

The Psychology of Mergers

A People & Culture White Paper

Introduction

The numbers vary but most commentators agree that between 50 and 70% of mergers fail to achieve their objectives. Worse than that a KPMG survey of 700 mergers in 2004 showed that not only had the new entities failed to achieve the revenue and cost synergies originally predicted but in many cases the merger had actually diluted shareholder value.

Recent research has indicated that in more than half of merger failures the root cause is a failure to attend to the people factors. Side-tracked by the strategic and structural considerations of systems and processes, the human dimension is at best poorly managed and at worst gets missed completely.

The purpose of this briefing paper is to address the human side of the merger process and create an understanding of the employees' psychological and behavioural responses at each stage of the journey. This knowledge will enable organisations to:

- Identify the factors which cause integration difficulties and organisational stress
- Understand the impact these have on employees and organisational performance
- Define the management practices which will prevent the negative psychological and behavioural consequences of a merger, thereby increasing the likelihood of merger success and the creation of a stronger more resilient company

A recent study by the Association of Business Communicators asked CEOs after a merger what changes would they make if they had to do it all again. The top response: the way they communicated with employees. In a transatlantic study of senior executives with merger experience 75% listed employee communication and harmonising organisational culture as critical success factors.

The Human Impact of Mergers

“Mergers and acquisitions represent a significant and potentially emotional and stressful life event because they change an individual’s working life significantly but fail to provide an individual with any control over the event”

(Cartwright and Cooper 1992)

The failure to adequately consider the human side of mergers can (and mostly does) have a detrimental effect on the realisation of merger synergies and benefits. In addition there are a number of direct commercial impacts:

- Increase in unwanted employee turnover and a loss of good people. Often the people who leave are important nodes in the informal network, the people who know how to make things work in the organisation. It is this loss of operational knowledge that slows or inhibits the integration process.
- Increased stress and uncertainty which manifests itself as sickness and absenteeism
- A fall in engagement which quickly leads to a fall in productivity and performance

Typically the key people problems that arise during the merger process can be grouped as follows:

- 1) **Neglect of psychological issues.** The psychological effects of change on people are not given adequate consideration when companies are integrated
- 2) **Inadequate communication throughout the entire merger process.** Employees are not kept informed during the integration process. Although people feel their jobs are at stake they typically have little reliable information on which to base decisions.
- 3) **Culture clashes between the two organisations.** Employees with different values and work styles are frequently required to work together with no structure for reconciling differences
- 4) **Ambiguous company direction and unclear roles and responsibilities.** Senior managers are typically slow in articulating the vision and mission of the new merged organisation. After downsizing, staff are left to deal with more work and have little sense of direction from which to determine priorities.

Once into the merger process itself, myriad urgent operational and trading decisions often distracts senior management from resolving people related issues. This phenomenon, known as “organisational drift”, not only exacerbates the above issues but can actually have a multiplier effect generating dysfunctional and counter productive behaviours which can undermine the realisation of any business benefits. The following sections address each of the four issue groups in turn.

Section 1 - The Psychological Journey

Unsurprisingly the psychological journey of employees reflects the transitional states that occur at key stages of the merger process.

Stages	Descriptions
Pre- merger stage	<ul style="list-style-type: none"> • Consideration of possible M&A • M&A related discussions are confined to top management • Information leaks cause rumours and speculation • The organisation is still relatively stable
Initial planning and formal combination stage	<ul style="list-style-type: none"> • The merger is officially announced • Reason, vision, goals of merger are clarified • Decisions on top level management changes and structure are made • Old organisational legal entities are dissolved and new ones created • Joint committees are formed to set guidelines for structural, procedural and operational integration
Operational combination stage	<ul style="list-style-type: none"> • Actual integration starts • Interactions between the two organisation extends to all work units • Employees tasks, roles, bosses and workplaces are reassigned • Employees learn new ways of doing things and new cultural expectations
Stabilisation	<ul style="list-style-type: none"> • Changes and adjustments are continued but gradually diminish • Norms and roles are stabilised and new practices implemented • Renewed expectation and co-operation • But the possibility of prolonged uncertainty, continual drifting and lack of direction

Whilst the various stages of merger and integration are well understood, there is far less clarity on the corresponding psychological journey. Considerable research into this area has identified “Merger Syndrome” which contains the following psychological impacts:

- **Anxiety.** Employees experience high degrees of anxiety when facing a merger which reduces productivity and generates various survival-seeking behaviours. Prolonged anxiety can cause psychological and physical illness, lack of motivation and increased operational tension due to stress.

