Understanding Synergies in Post-Merger Integration of Human Capital

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Abstract: In the current context of climate change, economic development, increased attention to human rights or other social causes, employees, in their capacity as human capital, have a high priority. The economic crisis has led to the review of corporate responsibility, especially in companies where social responsibility has not been based on sound principles of organization, coordination and monitoring. Once a target firm is bought or two companies merge, the most difficult job of the acquirer begins: to create the value that was expected from the deal through successful integration of the companies' employees. As a part of the acquirer's strategy, optimizing the human resources management is an important part of the post-merger integration of the two companies (the acquiring company and the target company). The purpose of the paper is to present a conceptual framework for the configuration of the human resources after the concentration, including the impact of human resources management on knowledge sharing. In this respect, we will consider the employees from three perspectives: stage I – employees are seen as corporate costs (salaries and other incentives, which are correctly and nondiscriminatory offered); stage II – employees are seen as assets of the newly formed company (investments in lifelong learning); stage III – employees are seen as business partners (the integration between personal and professional life; self-improvement). All these stages must be considered in relation to the psychological and operational synergies that are expected to be gained using human capital, by integrating two previously separate organizations and facilitate communication.

Keywords: integration; human capital; mergers and acquisitions; knowledge sharing; psychological and operational synergy

JEL Classification: J24

Introduction

A company's social interest should match the community's attitude towards its members, the ethics, and the environment. As part of the community, but also of the internal environment of a company, employees are considered a focal point for management, because their aptitudes, capabilities and knowledge are the ones that sustain, mainly, the core activity of a company. The recent concern of responsible management is to initiate and develop links with the employees, throughout the organization. In case of loss of confidence regarding company's position, corporate social responsibility instruments are very useful, and the future will definitely belong to socially responsible companies, not just with the environment, but capable of strategically use the values associated to the human capital. In mergers and acquisitions (M&As), the focus on human capital can translate M&A strategies into more effective post-merger integration at the companies' level.

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1. Corporate Social Responsibility: a New Dimension in Managing Employees in the Post-Merger Integration Period

At EU level, the principles developed to guide companies in implementing corporate social responsibility (CSR) have two dimensions: *the external dimension* (the relationship between the company and the external stakeholders) and *the internal dimension* (the relationship between the company and the employees) (Grosu *et al.*, 2011). Regarding the first one, stakeholders' pressures aim at environmentally-friendly business projects and are in constant evolution in recent decades (Nuță, 2011). As far as the internal dimension is concerned, the responsibility of the companies should take into account: improving the quality of life of employees at and outside the workplace; maintaining a safe and healthy work environment; responsible approach to restructuring in the event of a crisis, taking into account the interests of all parties involved; minimizing the impact of its activities on the environment and natural resources. The EU's recommendation is that these principles to be integrated by companies in their codes of conduct, but also to report on how they have been applied (European Commission, 2010).

In other terms, corporate responsibility is a sum of obligations (Iamandi, 2010: 29): economic, legal, ethical and philanthropic. If we associate them with Maslow Pyramid, economic and legal responsibilities can be considered implicit, being related to "physiological, security, and belonging needs" within Maslow's Pyramid. Ethical responsibility (where the employee treatment is included) occupies the same position as the "need for esteem, status, respect", while philanthropic actions are considered as associated with both the "self-realization" and "need for respect". According to Deng *et al.* (2013), acquirers with higher CSR realize a better post-merger integration and report larger increases in post-merger mid and long-term operating performance than those with low CRS. Also, the stock registers better returns in the first case. All these conduct to two conclusions: the market needs time to understand the benefits of the CSR and the mergers in which CSR has an impact fail less and complete faster.

In relation to employees, the integration of social responsibility into the business strategies of the companies followed three stages, namely:

- stage I – employees are seen as *corporate costs* (salaries and other incentives, which are correctly and nondiscriminatory offered);

- stage II – employees are seen as *assets* of the newly formed company (investments in lifelong learning);

- stage III – employees are seen as *business partners* (the integration between personal and professional life; self-improvement).

Starting from the previous three stages of the employees, we consider the synergies which can be achieved in each stage and how these can be optimized.

