Corporate Mergers and Human Resource vis-à-vis Finance

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Key Words:
1. Merger
2. Acquisition
3. Human Resource
4. Strategy
5. Issues

Abstract : Today the industry calls for Corporate Mergers as a means to solve the barriers of expansion. Organisations need people who can adapt, respond, anticipate and deliver, to meet the client's expectations and seek to maximize the efficiency of their own. This calls for immediate solutions in the form of Merger and / or Acquisition. Besides assessing the risk and potential of the merged entity, it is just as important to derive synergy to operate at its maximum efficiency without any financial burdon.

In this paper, the Researcher handles certain problems pertaining to Human Resources and their Financial implications and further develops the 'Soccer-Cup' model from the previous study made by McCann and Gilky.

Introduction:

Performance has become the mantra of life. And to perform, in any environment; takeovers, mergers and strategic alliances have become imminent at the gaining pace of the liberalisation and globalisation. Mergers and Acquisitions of companies are implicit in free enterprise system because of their obvious advantage such as infusion of better management by the inclusion of intellectual human capital through knowledge workers and consolidating capacities to economic level by forward and backward linkages and healthy growth of capital market. Companies today need to be fast growing, efficient, profitable, flexible, adaptable, future ready and have a dominant market position; without these qualities, firms believe that it is virtually impossible to be competitive in today's global economy. In some industries such as insurance or banking, firms may move into new markets; in others such as pharmaceuticals or software technology, firms may work with smaller firms that have developed or developing new products and/or distribute them more efficiently, have problems without having a log of market condition and market knowledge; whereas other firms focus on their own internal growth, leadership and development. Regardless of industry, however, it appears that it has become all but impossible in global environment for firms to compete with others without growing and expanding through 'deals' that result in mergers or acquisitions (Schular, 2001). Mergers, acquisitions and takeovers have been a part of the business world for centuries. Today companies are often faced with decisions concerning these actions - after all, the job of management is to maximise shareholder value. Through such activities, a company can (at least in theory) develop a competitive advantage which ultimately increase stakeholder's value. Mergers and acquisitions have become common in India today. Exhibit 1 shows Top 10 Corporate Combinations in India till date.

In a broad sense, Merger means 'joining together of two previously separate corporations.' A true merger, in the legal sense, occurs when both businesses dissolve and fold their assets and liabilities into a newly created third entity. This entails the creation of a new corporation with either the same horizon jointly held earlier or with the changed synergetic perspective to broaden the horizon. On the other hand, by literal sense, Acquisition means Taking possession of another business, also called a takeover or buyout.

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Exhibit 1:Top 10 corporate Combinations in India

Table : Top 10 Corporate Combinations In India	
1.	Tata Steel's mega takeover of European steel major Corus for $12.2 billion. The biggest ever for an Indian company. This is the first big thing which marked the arrival of India Inc on the global stage.
2.	Vodafone's purchase of 52% stake in Hutch Essar for about $10 billion. Essar group still holds 32% in the Joint venture.
3.	Hindalco of Aditya Birla group's acquisition of Novellis for $6 billion.
4.	Ranbaxy's sale to Japan's Daiichi for $ 4.5 billion.

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ISSN : 2229-6514 (Print),2230-8237(Online)

Exhibit 1:

5.	ONGC acquisition of Russia based Imperial Energy for $2.8 billion. This marked the turnaround of India's hunt for natural reserves to compete with China.
6.	NTT DoCoMo-Tata Tele services deal for $2.7 billion. The second biggest telecom deal after the Vodafone.
7.	HDFC Bank acquisition of Centurion Bank of Punjab for $2.4 billion.
8.	Tata Motors acquisition of luxury car maker Jaguar Land Rover for $2.3 billion. This could probably the most ambitious deal after the Ranbaxy one.
9.	Wind Energy premier Suzlon Energy's acquisition of RePower for $1.7 billion.
10.	Reliance Industries taking over Reliance Petroleum Limited (RPL) $1.6 billion.

It may be share purchase or asset purchase. In simple terms, a merger involves the mutual decision of two companies to combine; it can be seen as a decision made by two "equals", which combine to become one legal entity with the goal of producing a company that is worth more than the sum of its parts.

