To Realize the Full Potential of M&A, **Manage the Human Capital**

by Kenneth R. Brousseau, Ph.D., Rikard Larsson, Ph.D., and Marc Swaels

In today's New Economy, mergers and acquisitions are under a microscope. With so many of the past decade's M&As failing to achieve the anticipated synergies, managers, directors, and shareholders are not so enthusiastic. Research shows that human capital issues play a significant role in determining an M&A's outcome. In this document, we suggest several ways in which organizations can manage the leadership and workforce components in order to create high-performance organizations that deliver on their M&A promise.

In their book, *Angel Customers & Demon Customers: Discover Which is Which and Turbocharge Your Stock*[1], Larry Selden and Geoffrey Colvin argue that the success rate of mergers and acquisitions would improve dramatically if more attention were paid to the quality and profitability of the acquired customers.

"M&A, like other aspects of running a company, works best when seen as a way to create shareowner value through customers," the authors wrote in a June 2003 Harvard Business Review article on the subject.

It's a credible viewpoint. As human capital experts, we'd like to extend that line of thinking further. If the winning formula is to attract, retain, and grow the most profitable customers and if these customer relationships depend on the employees of the new organization, doesn't it make sense to give proper attention to the "people issues" at the very beginning of the merger process?

Yet, time and again we've seen merged companies falter as acquired company "stars" abandon ship taking their expertise and knowledge with them and as mistrust and factionalism paralyze the merged workforce. No one is being

1 Portfolio/Penguin, 2003

served - not employees, customers or shareholders - and failure to realize the expected merger synergies is generally the result.

We suggest that if the same rigorous due diligence applied to a target company's financial and legal aspects were used to assess the human capital component, leadership and workforce strategies to foster human collaboration could be developed at the onset. This would then lead to early creation of smooth-functioning enterprises that meet the expectations of all stakeholders.

M&A Success Factors

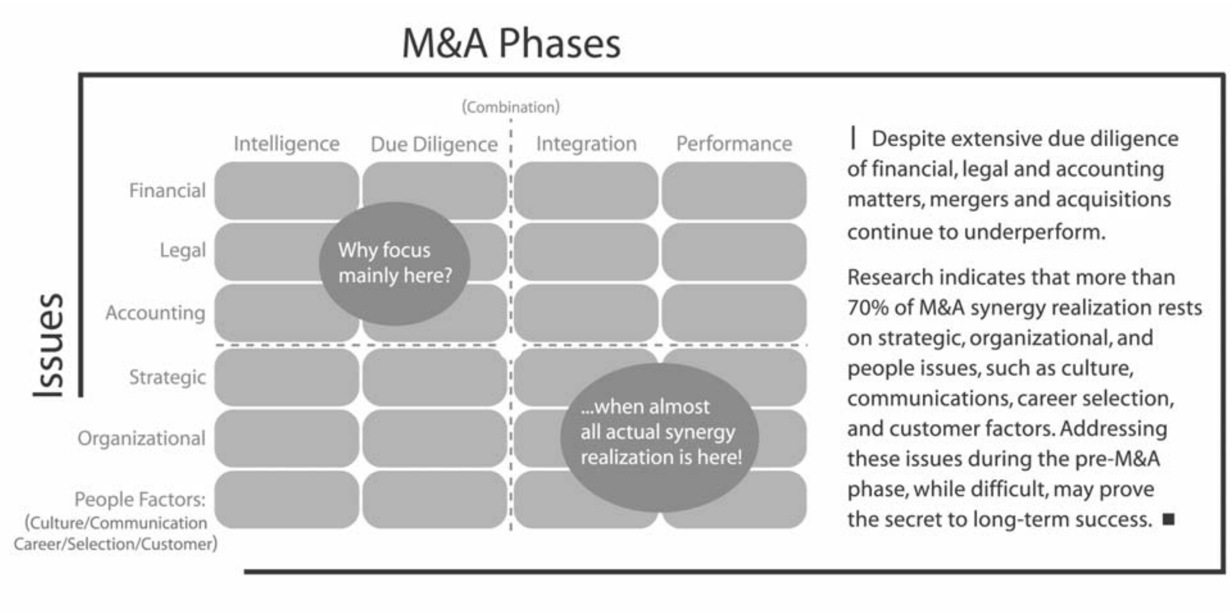
Mergers and acquisitions are probably the most volatile events in corporate life. They offer the opportunity for fantastic synergies and the potential for value-destroying disasters. As a consequence, much research has been done to determine success factors and best practices.

In their extensive research, Rikard Larsson and his colleagues have found that successful M&As are based on strategic business combinations, that is joining companies with related or complementary products or services, and on effecting an organizational integration that identifies and addresses human capital issues.

One of the most common of these human issues is employees' frequent tendencies to resist change. Stress exacerbates this resistance. Merger announcements create stress in the target company's workplace, and in the acquirer to a lesser extent. People are worried, and, if we are to be honest, they have good reason to be. Job losses, reassignment, demotion, and other negative career implications are almost inevitable.