This development is based on the relationship between employee satisfaction, commitment and motivation. It all starts with the **economic dimension of the employer-employee relationship – salaries**, which represent the easiest and most common assessment of human capital in companies. Although important and well-perceived, this is not effective (we are considering the impact of expenses on financial performance), and not enough. The appraisal and the acknowledgement of employees lead to their progress and motivation, indirectly increasing the company's financial performance. However, for stage III, the employer may require the employees to express opinions about the company so that they feel involved in the operations. From these actions, the employer must also win. Thus, people are employed in a company based on their qualifications and competencies. The experts in the field are more specialized employees who are expected to achieve maximum performance in the given field. In terms of motivation and performance, the costs associated with an expert are higher, but the revenues he generates through his work are proportionate to his knowledge.

Of course, if we look at economic entities as a whole, we also take into account the **social dimension of the employer-employee relationship**. Acquiring companies that have a culture that accepts and encourages innovation should try to understand the culture of the target company, which gives them a competitive advantage. In this case, the development of human capital can be managed if the organizational membership is relatively stable. This task becomes more difficult when there is a mobility of human capital. Transitional changes in the employee profile are a significant challenge when trying to use human capital as leverage.

It is important to note that a responsible management system for its own employees contributes to their motivation, which in turn leads to the optimization of human capital and has positive repercussions on the company's performance.

2. Optimizing Human Capital During Post-Merger Integration: the Psychological and Economic Synergies

Given the importance of the employees and of their culture, human resources management practices must mediate the M&A-PMI relations. Starting from the three forms of post-merger integration, identified in the literature, we show how each M&A-HRM-PMI path takes on different functions, follows distinct logics, and yields specific interdependencies between acquiring and acquired firms (Brueller *et al.*, 2016). On the same tone, Aguilera and Dencker (2004) consider that there should be a link between M&A strategy and human resources management strategy. Consequently, given that each concentration, i.e. a business combination, has its own characteristics, its integration and oversight must be tailored to the characteristics of the transaction. Thus, the integration can be analyzed from several points of view (Gates and Very, 2003).

1. **Integration as an adaptive process**. Even under a pre-merger / acquisition plan, it is likely that during the integration period it will undergo changes due to unforeseen events or human capital, which is the most unpredictable resource of a company, from the point of view of the control that a company can have on its employees. It should also be borne in mind that integration is a process of adjustment, in a complete context and with sometimes insufficient information.

From the perspective of human resources, integration can be analyzed taking into account the steps in Figure 1.

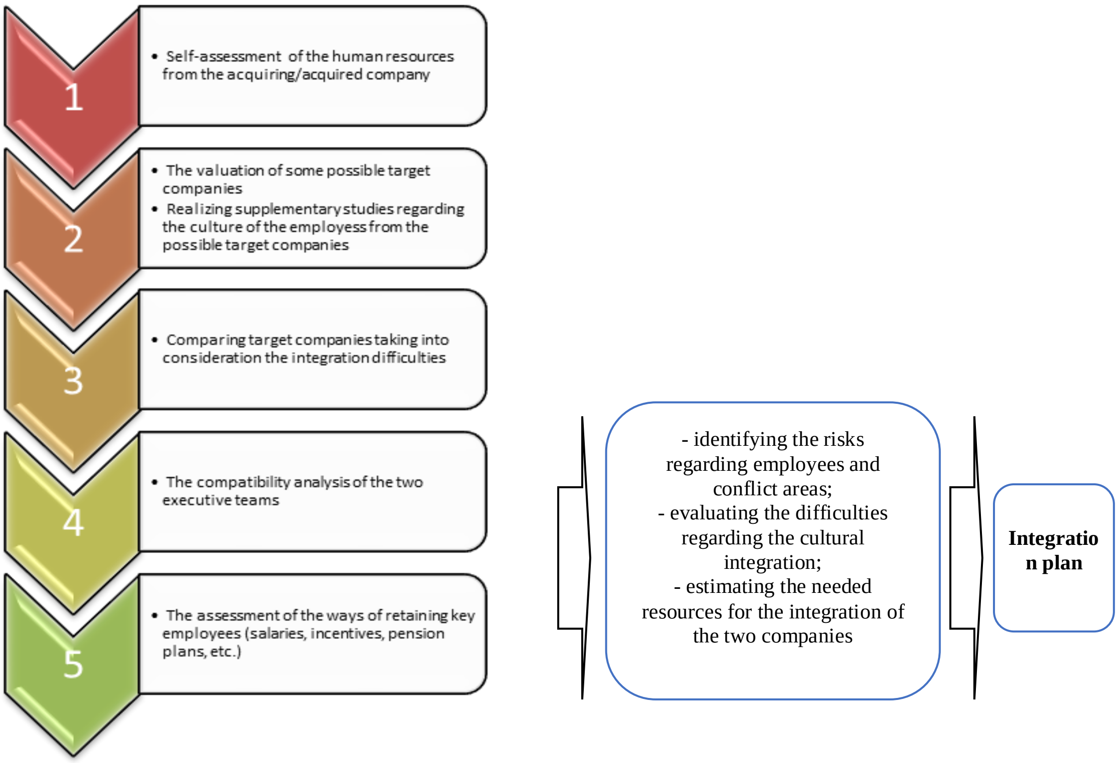
1
• Self-assessment of the human resources from the acquiring/acquired company
2
• The valuation of some possible target companies
• Realizing supplementary studies regarding the culture of the employess from the possible target companies
3
• Comparing target companies taking into consideration the integration difficulties
4
• The compatibility analysis of the two executive teams
5
• The assessment of the ways of retaining key employees (salaries, incentives, pension plans, etc.)
- identifying the risks regarding employees and conflict areas;
- evaluating the difficulties regarding the cultural integration;
- estimating the needed resources for the integration of the two companies
Integration plan