The keys to resolving anxiety are ongoing communication, (announcements significantly ahead of time on key staffing or downsizing decisions to allow employees time to plan) and speeding up key integration decisions.

- **Social Identity.** Mergers and acquisitions typically involve the loss of an old organisational identity for at least one of the partner companies, interacting with organisational members with a different organisational identity and adapting to a new organisational identity.

This can cause serious problems. Those employees who identify themselves more strongly to their previous organisation are more likely to feel a strong sense of loss, anger and grief and are therefore less likely to accept the change initiative. As the process proceeds people from both organisations are likely to develop strong “in group” / “out group” biases, which provide a common source of serious organisational conflicts and may precipitate acts of rejection or non compliance.

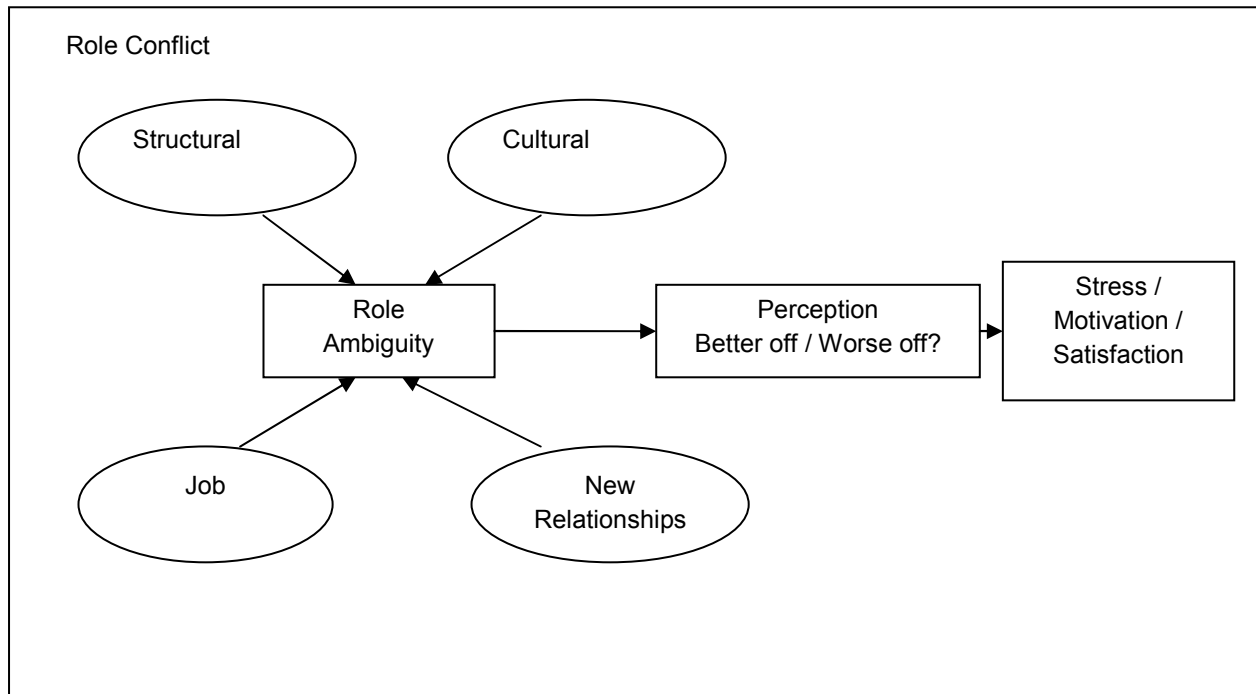
The antidote to social identity conflict is twofold - the rapid development and implementation of a new vision, common goals, values and organisational symbols - and the creation of cross organisational structures and teams which encourage people to see themselves as part of a new large group with mutual interdependence. Social identity theory articulates that these cross cutting schemes are likely to reduce intergroup bias and help people break their identity barriers.

- **Acculturation.** This predicts that tensions and conflicts will be highest when organisational members’ desire to preserve their separate culture is strong whilst at the same time the forces of organisational integration are also strong. This is a typical situation for most horizontal mergers. It also predicts that this stress and tension will lead to resistance and serious inter-organisational culture conflicts.