Some business leaders believe that merging companies of similar cultures solves many of these problems. It's not that simple. Neither the selection of strategic business combinations nor cultural/human resources factors alone appear to be sufficient for merged entities to deliver their promise. Larsson's research indicates that while the strategic business component is necessary, the integration process determines the extent to which its potential is unleashed.

Make no mistake. Integration isn't only about balance sheets, information systems, truck fleets, production facilities, and office buildings. It's also about people. It's about helping them manage and accept change so they can focus on the essential task of creating an organization that serves them, your customers, and your shareholders.



Integration Styles

Over the past few decades, two common approaches to integration have been seen: soft/avoiding and hard/controlling. In the soft approach, organizational integration is largely put "on hold" with the thought in mind that a natural integration will occur as employees learn to trust one another. Employee resistance is minimized, but so are the advantages of getting integration under way immediately.

In the hard approach, the acquirer moves swiftly to suppress resistance and culture clashes by imposing the operating model. The idea here is that decisive action reduces uncertainties and does not interfere with momentum. Integration is initiated quickly this way, but employee resistance soars.

Our experience reveals that there is a third, more effective integration model, which we call the co-competence approach. It requires both parties to identify and acknowledge each other's strengths and combine forces on integration projects that make use of the right talents. Co-competence isn't always easy, but it excels at handling the employee resistance component, which then allows the integration process to proceed effectively.

The co-competence approach, with its strong human capital component, also addresses important organizational model issues, oftentimes overlooked in terms of the nuances. For example, Randy Stott of the Senn-Delaney Leadership Consulting Group has found that different types of company operating structures require different leadership styles. This, in itself, is no revelation, but Stott adds a new twist.
Stott identifies two typical operating models: the holding company with its

portfolio of autonomous businesses (i.e. General Electric Company) and the integrated company (i.e. Kellogg Company), with a single strategy covering all businesses. Then, he says, there is a third model, the "allied" model, in which business units develop their own strategies but share non-core functions. Effective leadership behaviors in all three of these entities can be very different.

Discovering these differences early on through the co-competence integration approach and then making explicit the future operating model can contribute significantly to a smooth integration.
It's clear that the speed with which personnel decisions are made in a merger is crucial. Prompt management announcements reduce uncertainty for employees, vendors, and customers, allowing business to return to normal more quickly. Yet, with speed of the essence, how can the work of understanding employee strengths, weaknesses, and motivations, which is necessary to the co-competence integration approach, be done?

Behavioral sciences research and, to some extent, technology now offer companies a viable way to address those thorny "people issues," including employee resistance, thereby improving significantly their chances of realizing - perhaps even exceeding - the potential benefits of creating a new organization.

A New Model

Korn/Ferry's Leadership Practice has developed an assessment tool based on the ground-breaking research of Michael J. Driver, Kenneth R. Brousseau, and Phillip L. Hunsaker. In their studies of how people make decisions, these social scientists found that decision styles are determined primarily by two factors.

The first is the amount of information people use in decision making. Some people seem to require just a small bit of information before they act, while others appear to need a thorough analysis. In their book, The Dynamic Decision Maker (Self Discovery Press, 1993), the researchers cite J. Paul Getty and Howard Hughes as examples of these contrasting decision styles.

Hughes liked to pour over every detail. When preparing for his round-the-world airplane flight, he obsessed about covering every possible problem that might occur, going to the extent of building special equipment for straining oil in case he was stranded in a part of Siberia where the type of oil he needed was unavailable.

Getty, on the other hand, made decisions quickly. He once bought land for oil exploration that could be accessed only through a narrow isthmus, saying he would figure out how to deliver the necessary equipment later. When the time came, he had a narrow-gauge railroad built for the purpose.

The second decision-style determinant involves the number of solutions the individual considers based on the information he processes. Some devise one solution and follow it through; others consider various options, sometimes following several simultaneously, or changing course as necessary. Getty is an example of the multi-focus approach in that he used his oil business success to venture into a wide range of new endeavors. In contrast, Thomas Watson, IBM's founder, dedicated his career to creating a giant in the office machine business, never straying in focus.

Assessments Provide Insight

By analyzing how people use information and how they develop solutions, Driver, Brousseau and colleagues identified four basic decision styles. These form the basis of Korn/Ferry's proprietary Web-based assessment process that evaluates leadership style, thinking style, and career motives.

Assessing employees in this way is not a judgmental process. Hughes, Getty, and Watson were hugely successful businessmen, despite their contrasting styles. Assessing employee decision styles is about understanding how people behave so that they can be assigned integration tasks and post-merger jobs at which they'll excel and so that conflicts can be resolved easily. And, workplace conflicts need to be resolved if there is to be long-term success and realization of M&A synergies.