Figure 1. Integration of human resources into the general process of integration of two companies involved in the merger/acquisition

Source: Own processing after Dörrenbächer and Witzmann (2015)

Therefore, from the perspective of the acquiring company, integration is a process of learning the characteristics of the target company, allowing changes to the initial integration plan. According to some research, these changes made in the post-merger integration result in a value creation superior to the one initially estimated (Very and Schweiger, 2001; Dörrenbächer and Witzmann, 2015).

2. Integration as a contingent process. From this perspective, integration is as a process which depends on two variables: the *need for strategic interdependence* and *organizational autonomy*. Although they seem to exclude each other, they draw attention to three ways of post-merger / acquisition integration: absorption, symbiosis and preservation (Gates and Very, 2003). The three cover the full spectrum of possibilities that may arise from the two variables mentioned above. The extant literature tends to frame M&As and post-merger integration as strategies and outcomes, respectively (Almor *et al.*, 2009; Holland and Salama, 2010; Barros and Domínguez, 2013); but this framing often leaves their underlying processes underexplored. Brueller *et al.* (2016) identified three generic M&A strategies - annex & assimilate, harvest & protect, and link & promote - and these can be matched with three previously mentioned post-merger integration outcomes.

Thus, a first M&A strategy is *annex and assimilate*. In this case, the acquirer holds the strategic and operational leadership, and the primary goal of the M&A is to absorb the target's assets. In this context, the post-merger integration takes the form of *absorption* and it is characterized by high interdependence and reduced need for autonomy, which means that the two companies apply a consolidation process of all the operations and activities. For the human capital, the used practices regard recruitment, selection and training, which have as main purpose to enhance personnel's skills and abilities. The economic (operational) synergies are obtained by removal of redundancies and integration of human capital, usually by imposing the culture of the acquirer. The psychological ones fall second, because the acquirer imposes its rules, regulations and culture.

Harvest and protect, the second M&A strategy, is characterized by capturing and preserving intangible assets of the target company, while the latter holds some strategic and operational power, but the acquirer sets the rules. For this M&A strategy, the second way of integration, *preservation*, is characterized by high autonomy and low interdependence, and starts from the premise that the target company is absorbed and takes some of the characteristics and processes of the acquirer, holding some operational and tactical power. Regarding the human capital, the strategies include performance and development programs, competitive pay systems, upward career mobility, enhance motivation of personnel, personnel retention and capability alignment. The psychological synergies are preceding the economic ones, acquirer searching for ways to motivate its employees.

The third proposed strategy, *link and promote*, considers that the two companies hold ample strategic power and operational leadership. As a result, the post-merger integration takes the form of *symbiosis*, equally characterized by the two variables (need for strategic interdependence and organizational autonomy), denotes that the two companies coexist in the early stages of the transaction, on an equal footing, and later become interdependent. The relationship between them can be characterized as symmetrical and synergistic. Regarding the employees, the two companies take into consideration flexible job designs, cross-firm engagement programs, transparent management. They empower employee to engage at higher levels across both firms. The psychological synergies are at their maximum and determine operational synergies, especially under the form of revenues increasing.