Intercultural presentations and workshops reduce stress and conflicts. In particular mirroring workshops have been shown to be highly effective at creating an environment within which mutual cultural problem solving can occur. This approach is discussed in more detail in the section on culture.

- **Role Conflict.** Mergers involve disrupting existing roles and reporting structures and creating new role profiles and structures. This is neither a clear cut nor a short term activity. Often this process becomes drawn out and may mean a long period of organisational drift and uncertainty. During this period employees experience high degrees of ambiguity, confusion and conflict regarding their cultural, structural and job roles in the organisation.

Two way communications in this period is vital. This involves active listening to the problems as they arise and a rapid bespoke response.



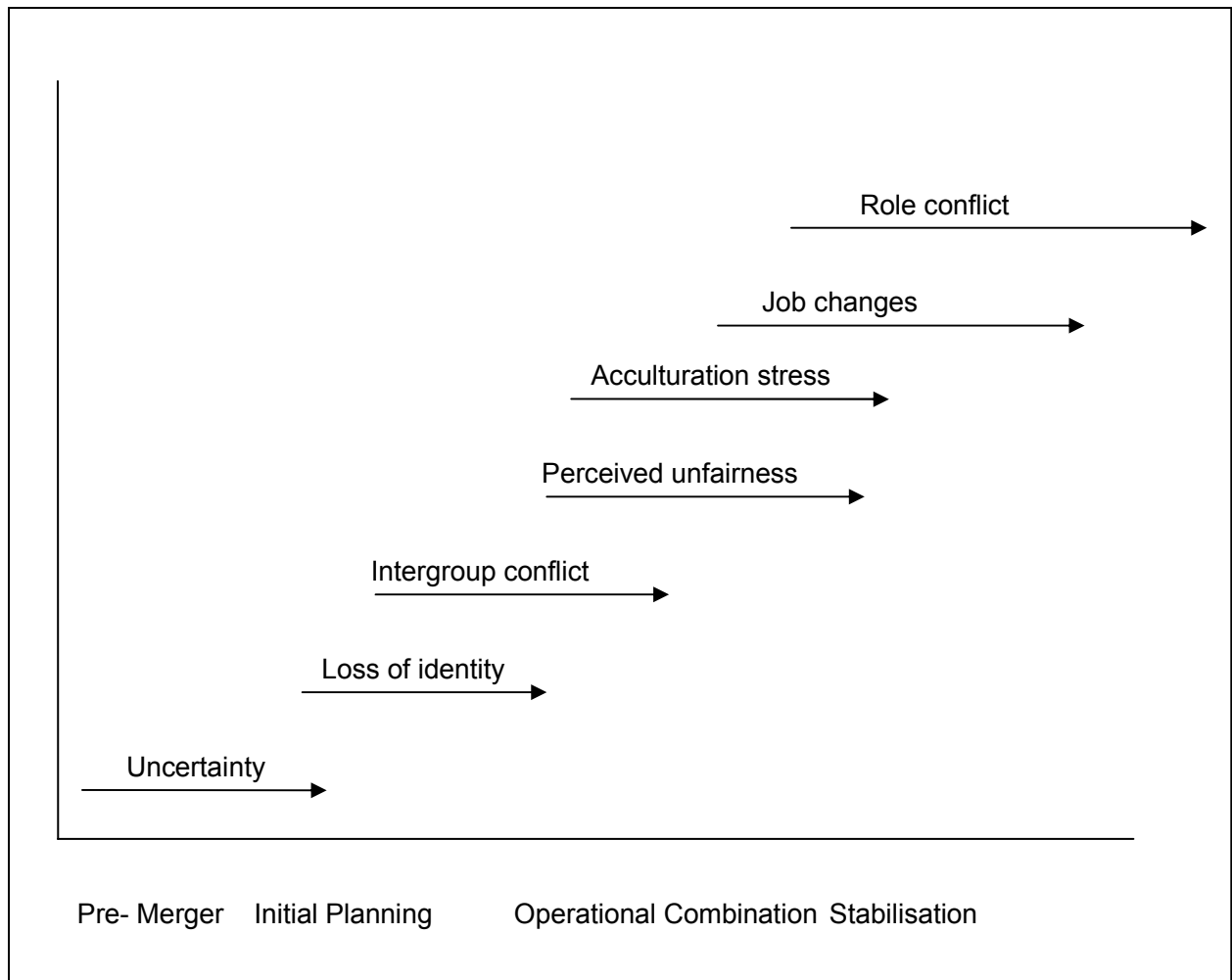
- **Job Characteristics.** According to this theory a merger is simply another form of large scale organisational change and employees attitudes and behaviours will be unchanged or even better if they expect or experience a better job environment after the merger. However a general observation from research in this field is that in many cases employees' perceived or actual job circumstances decline after a merger, leading to a substantial drop in job satisfaction and engagement.

