or training on new products, policies, and processes. The second sub process enables integration of HR practices and processes through combination of organization structures, reward systems, service conditions and policies of employee relations. HR integration assumes importance in the light of the fact that many a mergers fail because of inadequate attention paid to HR related factors. Bertoncelj, Andrej and Darko Kovaè (2007) identified ten critical key success factors for mergers and acquisitions. They listed five soft or HR related success factors along with hard or economic factors. Hard factors were acquisition search, due diligence, financial resources, synergies and integration plan. Enumerated soft success factors were: learning environment, management team, intellectual capital, organization culture and communication. Larsson and Finkelstein (1999) also found that employee resistance after an acquisition was negatively related with synergy realization. Birkinshaw and Bresman (2000) distinguish between task and HR integration. Task
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integration refers to value creation through transfer of capabilities and resource sharing. HR integration, on the other hand, refers to generating satisfaction and ultimately, shared identity amongst employees of both companies. Task integration was facilitated by human integration and low level of latter limited the effectiveness of former as a driver of acquisition success.

Considering the important of soft factors that are invariably related to HR, it becomes imperative to address HR related challenges in mergers and acquisitions. In a survey conducted in 1991 amongst senior executives in one thousand largest companies in the US, the following reasons emerged as the biggest cause of their anxieties (Marks, 1994:6):

1. Loss of job due to merger or acquisition (54%)
2. Burnout (26%)
3. Failure to get promoted (8%)
4. Being fired (6%)
5. Failure to get a raise (5%)
6. Insufficient income to meet living standards and financial obligations (3%)
7. Illness (2%)

First question that needs to be addressed at this juncture is: why do acquisitions and mergers cause apprehensions amongst employees? The reason lays in the fact that worldwide acquisition and mergers are associated with changes in culture, policies and practices, structure, power position, compensation and job loss. For example, Conyon et al.(2002), in a study of impact of mergers and acquisitions on employment in UK, found that merger activity is followed by ‘substantial and significant employment and output falls’. Thus, any rumour of impending merger or announcement triggers extreme reactions amongst the employees of the target giving rise to what is known as the ‘merger syndrome’.

‘Merger syndrome’ has been described as a primary cause of the disappointing outcomes of a well-planned merger, (Marks and Mirvis, 1998). This is triggered by unsettled conditions in the earliest days and months following the announcement of a deal; it includes stress reactions and development of crisis management in the merging companies. The syndrome is known to arise even when integration has been
devised taking into consideration all the human aspects of the merger. Personal reactions to merger syndrome are:

1. Personal preoccupation: People worry about what merger means for them, their compensation and careers
2. Worst-case scenarios: People imagine worst implications for themselves. This is based upon a mix of fact and fantasy.
3. Rumor mongering: All the people have a view about the future of the organization and discussions in the organization center around the merger. This gives rise to a strong rumour mill.
4. Distractions from job performance: With strong rumour mills, the focus on job and performance is lost.
5. Psychosomatic reactions: Merger is known to affect physiological and psychological well-being of people. Reports of headaches, high blood pressure, sleeplessness and increased alcohol and drug usage are common.

As the combination progresses, the following matters need to be addressed (Marks and Mirvis, 1992:76) in order to give due importance to people related factors.

1. Are new job assignments and reporting relationships clear?
2. Do people understand new procedures and policies?
3. Do they have the equipment and resources they need?
4. Do they know how to get the information they need?
5. Do the employees believe that they will benefit from success?
6. Do they believe in the goal of their work groups, functional area and the combined company?

The trauma faced by people gets accentuated if the merger or acquisition is not a voluntary one. In a study of senior and middle management’s employees’ perspectives on mergers and acquisitions, Tynes (1997) reported the following statement made by an executive whose bank had been declared insolvent by federal reserve:

*When you go under and you are assisted by the FDIC in an acquisition it’s not good. It is pretty intense when they close a bank. On Thursdays, they call them “Black Thursdays,” at 3 o’clock the FDIC shows up along with the State Banking Department, and converges on the bank in about twenty vehicles, with about fifty people. And they come in and they lock the doors, and announce to the president that they have been closed and sold to . . . Then the president of the bank and [the Office of the Controller of Currency-a federal*
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office) announce that ‘You are now officially declared insolvent.’ The federal people are all standing around watching, and they transfer, they usually close it in an evening and open it up the next morning. There were people that were working who couldn’t even go home, couldn’t sleep. They were bringing in food. So the FDIC fishes around for a deal and then they do it. They are very quick about it because they don’t want word to get out, because that will cost them more money.