On the other hand an acquisition or takeover is characterised by the purchase of a smaller company by a much larger onse. This combination of "unequals" may produce the same benefits as a merger, but it does not necessarily have to be a mutual decision. Here, the shareholders usually have their shares in the old company exchanged for an equal number of equivalent shares in the merged entity. In an acquisition, the acquiring firm usually offers a cash price per share to the target firm's shareholders or the acquiring firm's share's 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. Many times theses terms are synonym as corporate combinations. Many mergers are in truth acquisitions. One business actually buys another and incorporates it into its own business model. Because of this misuse of the term merger, many statistics on mergers are presented for the combined mergers and acquisitions (M and A) that are occurring. This gives a broader and more accurate view of the merger market (Panjrath and Panjrath 2008).

Why Mergers and Acquisitions?

Corporate Mergers and acquisitions (M and A) are a predominant feature of the international business system as companies attempt to strengthen their market positions w.r.t. the global societies to exploit new market opportunities and cashing on changing 'standard of living'. New announcements are made every day in the business press, each year sets a new record for the total value (Human Capital) of M and A s; especially those across national borders. Technology, globalisation, new world trade regimes and their rules, competitiveness are mainly driving the developments in knowledge-based economies today.

In India, policies are being continuously liberalised towards a market based economy especially since 1991 and in line with WTO, since its birth in 1995. Liberalised foreign direct investment (FDI) policies are essentially aimed at enhancing international competitiveness and exports, besides as an additional source of investment. Most of the sectors including drugs and pharmaceuticals and biotechnology have been opened up through automatic route for FDI up to 100%, this is an opportunity for Indian labour, technocrats etc. for further encashment of the creation of their value.

There are several possible motives or reasons that firms might engage in Corporate M and A. One of the common motives is expansion. Acquiring a company in a line of business /geographic area into which the company may want to expand can be a quicker way to expand than internal expansion. An acquisition of a particular company may provide certain synergistic benefits for the acquirer, such as when two lines of business complement one another. At the same time human capital can be shared w.r.t. their complimentary requirements and social issues too.

According to Schular, Jackson (2001), there are numerous reasons for companies to merge or acquire. Some of the most frequent include:

1. Horizontal mergers for market dominance; economies of scale
2. Vertical mergers for channel control
3. Hybrid mergers for risk spreading, cost cutting, synergies, defensive drivers
4. Growth for world-class leadership and global reach
5. Survival; critical mass
6. Acquisition of cash, deferred taxes, and excess debt capacity
7. Move quickly and inexpensively
8. Flexibility; leverage
9. Bigger asset base to leverage borrowing
10. Adopt potentially disruptive technologies
11. Financial gain and personal power
12. Gaining a core competence to do more combinations
13. Talent, knowledge, and technology today

Kishore (2007) have classified motives of M and A into three Broad categories as given in Exhibit 2 .

Exhibit 2 : motives of M and A (Kishore, 2007)

Strategic Motives	Financial Motives	Organisational Motives
1. Expansion and Growth	1. Deployment of surplus funds	1. Superior Management
2. Dealing with the entry of MNCs	2. Fund raising capacity	2. Ego Satisfaction
3. Economics of Scale	3. Market capitalisation	3. Retention of managerial talent
4. Synergy	4. Tax planning	4. Removal of insufficient management
5. Market Penetration	5. Creation of shareholder value	
6. Market leadership	6. Operating economics	
7. Backword/Forward Integration	7. Tax benefits	
8. New product entry	8. Revival of sick unit	
9. New Market entry	9. Asset stripping	
10. Surplus resources	10. Under valuation of target company	
11. Minimum size	11. Increasing Earning per share	
12. Risk Reduction		
13. Balancing product cycle		
14. Arresting Downword trend		
15. Growth and diversification strategy		
16. Re-fashioning.		

Exhibit 3 : Top 12 motives for promotion of manda activity of US firms (KISHORE. 2007)

MOTIVES	RankTake
advantage of awareness that a company is undervalued	1
Achieve growth more rapidly by the internal effort	2
Satisfy market demand for additional products/ Services	3
Avoid risks of internal start-ups of Expansion	4
Increase earning per share (EPS)	5
Reduce dependence on a single product/ services	6
Acquire market share or position	7
Offset seasonal or cyclical fluctuations in the present business	8
Enhance the power and prestige of the Owners, CEO or Management	9
Increase utilization of present resources- e.g. physical plant and Individual skills	10
Acquire outstanding management or technical personnel	11
Open new markets for present products/ services	12

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ISSN : 2229-6514 (Print),2230-8237(Online)

Financial factors motivate some mergers and acquisitions. For example, an acquirer's financial analysis may reveal that the target is undervalued. That is, the value of the buyer may be significantly in excess of the market value of the target, even when a premium that is normally associated with changes in control is added to the acquisition price. Other motives, such as tax motives, also may play a role in an acquisition decision. Of course, the financial motive has human as another very important dimension, since it has both political as well as social side. Without considering duly one cannot take any decisions regarding M and A on financial motive per say.