High levels of staff consultation and encouraging employees to participate in job redesign processes is a useful approach to reduce resistance and maintain a positive attitude during the transition.

- **Organisational Justice.** Employees pay close attention as to how decisions are made regarding the reselection and displacement of employees and how people are treated during the decision-making process. Perceived inequities in the administration of these processes lead to falls in satisfaction, trust and commitment. In fact research into this area has shown that this can have the most significant impact on employee attitudes and behaviour post merger. (Buono & Bowditch)

Clear principles and transparent cross organisational selection processes are essential if engagement is to be maintained.

These psychological issues arise during the merger process at different times:



These issues are predictable and manageable. It is important to build the communication and engagement activities around their emergence. It is also important to have employee attitude measures in place that surface when and where these issues are emerging

Transition speed around key decisions is essential to maintain motivation – beware of organisational drift.

Finally pay careful attention to signs of stress. Managers need to be aware of “merger syndrome” and have effective methodologies for relieving team stress

Section 2 – Communications

“Communications are without question the first and most important organisational activity that should be carried out after the public announcement of the transaction. A communication programme is one of the most important steps management can take towards expeditiously melding two companies”

Winning at Acquisitions and Mergers

“What makes some mergers fail while others succeed? This subject has been researched over the years one of the key findings is do the parties have an effective communications programme in place to help the integration process?”

The art of M & A

The literature on communications as part of the merger process is unequivocal – in a merger it is impossible to over communicate. Employees seem to have an insatiable desire for information in the absence of regular timely communication misinterpretations and rumours fill the vacuum. Effective communication is however a difficult thing to achieve:

- Maintaining a balanced focus on delivering day-to-day business versus change
- Managing leaks to the media
- Recognising that communications is often governed by regulatory requirements and that anything said internally is likely to be shared externally and it is therefore very difficult to give employees additional or advance information

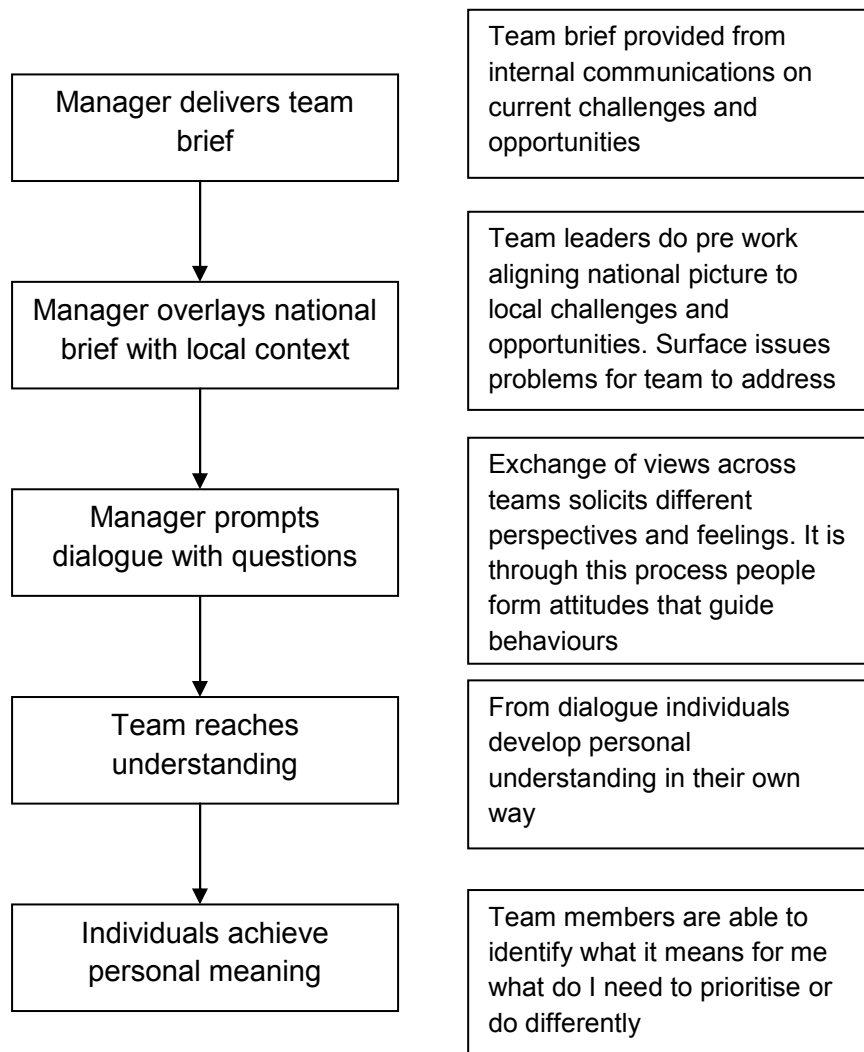
Despite these issues there are some critical success factors in planning communications activity:

- Align communications to the employees psychological journey
- Develop a detailed communications calendar with clear objectives relating to the understanding that needs to be created in each of the target audiences at the appropriate time
- Ensure that multiple media channels are used for both disseminating the communication and collecting employee feedback. Two way communication is vital
- Ensure the leadership of both parties is committed to consistent communication throughout the process
- Focus on face to face communication
- Continually survey employees to monitor the “pulse”
- Provide employees with the facility to ask any question at any time

- When issues are surfaced ensure they are understood at the very top of the organisation

Focus on creating understanding rather than communicating

Face to face communication is vital and many organisations use some form of team brief process. Usually this tends to be a one way briefing with questions. Communication theory shows that what is crucial is that the message is internalised by the employee such that it creates real meaning i.e.



To achieve personal meaning the process depends on the questions asked to prompt dialogue. The type of questions leaders might ask are:

- Why do we think this merger is really important?
- What do we think are the business imperatives as to why this is appropriate now?

- What examples do we have of successful mergers, and how did they benefit customers of those organisations? (wider product range, better service improved rates, higher levels of service) or employees? (great place to work, better career prospects, higher engagement)
- How do we think the merger will benefit customers?
- How do we think it will benefit employees?
- What opportunities do we see for this team and how we perform or contribute?
- How do we think we are going to reflect our views on the merger outside this team?

Monitoring Employee Attitudes

Employee engagement during the merger process is vital. Engaged employees will be more willing to take the fluctuations in workload in their stride. In addition they are more adaptable and willing to demonstrate pro-merger behaviours. Key to monitoring engagement is the pulse survey whose primary role is to provide an overall view of the level of engagement and also to indicate which activities are contributing positively or negatively to the level of engagement.

The pulse survey sits alongside the overall communication process and provides;

- Input to future communications to clarify, modify and adapt to feedback
- Validation that teams have understood the briefing
- Monitoring for consistency of delivery and the opportunity to identify where there has been misinterpretation or where different levels of understanding have been created
- Identification of unresolved questions and issues

Key demographics

There are two key communities that need to be monitored particularly closely:

- **First line management.** Team leaders and supervisors are critical in ensuring a positive view of the change. They are the “trusted point of communication” for most employees therefore monitoring their engagement is crucial. They need to be opinion leaders (in what they say and how they act). They need to be confident in dealing

with tough questions and able to stimulate dialogue to surface and resolve issues as well as dealing with dysfunctional behaviour.

- **The strongly engaged.** Research shows that the views and attitudes established in the pre merger phase are highly predictive of how people will behave in the early post merger period. It is important therefore that we monitor any potential impacts on the engagement of this group since they will be carrying the rest of the organisation with them.