All these people-related issues need to be addressed early in the process of integration and HR department needs to take a proactive stand in recognizing them. This warrants early involvement of the HR department in the merger process. Many organizations, though now more concerned about ‘softer’ issues, still overlook HR side of integration, at least in the initial stage of the merger process. According to a survey conducted by Watson Wyatt Worldwide (as cited in Greengard, 1999) in 1999 in US, Asia Pacific and Brazil, only 16% organizations in US, 19% in Asia Pacific and 12% in Brazil involved HR in the initial planning process. Only 41% organizations in US, 21% in Asia Pacific and 13% in Brazil involved HR in the investigative stage. 16% organizations in US, 17% in Asia Pacific and 25% in Brazil involved HR in the negotiation stage, whereas, 27% organizations in US, 43% in Asia Pacific and 50% in Brazil involved HR in the integration stage (Figure 2.3). In their study Jeris, Johnson and Anthony (2002) also found that HR department was not involved in the strategic decision to merge but HRD expertise was counted on for implementation at a ‘more tactical level’.

Figure 2.3

How and When is HR Involved

![Bar chart showing percentage of HR involvement in different stages of merger process across regions.]

Source: Greengard, Samuel, 1999
Despite late involvement of HR function in the merger process, researchers have recognized the important role it plays / can play in integrating people. Various interventions have been suggested to facilitate the process of HR integration.

### 2.7 HR Interventions in Mergers and Acquisitions

Hanson (2001: 5) asserts that human resource transition is a process, not an event- ‘it is a series of steps that must take place from initial planning through final implementation’. He suggests the following ten-step roadmap that form a part of the transition process.

1. Develop workforce integration project plan.
2. Conduct HR due diligence review.
3. Compare compensation and analyze difference in value.
4. Compare benefits strategy and analyze difference in value.
5. Develop compensation and benefits strategy for workforce integration
6. Determine leadership assignments.
7. Address duplicate functions
8. Prepare employee communication strategy
9. Define transition data requirements
10. Develop employee retention strategy.

Appelbaum (2000) emphasizes the importance of taking quick organization structure decisions. It is imperative for merging firms' employees to openly discuss, as a group, and formulate the best organizational structure. It is also important to establish clear reporting relationships, which need to remain unchanged, in the transition period.

Discussing the HP- Compaq merger, Craven (2004) says that HR integration was carried in three phases. In the first phase, stress was on the communication of business objectives and cultural aspects of the new organization, winning over Compaq employees who appeared disillusioned with the merger, and designing the new organization structure. In the second phase, HR partnered with business to create a high performance workplace. Two different cultures and reward systems were combined and employee performance and personal objectives were tied to business strategy. Employee development and swift behavioural change were encouraged by
using reward as a motivator and providing employees training. Employee feedback and developmental training was also initiated. Third phase focused on making the organization the best place to work in the world by providing a satisfying and rewarding environment.

Schweiger and DeNisi (1991), in a study conducted at two plants of one of the two Fortune 500 merging companies, found that the merger led to increase in perceived uncertainty and absenteeism amongst employees. Simultaneous decrease was found in job satisfaction, perceptions of the company’s trustworthiness, honesty, and caring, intentions to remain, and self-reported performance. Realistic communication was found to help employees cope with the uncertainty of the situation and insulate themselves from some of the allied negative outcomes.

Galpin and Herndon (2000) emphasize that effective communication during a merger should be linked to the strategic objectives of the integration effort. Immediately after announcement the leadership should be able to convey its commitment to the deal, reaffirm the organization’s values and give specific information about the state and objective of merger process. In the following period, communication should be used both, to provide organization specific information and identify managers’ and employees’ issues. Information on changes introduced in the organization and their impact on employees should be shared. All along, communication should be honest, proactive and should be planned with ample lead-time and disseminated early. Papadakis (2005) found that increased communication frequency to employees after a merger or acquisition leads to increased success in the implementation process. The existence of an integrated communication program was also recognized as one of the most significant factors contributing to the successful implementation of merger related changes. He also found a positive relationship between communication frequency and successful implementation of the mergers as high level of communication helps in creation of a smooth working climate and in understanding cultural differences. Zhu et al (2004) further add that communication during a merger needs to vary in its openness, depending on the nature of information to be communicated, goals of the organization, specific needs and concerns of the employees, and different needs and expectations of acquiring and acquired company employees.
Once the deal is closed, the organization needs to decide on their reward strategy. Zingheim and Schuster (2001) suggest that a wide range of alternatives exist for making rewards work in favor of both the companies’ and their workforce: 1) Continue talent-securing tactics—this involves paying stay bonuses and doing whatever it takes to keep people with core competencies essential to making the merger or acquisition successful. 2) Implement total reward solution of dominant- or realignment of the reward practice of the acquired company with that of acquiring company. 3) Retain acquired company’s pre-acquisition reward practice—Here the acquirer allows the acquired company to maintain its pay and reward practices as they existed prior to the merger, particularly if the organizations are in different industries and different stages of maturity. 4) Blend practice under a minimal innovation scenario: This entails choosing either the most expensive or least expensive of alternatives or averaging different elements. The patchwork may or may not work—in large part it is based on the compatibility of combined alternatives. 5) Design a totally new reward solution—This requires designing a new reward solution that integrates total rewards for the new organization. A total reward approach encompasses total pay and also a positive workplace, individual growth and a compelling future.

