

CORNELL HR REVIEW

LEADING THROUGH TRANSITION: HUMAN CAPITAL STRATEGY FOR MERGERS AND ACQUISITIONS

Crystal Lee & Richard Carpenter

As the official coverage provider, the Cornell HR Review covered the keynote and panel discussions at the Human Capital Association's (HCA) 10th Annual Symposium. The HCA is a student-run organization within Cornell University's S.C. Johnson School of Management and School of Industrial and Labor Relations. The organization strives to drive the future of the HR profession through educational and professional development opportunities across the Cornell community. Their annual symposium provides a forum for students, faculty, and corporate executives to come together and explore the various human capital issues prevalent in global business. This year's symposium focused on the role of HR in ensuring the success of strategic mergers and acquisitions—both during the due diligence process and in post-merger integration.

Keynote Address:

John Lynch, Senior Vice President of Corporate Human Resources at General Electric Company (GE), delivered the keynote address. He spoke on the theme of this year's event: "Leading through Transition: Human Capital Strategy for Mergers and Acquisitions".

GE is a mission-based company offering products and services aimed at making a positive impact on people and the environment. GE's philosophy is to be a "we" company and not a "me" company. Lynch added that this relationship-based culture makes working in HR at GE particularly enjoyable.

GE manages its portfolio in three parts: acquisitions, joint ventures, and divestitures. In a company as large as GE, mergers and acquisitions are fundamental for growth. This is evidenced by the company spending about \$300 billion on acquisitions during the past decade. Lynch provided an example of how a strategic partnership between GE Capital and Mubadala helped GE expand into the Middle East. M&A and joint ventures, when successful, assist GE in growing and developing synergies. They are an excellent tool for entering a new market, as they enable the acquiring company to take advantage of the local company's knowledge and expertise.

Divestitures are another important way that GE manages its portfolio. Lynch pointed out that the critical question to ask when deciding on whether to pursue a divestiture is "Are we the best managers of this business?" If someone else can manage it better, then it is probably time to exit.

Lynch then began to discuss the role of HR in the due diligence phase of the acquisition process. As he explained it, in many companies support functions like HR often make the mistake of acting like the cops, looking for every conceivable red flag that could kill the deal. They become the deal prevention group. Instead, he proposed that HR should become the deal support group. This would be done by HR seeking ways to move the deal forward despite the problems and surprises that inevitably arise during any merger or acquisition. This could present itself in multiple ways, such as HR using information discovered during the due diligence phase to negotiate a reduction in a company's purchase price. In this way the acquiring company can benefit and still obtain synergy in the deal.

According to Lynch, HR should examine three key areas during due diligence:

- 1. Costs:** Some discoveries during the due diligence process will affect the bottom line. Major examples of these potentially deal-breaking costs include underfunded pension plans and major litigation, such as a class-action discrimination lawsuit, the to-be-acquired company is facing.
- 2. Leadership, talent, and culture:** Preserving shareholder value is directly connected to retaining key talent.
- 3. Capacity for change:** The one certainty in a merger or joint venture is that it will involve change. For this reason it is crucial to check whether there is anything within the target company that could potentially restrict HR's ability to bring about change.

Due diligence is the key to the right **decision**, **price**, and **structure**. Lynch used underfunded pensions and retention bonuses as examples of costly HR-related issues which can be addressed in the purchase agreement. He suggested that these types of concerns could be negotiated as the responsibility of one party or the other or could be addressed by deductions in purchase price.

Mr. Lynch went on to stress that if there is one area that the deal team expects HR to be an expert on, it is employee representation. This includes everything from understanding how to respond to a CEO's demands, to understanding the requirements imposed by employee contracts and collective bargaining agreements. HR should understand what is negotiable, and should know how to communicate with the legal team about these issues. In addition to knowing the key legal requirements surrounding the business, Mr. Lynch stressed the importance of financial knowledge in any great HR employee. He suggests if you are in HR, make a friend in the finance department so that you have someone who can help you understand how things affect the bottom line. Understanding the financial impact as a benefit change, a salary increase, or any other HR decision will set you apart from your peers.