Reasons for Failure:

Mergers and acquisitions fail for a variety of reasons, often several simultaneously. Typical reasons for failure include:

1. Expectations are unrealistic e.g. Hastily constructed strategy, poor planning, unskilled execution
2. Failure/inability to unify behind a single macro message such as, talent is lost or mismanaged
3. Power and politics are the driving forces, rather than productive objectives – human nature
4. Requires an impossible degree of synergy due to, culture clashes between the two entities go unchecked
5. Transition management fails
6. Defensive motivation
7. Focus of executives is distracted from the core business
8. The underestimation of transition costs
9. Financial drain
10. Perhaps of these, culture clashes, gaps, or incompatibility and losses of key talent are cited the most frequently, although even these become intertwined with other reasons (Bianco, 2000).

Human Side of Merger and Acquisitions:

Plenty of attention is paid to the legal, financial, and operational elements of mergers and acquisitions. But executives who have been through the merger process now recognise that in today's economy, the management of the human side of change is the real key to maximising the value of a deal (Kay and Shelton 2000). Employers now recognise that human resource issues are the primary indicator of the success or failure of a deal. The management of the human side of M and A activity, however, based upon the management's attention. So if people issues are so critical, they should not be neglected (Schuler and Jackson 2001). The real reason behind this philosophy is-

1. The belief that they are too soft, and, therefore, hard to manage
2. Lack of awareness or consensus that people issues are critical
3. No spokesperson to articulate these issues
4. No model or framework that can serve as a tool to systematically understand and manage the people issues; and therefore
5. The focus of attention in M and A activity is on other activities such as finance, accounting, and manufacturing.

Earlier research literature, however, has partially focused on the psychological and behavioural effect of M and A on employees such as it increases employee stress and anxiety and lowers job satisfaction, commitment, morale and leading to greater turnover, absenteeism, destructive or self-centred behaviors. The literature also attributes numerous M and A related factors to the causes of those psychological and behavioural effects. These factors include various characteristics, such as the motive of merger, friendliness of merger, relative organisation size relative success, and cultural compatibility. These factors also include various managerial practices employed during the post-M and A integration period such as, ways to communicate with employees during the M and A transition period, ways to combine organisational cultures, post integration speed, and ways to handle employee displacement. Among these factors, communication is probably the most popular prescription that appears in the M and A literature, which claimed that open, timely, and accurate communication with employees improves M and A outcomes.

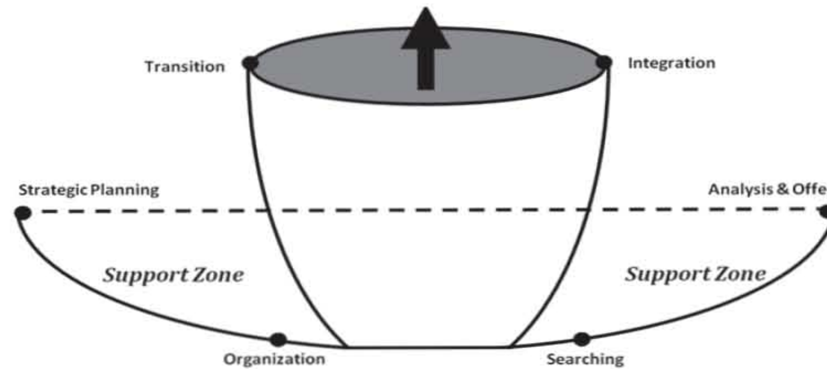
HR Problems in Mergers and Acquisitions:

McCann and Gilkey (1988) have developed seven-steps of the merger process that provides a useful framework for considering the difficult human resource problems that may arise in any merger or acquisition.