The previous strategies are briefly presented in Figure 2.

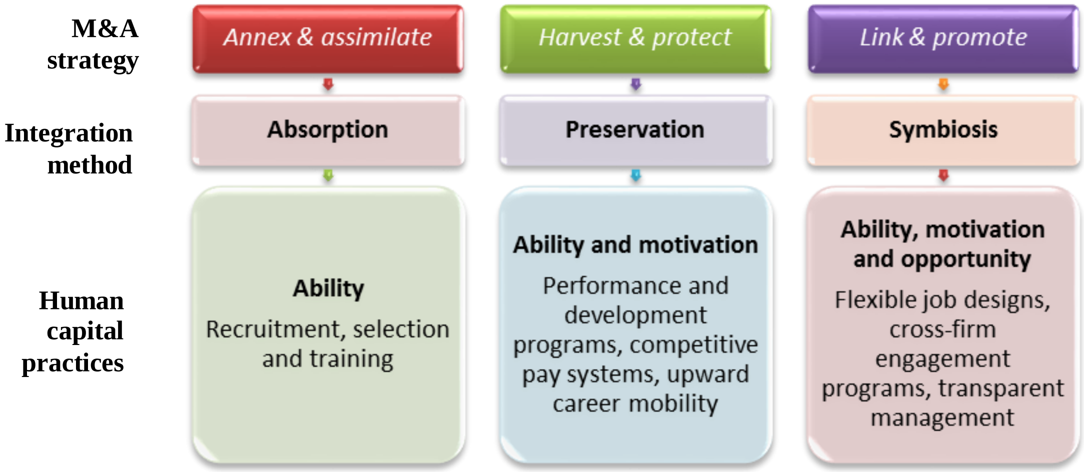
M&A strategy
Integration method
Human capital practices
Annex & assimilate
Harvest & protect
Link & promote
Absorption
Preservation
Symbiosis
Ability
Recruitment, selection and training
Ability and motivation
Performance and development programs, competitive pay systems, upward career mobility
Ability, motivation and opportunity
Flexible job designs, cross-firm engagement programs, transparent management

Figure 2. The possible M&A-PMI-HR relationships

Source: Own projection after Brueller, N. N., Carmeli, A., Markman, G. D. (2016), Linking Merger and Acquisition Strategies to Postmerger Integration: A Configurational Perspective of Human Resource Management, Journal of Management, 44(5), 1793–1818.

3. Integration as a multi-stage process. In this case, integration can be described in two steps: “the first 100 days” and “the transfer of capabilities”. The first stage starts immediately after the transaction and aims at maintaining the momentum of the two companies and facilitating integration, thus creating a favorable atmosphere for the exploitation of synergies. Once the atmosphere required for employees and executives is set up, the second step aims to create value as a result of synergies that should generate the added value expected from the beginning of that transaction.

From the perspective of some authors, mergers and acquisitions are not *de facto* strategies but ways/tools used by companies to carry out the strategies they propose (Marks and Mirvis, 2010). Thus, some companies translate their growth strategies into search and selection of partners to conclude different types of alliances. Consequently, they choose to merge with or acquire totally or partially other entities on the market.

An integration strategy specifies the level of M&A integration, which conceptually ranges from letting the target remain autonomous to full assimilation. Once this decision is finalized, the integration leads for each functional area can agree on some working assumptions regarding the staging of actions (Recardo and Toterhi, 2015).

In conclusion, every analysis of a M&A can start from two questions: "Did they get the numbers right?" and "Did they get the people components right?". For the second questions, a well prepared human resources function will help the managers through due diligence, negotiation until the complete integration (Galpin and Herndon, 2014: 313).

3. A Balanced Scorecard Model for the Post-Merger Integration Period. The Employees' Component

Despite numerous studies, it is difficult to classify M&A strategies into distinct types because M&As are diverse, have different aims, and thus often call for context-specific considerations, processes, and capabilities. Studies classify M&As on a dichotomizing view (horizontal vs. vertical, friendly vs. hostile, related vs. unrelated, domestic vs. global, "platform" vs. "bolt-on" acquisitions) (Chatterjee and Brueller, 2015; Chatterjee, 1986; Nolop, 2007).