Lynch explained that although "doing the deal" takes weeks or months to complete, "making the deal work" requires years of integration. After a merger or acquisition integration is critical for the success of a deal and should never be underestimated. The

integration phase begins during due diligence phase. He explained that when the deal team visits the target company for further examination, any interaction between the deal team and employees of the target company will leave a lasting impression. Therefore, it is important to plan integration as early as the due diligence phase.

To highlight the importance of integration it is important to note that most acquisitions fail on cultural grounds. With that in mind, Lynch suggested that HR employees should think about acquisitions this way: *you* aren't buying the company—the company's money is. Arrogant attitudes should be replaced with the idea that we are *merging* the operations of two companies, not simply *acquiring*. HR plays a leading role in this. HR tends to be the point of contact for the CEO of the acquired company. Hence, it is crucial to understand the CEO's concerns and to establish a relationship of trust. This relationship will enable HR to build a strong bond with the acquired company.

HR plays a crucial role in integration by selecting the right integration leaders, engaging top acquired talent, retaining leadership of the target organization, and driving cultural assimilation while preserving positive aspects of the acquired company. Mr. Lynch provided a list of desirable attributes in an integration leader:

- project manager
- liaison
- troubleshooter
- change agent
- role model
- communicator
- integration advocate dedicated to delivering growth and cost synergies

Lynch closed his address by encouraging the audience to seize the next opportunity to join an integration team. Being part of deal team, he said, is one of the most developmental experiences he has ever had and he feels it is one of the most enjoyable activities in HR. Thus, young HR professionals should grab the opportunity to get a seat at the table.

Panel #1 Discussion: Due Diligence

After the keynote address by John Lynch, the event launched a panel discussion on the role of human resources in the due diligence process prior to an acquisition. HCA Co-President Lindsay Petrovic moderated the panel featuring participants Brian Moriarty (VP of Mergers, Acquisitions, Divestures and Outsourcing, Hewlett-Packard), David Kasiarz (SVP Global Compensation and Benefits, American Express), and Kevin Walling (CHRO, The Hershey Company). Tapping into their M&A experience, these three panelists stressed the importance of HR in the due diligence process. Below are the main points the panel discussed:

- **A merger will not succeed unless it succeeds on the people front.** The panelists emphasized how HR plays a crucial in all three phases of a merger or acquisition:

- (1) strategic planning, (2) execution, and (3) integration. Taking into consideration the culture of both organizations is critical in all three of these phases. If the acquisition team fails on the people part, the whole deal will fail.
- **HR must understand the value drivers for the deal, and develop a people strategy to support those value drivers.** HR needs to understand their company's strategic goals in acquiring the target company. What are the true value drivers of the deal? Also, what synergies is the company hoping to achieve? Some companies use M&A as a way to expand into new global markets by leveraging the target company's expertise and distribution channels. Others use M&A as a means to either diversify their product offerings, rejuvenate themselves, or to obtain beneficial new technologies that would be too expensive, or take too long, to develop internally. HR should relentlessly make sure that the value drivers underlying the deal are never lost, and that the people strategy supports the value drivers.
 - **Key HR-related risks to explore during due diligence.** While there are numerous issues HR should look into when preparing for a M&A, the panel brought up these key issues as being especially important:
 - underfunded pensions
 - union contracts
 - local employment, labor, and pension laws
 - pending lawsuits and contingent liabilities relating to employment discrimination or wage-and-hour disputes
 - executive compensation (balloon payments, change-in-control agreements, and hidden pension liabilities)
 - key differences in cultural elements (What do we/they value? How do we/they make decisions? What do we/they reward?)
 - willingness of key talent to remain with the post-merger company, especially where talent is a value driver
 - likelihood that employees will use proprietary knowledge to compete with the post-merger company
 - family relationships in the target company's ownership that could obstruct the deal
 - **Faced with limited time and information, HR leaders on due diligence teams must look beyond headquarters and carefully ask the right questions.** There is never enough time to get a perfect assessment of the target company, and whatever information is uncovered has a short shelf life. Furthermore, the employees at headquarters often do not know the details surrounding the deals being negotiated at lower levels of the business. For that reason, HR should turn over rocks, ask good questions throughout the process, and continue to refine its hypotheses based on what it observes. One panelist recalled walking away from multiple deals because the target company could not sufficiently answer questions related to the Foreign Corrupt Practices Act. Another panelist once discovered

that what appeared on the target company's financial records as a "sales incentive program" was actually a cover-up for payments made to organized crime.