The researcher studied these seven steps and developed a conceptual framework based on earlier research. These steps have a logical outcome of the M and A process. Here, we propose a 'Soccer-Cup' model of M and A activity which can become a ready to use reference for almost any kind of such activity where organisation can be made assure that they have a 'support zone' acquiring a new company as well as the acquiring organisation should also focus for 'Successful Outcome' through two points as shown in the model.

Further the support zone provides a kind of insurance for the acquiring company by checking the strength and opportunities of merging company. At the same time the acquiring company can without weakness and threats associated with the M and A process by analysing and through an offer. The suggested Soccer-Cup model is as shown in Exhibit 4.

Exhibit 4: The Soccer Cup Model



The Pre-Merger Stages:

1. Strategic Planning: The first step is strategic planning in which the acquiring firm develops its mission statement and determines the type of merger or acquisition that will be sought and how it will achieve corporate objectives.
2. Organisation: In the next stage the firm is primarily concerned with organisation—creating a specific team to manage the M and A activity. Marks and Cutcliffe (1988) In their eight-year study of mergers and acquisitions, found that corporate executives generally failed to integrate human resource aspects into the merger process, perhaps because they were not familiar with the appropriate methods of managing the change in their organisations or because they did not realize that the merger might have a significant negative effect on their employees. Consequently, financial and legal concerns dominated the pre-merger stage, and human resource managers, who could have provided advice on managing the human side of the transaction, were seldom included in the core planning group. Similarly, Fombrun, Tichy, and Devanna (1984) stress the need to include human resource managers in the core strategic team. Because 'people problems' are a primary source of poor M and A performance, including HR managers early in the decision-making process is an important part of any M and A strategy.
3. Searching: Searching for potential acquisitions and thoroughly investigating the merits of each is the third step of the merger process. Of particular relevance to HR are the results of Schweiger and Weber (1989) who found in a survey of 80 firms that the most important factors in evaluating potential acquisitions were the talent and management philosophy of the acquired top managers and the talent of the acquired middle managers. Similarly, McCann and Gilkey (1988) and Walsh (1989) note that most M and A's are undertaken partly to capture the valuable asset of a qualified management team. The retention of management thus becomes a key factor in the success of a merger or acquisition.
4. Analysis and Offer: The fourth stage of the merger process is analysis and offer, in which a primary objective is to evaluate the 'fit' of the two firms. McCann and Gilkey (1988) identity three types of fit - financial, business, and organisational fit - that must all be present if the merger or acquisition is to be successful. For the purposes of this study, organisational fit, which includes human resources and the two organisational cultures, is of primary importance, since it helps to determine how well the two firms can be integrated. They suggest that 'the greater the differences between the two firm in these areas, the greater the difficulty in achieving the desired level of integration and in realizing business synergies which will ultimately show up in financial performance'.

The Post-Merger Stage:

5. Transition: The last two stages in a merger or acquisition are the transition and integration. These two stages are the most complicated and are surrounded by the highest level of uncertainty. The transition stage is in fact the most poorly managed of all, and consequently it is the stage where most failures occur (McCann and Gilkey 1988).

a. A Delicate Balance: Management of the transition stage requires a delicate balance between providing a stabilizing influence and creating a climate for change. Uncertainty and anxiety, anger, frustration, psychological withdrawal and family disruptions are pervasive during MandA activity. Those who voluntarily leave their company indicate that uncertainty leads them to do so early in the acquisition process.

b. Insecurity and Anxiety: Negative employee feelings and behaviour are typical responses to threatening situations - in this case, job insecurity. The magnitude of the response will be determined by the employee's perception of the severity of the threat and the degree of powerlessness to counteract it, which will in turn be a function of his or her confusion concerning the expectations of the new firm. For example, if employees are unaware of how they will be evaluated for the retention decision, feelings of powerlessness will be high. Since information is generally scarce in the transition stage, the employee's perceptions will be influenced predominately by rumour and speculation. Greenhalgh and Jick (1979)

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ISSN : 2229-6514 (Print),2230-8237(Online)

found a positive correlation between job insecurity and resistance to change. Individuals faced with a threatening situation exhibit strong attachment to previously learned behaviours, even if they are inappropriate. Since the transition stage in the merger process is supposed to facilitate change, high levels of uncertainty are clearly counterproductive.