Given the characteristics of M&As, we propose a Balanced Scorecard (BSC) with four axes, which we consider to be opportune for post-merger integration: *financial axis* (because the operational and financial synergies are reflected in an increase in financial performance); *operational axis* (considering the fact that the customers are included here); *integration/project axis* (which also assesses the integration plan); *employees' integration, innovation and growth axis* (given the fact that people's integration precedes the integration of assets and activities, we consider essential to monitor the employees). The general model is presented in Figure 1.

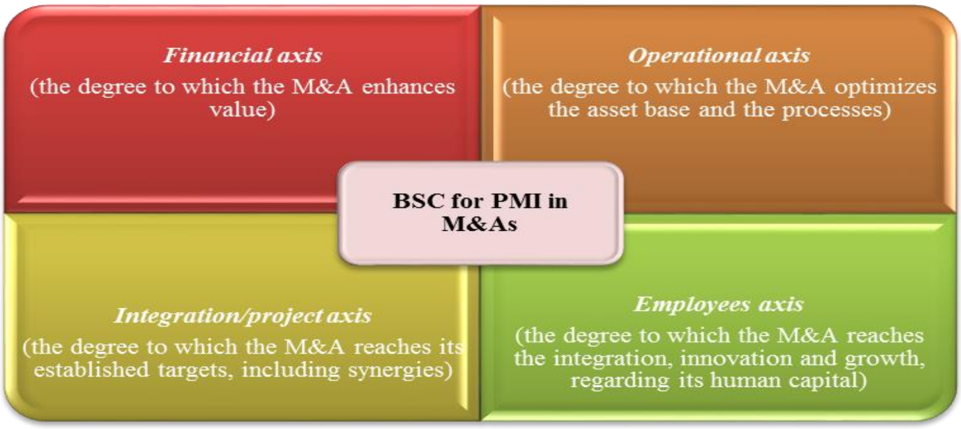
Financial axis
(the degree to which the M&A enhances value)
Operational axis
(the degree to which the M&A optimizes the asset base and the processes)
BSC for PMI in M&As
Integration/project axis
(the degree to which the M&A reaches its established targets, including synergies)
Employees axis
(the degree to which the M&A reaches the integration, innovation and growth, regarding its human capital)

Figure 1. A model of Balance Scorecard for the post-merger integration

Source: Own projection

For each of the four axes, we propose strategies to be followed, objectives to be reached and, finally, the indicators/metrics which should be targeted.

Table 1. The indicators for the financial axis

Strategy	Objectives	Indicators/Metrics
Maintaining financial stability	Maintaining financial stability	Current ratio Solvency Cash-flow
Increasing the diversity of revenue sources	Identifying new markets (CBM&As)	Volume of revenues by types of economies (developed, emerging, frontier, if we consider FTSE Russell classification) Sales/customer Turnover growth Profit margin
	Identifying new businesses (unrelated M&As)	Volume of revenues, considering different segments of activity
Increasing return	Increasing ratios	Return on Invested Capital
Increasing the overall efficiency regarding performance	Economies of scope and economies of scale	The expenses efficiency to 1000 u.m. revenues

Source: own projection

In the case of related M&As, mainly horizontal M&As, economies of scale and economies of scope can be seen as overall advantages where the purposes are to increase efficiencies. The other metrics can be applied to any M&A.

Table 2. The indicators for the operational axis

Strategy	Objectives	Indicators/Metrics
Increasing the investments	Improving the existing investments	Value of the brownfield investments
	Creating new plants	Value of the greenfield investments
Increasing the sales	Increasing ratios	Inventory turnover
Improvement of operating cycle	Manufacturing costs reductions	% of deviation reported to the previous period
Market share	Reaching a specific market share	Market share Retention of the key customers Customer satisfaction

Source: own projection

Regarding the *potential of the markets*, they can be seen as growing or mature markets. In growing markets, the demands are hard to attain, and organizations find it hard to find the resources and knowledge to cover the requests; resources must be acquired, people need education and required end products take several years to develop. By acquiring other firms these essentials can be obtained faster by the usage of short cuts such as M&As (Kräkel and Müller, 2015). Regarding competition, in slow, static and mature markets where competition is established, the cost of expansion and building from the scratch (greenfield investments) is not always worth its money. To acquire these resources through M&As or to find brownfield investments are in many cases seen as the only option to get supplementary revenues. Companies following a multi-domestic strategy will mostly depend on local firm's resources, such as local technology, local brand name, networking, and distribution channels (Tulung, 2017; Johnson et al., 2004; Meyer and Estrin, 2001).