Role of leadership in a merger or acquisition encompasses six dimensions\(^\text{10}\) (Sitkin and Pablo, 2005). A leader in a personal leadership role personifies the new merged entity and conveys vision and values fosters loyalty. A leader exhibiting relational leadership engenders a sense of trust and justice by creating an organizational

\(^{10}\) Personal leadership refers to the idea that it matters that a leader conveys to other organizational members who s/he is, including a sense of personal vision, values, emotions, and beliefs. Relational leadership emphasizes the important role of the leader in forging strong ties with individuals in the organization. Contextual leadership involves creating the situational conditions that enable organizational members to focus and be effective. Inspirational leadership involves building the desire for greatness or excellence by raising expectations and the acceptance of challenges, with enthusiasm and confidence. Supportive leadership involves making others aware of pressing organizational problems and making them secure enough in their own capacity to take appropriate corrective action. Finally, firms are institutional ships and require symbolic leadership at the helm, with the leader acting as steward of the institution, honoring and protecting deeply held community values. In this stewardship role, it is important for leaders to be the chief integrator and balancer, insuring that the multiple elements of leadership are drawn together and effectively balanced for a particular situation.
atmosphere that is respectful of inter-firm differences. He shows a drive to join forces and is committed to the new entity. Contextual leadership helps to build community and endeavors to create processes that facilitate cooperation and coordination. The leader creates shared identity through new processes and procedures. A leader with inspirational leadership qualities encourages higher aspirations, accepts (even relishes) challenges of M&A, focuses on opportunities as well as threats to success, drives stretch targets and high expectations. He builds momentum for high strategic and operational goals. A supportive leader forges a sense of collective capability. He does not whitewash tough news or decisions, but is honest while being appreciative and supportive. A leader exhibiting characteristics of stewardship raises an internalized sense of responsibility in the post-acquisition organization. He/she accepts responsibility for the whole; not just favourite parts and expects and moves others to see themselves as responsible for making the new organization work. Covin et al (1997), on the other hand, found that referent and expert power was positively associated, whereas coercive power was negatively associated with employee post-merger satisfaction.

Thach and Nyman (2001) speak about different roles played by leaders in different phases of the merger process. In the pre-combination phase as employees experience a gamut of emotions ranging from anger to grief, before the leaders move forward and encourage employees to continue to focus on work, they must handle the emotional fallout. It is also important to keep the focus intact on business and customer needs. In order to keep employees focused on work, leaders need to ‘renegotiate performance objectives’. It is expected that employees, immediately after the announcement, will begin questioning which projects should proceed, therefore leaders need to hold meetings to decide what work will stop, start, and continue. Communicating with employees at this stage is also important. Important questions that need to be answered are: what will happen to employees; what is the background of the acquiring organization; what is the long-term strategy for this merger and what is the positive impact of the merger. This might mean increasing the frequency of one-on-one discussions with employees. In the combination phase leaders and employees know the roadmap, know the philosophy of the organization, know they have a job, and are putting the new organization together. Main role of the leader is to supervise
implementation and working through cultural and system differences between the integrating companies.

Cultural integration also contributes to the manner in which people are assimilated in the new organization. Buono and Bowditch (1989) suggest that there are two fundamental ways of introducing cultural changes in an organization after a merger. First is getting employees to accept a new set of beliefs and values by studying their attitudes and then trying to change the associated behaviour. Once the behavioural changes are effected, effort should be made to modify the underlying beliefs and values by communicating explicit cultural messages like announcement, memos, and speeches and implicit cultural messages like rituals, ceremonies, stories, metaphors, heroes, logos and décor. Second way to induce cultural change is to recruit and socialize new members who fit into the culture while removing those who do not fit. It is possible that many of the deviants may voluntarily leave the organization.

According to Schweiger and Goulet (2005) in a merger or acquisition, cultural differences are likely to give rise to ego defenses that encourage maintaining individual identities of the acquirer and target. The elimination of cultural differences is therefore an important step towards successful integration. Thus, both the acquirer and acquired must rise above their ego defenses so that they can develop empathy for one another. This process of learning and developing empathy can be accomplished if one discovers the limitations of one’s own culture and the positives in other cultures. This can happen through intermingling of culture which is facilitated through the process of social control, which includes activities like introduction programs, training, cross-visits, retreats, celebrations and similar socialization rituals. The process of social control enables employees to create, of their own volition, a joint organizational culture regardless of expectations of synergies, the relative organization size and differences in nationalities and cultures (Larsson and Lubatkin, 2001).

Having deliberated on important and critical work in the field of mergers and acquisition, both general and HR related, and understanding different terms and various perspectives, in the next chapter, we try to draw linkages between diverse aspects of HR integration that are of interest to the researcher and narrow down the scope of our study.