c. Unanticipated Turnover: The predominance of negative attitudes caused by uncertainty often leads employees to act on the worst scenario and begin updating resumes (Greenhalgh and Jick 1975). The most valuable employees (Intellectual Human Asset) - those that the post-merger corporation can least afford to lose-tend to be the first to leave the organisation. For example, when Fluor Corporation acquired St. Joe Mineral in 1981, in a deal costing $2.2 billion, the large-scale migration of key managers following the acquisition contributed to millions of dollars in losses at the previously profitable St. Joe (Shrivastava 1986). An estimate of unanticipated turnover suggests that 47 percent of top executives in an acquired firm leave within the first year and 75 percent within three years. Within five years 58 percent of all managers leave (Walsh 1989), and it is often the managers with the best performance histories who leave early on (Walsh and Ellwood 1991).

6. Integration: In the integration stage changes that are designed to capture synergies are implemented. This phase is most often poorly managed (Shrivastava 1986).

a. Procedural Integration: Procedural integration is designed to standardize work procedures and improve productivity. Since each firm has its own systems and procedures, combining the two requires that some of the old ways are abandoned. Marks and Mirvis (1986) suggest that where the system of the dominant firm is adopted over that of the subdominant, it may be understood to imply that the former is superior and that its people are wiser and more able. After a series of such 'losses,' the subdominant group will lose its organisational identity, and conflict both within and between the groups will result. For example, after Texas Instruments merged with MandC, it attempted to transfer its sophisticated planning and budgeting system to the more informally run MandC. However, this action resulted in a drop in performance and resistance to the change. It took several years for the new system to stabilize, and even when it did, the performance level was far from optimal (Shrivastava 1986). The dominant firm often attempts to centralize the control function within the acquired firm, particularly with respect to expenditures (McCann and Gilkey 1988). The approach can create problems, however. Hayes and Hoag (1974) found that two-thirds of the managers who left behind acquired firms did so because of loss of autonomy and control. When key functions were centralized in the acquired firm, problems such as higher absenteeism and turnover and lower productivity were nearly twice as likely as when no change was made.

b. Physical Integration: Physical integration is intended to use the mutually exclusive assets of the two firms as the basis for capturing synergies. Some common assets will become redundant and workforce reductions may take place. Schweiger and Weber (1989) found that 75 percent of the organisations they surveyed had terminated employees following a merger or acquisition event. Workforce reductions frequently lead to subsequent problems, however. In one study 70 percent of the companies that had downsized following a merger or acquisition reported one or more post-event problems, compared with 40 percent of the companies that had retained all their workers (Bohl,1989). After downsizing, considerable uncertainty and frustration may be exhibited among remaining employees, who may feel that the termination decisions were based on unclear or inappropriate criteria. One policy in particular-the automatic elimination of redundant positions-correlates highly with post-event problems. Policies that created fewer problems included automatic retention of all employees wishing to stay, one-on-one interviews with employees, and retention of employees meeting specific criteria.

c. Socio-cultural Integration: Socio-cultural integration is the final and most difficult task in a merger or acquisition. Because the organisational culture is part of the employee's identity, a failure to address culture issues may lead to a loss of commitment among employees and may result in lost opportunities to retain qualified personnel and motivate individuals. According to Marks and Mirvis (1986) the most important source of conflict in an acquisition is the clash of cultures that occurs when the dominant firm attempts to subvert the formal and informal organisation of the such firm. There are 3 main reasons for this conflict: 1)The power differential between two groups, 2)The unidirectional flow of culture from the dominant group, 3) The active resistance to a loss of culture in the acquired firm (Sales, Mirvis 1984).

This model can be further enhanced by adding various key elements to these pre-defined points of 'Soccer-Cup' Model.

Conclusion:

HRM has an influence on the success of M and A in each stage of the business process. The study shows that through the traditional and conceptual process of either on / of starts with strategic planning, this planning should have an element of support activity without which the process does not become viable.

The organising and searching activities in the suggested 'Soccer-Cup' model have proved to be trustful, once again as a back process activities rather than the purpose of M and A process. And the analysing part had given the strength to acquirer to look into the matter with an open eye and then gives an upper hand to offer the realistic value to the stake holders of a merging company.

The 'all well' bell ranges up when synchronisation of transition phase; which is most vulnerable phase of the whole model. Thus, we conclude that the 'the transition phase' has to be 'handled with care' for further integration of merging company with that of acquiring company.

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ISSN : 2229-6514 (Print),2230-8237(Online)