Table 3. The indicators for the integration/project axis

Strategy	Objectives	Indicators/Metrics
Reaching synergy	Reaching operational synergy	Performance reported to schedule/budget
	Reaching financial synergy	% of estimated synergy
	Reaching collusive synergy	Volume of sales % of deviation reported to previous period
	Reaching tax synergy	The net operating loss The effective % of income tax
Reaching the negotiated targets	Monitoring the integration	The development of a plan/program that can monitor the measurement and the achievement of the financial, operational and market objectives associated to integration

Source: own projection

The findings indicate that synergy potential (similarities and complementarities) between the merging firms, effectiveness of post-acquisition integration, and organizational cultural differences positively influence the overall acquisition performance of the involved companies (Tarba *et al.*, 2017; Osarenkhoe and Hyder, 2015). *Gains of increased market size and succeeded market share* can be achieved by forwarding the target organization's market position. In this context, synergy can mean an increase in the revenues obtained by selling a single product (economy of scale) or a wide range of products (economy of scope). In addition, an alignment of business units creates increased possibilities to offer the customers a broader product base in the same or similar market, thus contributing with a more complete market offer (Johnson *et al.*, 2004). *Regarding vertical M&As*, the costs associated with transactions in relation to customers, suppliers and other closely related stakeholders can be avoided or decreased through the internalization or by finding markets close to the acquirer's country. In the negative situation, the expected synergies may not be realized, either because they cannot be realized to the expected volume/value or because it is difficult to integrate the activities of the target business.

Table 4. The indicators for the employees/people axis

Strategy	Objectives	Indicators/Metrics
Creating a motivational environment for employees	Increasing satisfaction at work	Satisfaction survey for the personnel involved in teaching activities
Satisfaction of the employees	Key employees retention/loss	The number of new employees reported to the existing number The medium wage/categories
	Culture perception/assimilation	Number of team buildings
Promoting the idea of Lifelong Learning (LLL)	Improving professional skills	Number of training hours/employee Number of participants at training courses Number of courses
Improving organizational culture	Promoting the idea of organizational culture within the organization	Number of activities meant to improve the culture of the new company

Source: own projection

One of the main reasons for M&As is the access to resources that cannot be bought, or they must be acquired at a high cost. In other words, when acquiring a target company, the bidder intends to have access to target's resources (human, material, or research and development). *Knowledge and learning curve gains are essential when considering the human capital.* Transformation of knowledge such as routines, information flows and best practices are more specified resource gains (Johnson et al., 2004). The exchange of knowledge contributes with opportunities to learn more and to learn faster, and has an impact on employees' knowledge, skills and abilities for participating in knowledge sharing activities (Aklamanu *et al.*, 2015). In the case of human capital, the transfer of competences or knowledge it may be difficult, because it may be difficult to identify what these are and how they can be managed.

Conclusions

From an acquirer's perspective, a timely consideration of the target company's engagement with CSR should enable a comprehensive appraisal of the integration problem regarding employees, as the method, content and organisation of the target company's CSR activities offers an insight into the culture at the company or into its norms and values.

At the same time, taking CSR criteria into consideration when managing a M&A provides a comprehensive picture of any risks. In this way, any transaction costs which come up during the integration of both companies can be assessed more effectively.

Using the BSC to monitor the performance is a well-known tool, which can be applied in many fields (businesses, NPOs, etc.), including M&As. But, in order to reach its purpose, meaning to optimize the success of the M&A, metrics must be combined with consequences: *What are the rewards for high performance? What are the sanctions for poor performance?* Answering these two questions means that the companies which are involved in the concentration should establish incentives for the good results and correction methods, in the opposite case.

Also, the success of a M&A depends on the integration plan, thus considering the full life circle of the concentration (due diligence, closing the deal, integration, the activity of the merged company). An integration strategy specifies the level of M&A integration, which conceptually ranges from letting the target remain autonomous to full assimilation. This plan should be considered and created in the period of the pre-announcement of the M&A. Basically, any business concentration is an advantage, a strategy which should be built, maintained, and developed through its entire life cycle.

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