- **In performing due diligence, HR should be a doctor, not a patient.** Most HR-related problems discovered during due diligence are not deal-breakers, but are simply problems that need to be addressed. For example, if the due diligence team discovers that the target company's pension is under-funded, it can use that information to negotiate a lower purchase price. Similarly, contingent legal liabilities can be dealt with by adjusting the purchase price or by contracting away the liabilities altogether. Simply put, HR should find a way to make the deal work instead of seeking reasons to kill it.
- **Local oversight is a necessity in global acquisitions.** US-based companies will never know all the laws and regulations relevant to the deal. Thus, an on-site partner that is locally-trained in HR is indispensable.
- **Ideal members of a deal team are smart, persistent, and possess excellent project management skills.** Team members do not necessarily need to be experts in M&A, but they do need to be willing and able to learn. When assembling a team, business executives often rely on young professionals who possess these attributes, despite their lack of experience.

Panel #2 Discussion: Integration

After the deal is closed, the success or failure of an acquisition hinges on how well the two companies can integrate their resources, processes, culture, and talent. Integration was the topic of the second panel discussion, moderated by Andrea Tang, HCA's Co-VP of Executive Events. The panel featured Guillermo Cremer (HR Director for LATAM, General Mills), Jon Williamson (VP Human Resources, Johnson & Johnson), and Christine Bastian (HR Director and Lead HR Business Partner for Finance, Cisco). The discussion focused on HR's vital role in ensuring the success of the integration process.

- **Integration begins in the due diligence phase.** Integration and due diligence go hand-in-hand. The integration team should ask: "What did we find during due diligence that needs to be fixed during the integration phase?" In addition to addressing those discoveries, the relationships which were formed early to obtain information in due diligence will continue to be key in driving integration.
- **The Rule of 28: When evaluating a decision by considering its possible implications, there are 28 more implications that have not been thought of.** This is especially true in global acquisitions, which are extraordinarily complex. For that reason, it is crucial that companies obtain competent local counsel to help them discover some of those 28 things—thereby significantly reducing their risk. One panelist emphasized this by sharing an example involving Brazil's complicated tax laws, which are vastly different in each state. He noted that if an

acquirer does not have somebody that knows the ins and outs of tax in each state, the merger will run into serious problems.

- **The acquiring company should swallow its pride, and approach the acquisition with humility.** More often than not, the target company is being targeted because of its success. It did not need to be acquired to be successful. Therefore, the acquirer should think twice before imposing its own values, processes, and leadership on the target. Some companies choose to leave the target company largely unchanged with the exception of non-negotiables such as core values and IT, while others prefer to assimilate the target completely into the acquirer. Which method is best depends largely on a deal's underlying value drivers.
- **Three poison pills to any acquisition are (1) fear, (2) uncertainty, and (3) doubt.** Here are some ways to alleviate those problems:
 - Fear: Put a face to the company. The integration team should put in as much face time as possible and communicate early and often with everyone in the target company.
 - Uncertainty: Provide certainty wherever possible by coming in with a realistic, transparent plan. If the plan involves drastic organizational changes but the details are not certain, provide a timeline for when those decisions will be made.
 - Doubt: Have a compelling vision for the future and seek the buy-in of the target company's leadership. Employees need hope that something good will come out of the merger.
- **Retaining the target company's key talent is the same as getting people to stay at a party: Make sure they like the food, the drinks, and the dancing.** It is important to decide which employees can be replaced with the acquirer's own talent, and which absolutely must be retained for the merger to succeed. Once the critical populations have been identified, it is not enough to manage retention on a spreadsheet. Instead, the integration team should personally ask employees what is important to them, and communicate to them that they are wanted. ⌘

Richard Carpenter is a student at Cornell University, pursuing an MILR at the School of Industrial & Labor Relations. Richard earned his B.S. at Arizona State University and holds a J.D. from the University of Pittsburgh School of Law.

Crystal Lee is a student at Cornell University, pursuing an MILR at the School of Industrial & Labor Relations. Crystal worked for several years as a credit manager with Grant & Bowman and also served as an HR Leadership Program Intern with GE Capital.