Additionally, style assessments help identify who may be at risk navigating the merger transition period, normally a time of massive change. Some people cope well with change; others do not. This latter group may include people whose expertise collectively may represent an important portion of a company's intellectual capital. While their behavioral styles might suit their jobs, their styles might not fit the temporary merger transition environment well.

Armed with this information, those managing the transition can take steps to accommodate or work with these key individuals in ways that better fit their particular styles, keep them productive, and that ensures they are not lost merely because of the disruptions of the transition period.

Assessments Facilitate Decisions

The value of employee assessment can be demonstrated through the experience of our recent client with an international insurance company operating in Europe. The firm was proposing a substantial acquisition and had retained a management consulting firm to design the structure of the new organization for optimal efficiency and results. Early in their work, the parties realized that the true value of the acquisition rested on a group of key employees who had close control of significant customer segments. The need to retain these individuals was crucial to long-term success, and Korn/Ferry's assessment tools were put to work.

It quickly became apparent from the assessment results that one highly successful segment of the key group operated in an autonomous, entrepreneurial mode that would not integrate well into the centralized structure envisioned for the new organization. This segment controlled a significant share of a regional market, in part because of its ability to provide customized solutions for customers.

To avoid the inevitable clashes that would occur if the group were made to conform, the operating model was modified to accommodate the flexible operating needs of this business segment. The assessment process resulted in a compromise that retained key employees and customers and that ensured bottom-line results going forward.

Pre-acquisition employee assessment offers companies a valuable decision-making tool. In one instance, Korn/Ferry's work actually resulted in postponement of an acquisition. An international, privately-held food industry supplier was interested in acquiring an Italian market leader that was also family owned. From a business standpoint, the deal seemed to be a winner. The fact that both entities were family owned (i.e. presumably had similar cultures) was seen as a distinct advantage. But, Korn/Ferry's assessment of the respective management teams revealed otherwise.

The acquirer had evolved into a large organization with a diverse workforce, while the target company remained very much an entrepreneurial organization in which family members still played major roles. Neither cultures nor leadership styles were similar, and the potential for conflict was readily apparent, a serious issue because the Italian company's management was considered the "value" of the transaction.

After further negotiation, it became apparent that accommodating the target company's management style would be very difficult at that moment. The decision was made to postpone the acquisition and instead to continue an existing distributorship relationship with the Italian firm.

Implementing **Employee Assessment**

In the fast-paced M&A environment, employee assessment involving both the electronic tool and personal interviews can be done quickly. An acquirer may choose to begin by, for example, assessing candidates for the top management posts. The assessment results are compared to Korn/Ferry's "best in class" profiles for those types of positions. These competency models for executive positions across numerous industries and cultures are developed using our database of 600,000 business professionals worldwide. The profiles reflect the behavioral competencies and career motives of the most successful people in each job category and are a good indicator of the qualities needed for success.

Assessment results enlighten the integration process with objective information. Because the insight gained is shared among all involved, prospective co-workers begin to understand that Mary isn't "slow," she just likes to review all the data before acting, and John isn't being careless when he heads off in two directions after just a brief review of the situation. Even better, you have a good idea who will best handle a detail-intensive integration task, who will add the necessary decisive personality to a project team, or who may need coaching to reach the level of productivity you seek.

Once the top spots are decided, companies would do well to apply the assessment process to line managers who represent the "thermal" layer between the leadership and the rank and file. Because these individuals interact directly with those who "touch" the customer, their influence is exponential. When line managers are functioning well, there is a trickle-down effect. Making prompt lower-level hiring decisions also reduces uncertainty and negative attitudes across all employee populations.

An Army of **New Recruits**

Mergers and acquisitions, although not generally viewed as such, are huge recruitment efforts. You are acquiring an army of workers you know nothing about. Acquiring organizations often try to cope with this situation by eliminating some of these "unknown" workers. Not only does this often heighten employee resistance, but also it risks the loss of excellent workers you discover too late you really need to run the business.

The recruitment challenge does not focus only on existing jobs, but also on posts created when functions are realigned in the merged entity. The fact that the assessment tool is on line and available in different languages makes it flexible enough to use for a large number of employees. The resulting objective assessment information allows you to locate the best candidates for the job and to treat people fairly, which gains you employee trust and respect, and, ultimately, high performance.

The Foundation for **Success**

There is no doubt that the amount of energy generally directed toward the "numbers" aspects of a merger or acquisition is necessary. But, ultimately, these activities do not contribute to the value creation that is the intended purpose of a merger because that value rests on the actions of people. Therefore, long-term M&A success demands managing the business, organizational, and human aspects.

The co-competency integration approach, with its emphasis on helping employees cope with change and discover their strengths, leads to a breaking down of the deadly "us v. them" mentality so often seen. Cultural clashes are anchored in the parties' separate historical collective identities and defense mechanisms. Implementing career-based assessment, development, and communication can reframe the situation into joint, future-oriented individual and organizational opportunities, which then lead to a new organization well-equipped to realize its full potential.

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