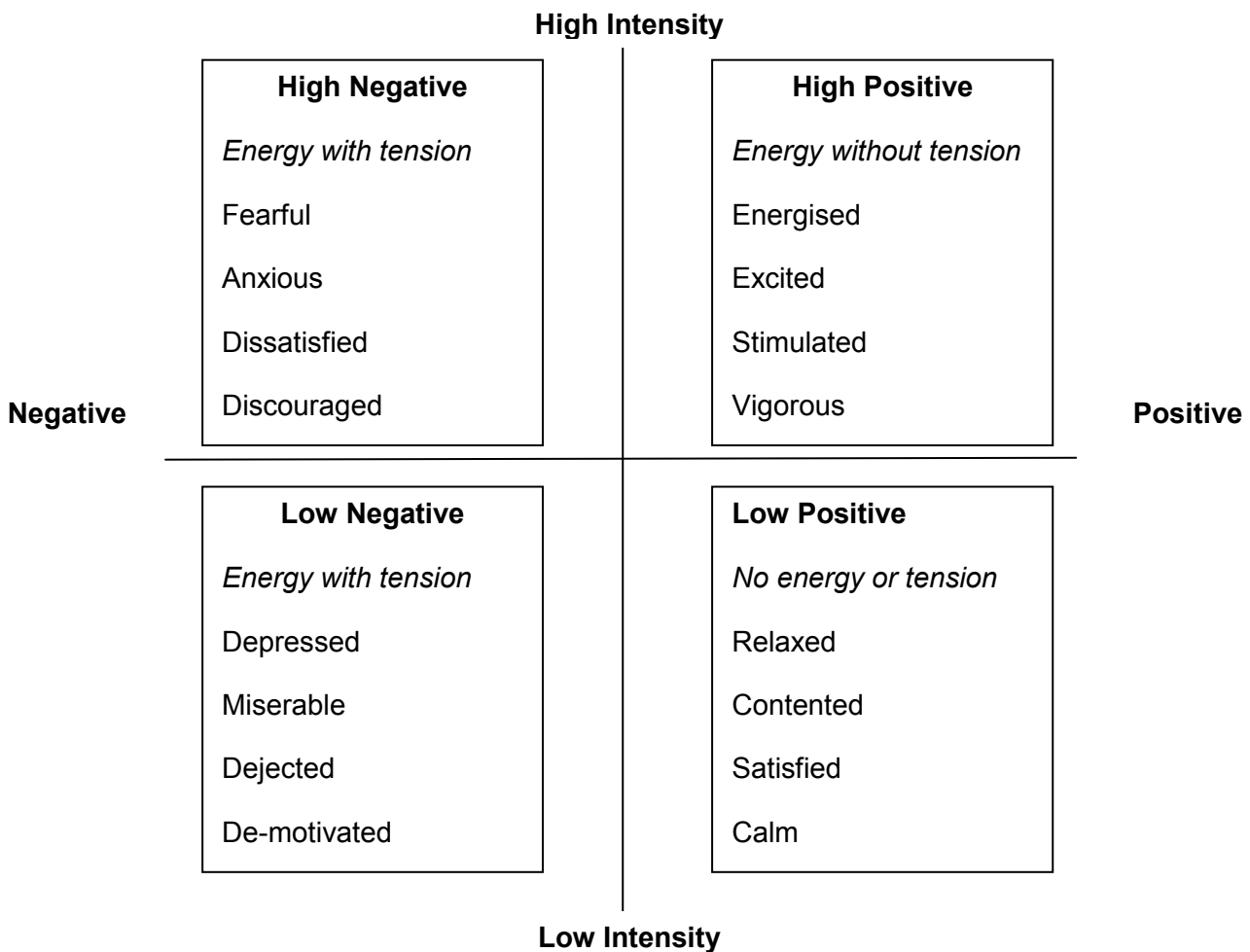
Pulse Survey questions

In designing the pulse survey there are three areas to consider:

- Emotional / psychological intensity.
- Key questions. Focusing on positivity, proactive behaviours and consistency
- Key attitudinal indicators such as morale, commitment and pride in the organisation

Emotional Intensity Model

This model provides a useful framework from which to derive emotional measures which monitor the how people are feeling, their emotional states and whether this emotional state will have a positive or a negative impact.



Section 3 – Culture

When members of two cultures meet in the stressful situation of a merger each perceives members of the other culture as foreign and intrinsically mistrusts them. Regardless of how much effort is made to welcome the new group on board, working with them leads to a natural tendency to be critical of “their” values, the way “they” work, “their” attitudes, how “their” priorities and methods impact on “our” aspirations, “our” security. Consequently there are three major cognitive processes that take place when employees consider the “other” culture during the merger process.

- **Polarisation.** People describe the two cultures in a way that highlights the differences or contrasts. Unchecked this becomes “stereotyping”, a belief system about the other culture that is difficult to change.
- **Evaluation.** People place a positive value on their culture and a negative one on the other.
- **Ethnocentrism.** Unwillingness to see behaviours and events from the point of view of the other

These distorted perceptions and hostile feelings toward employees from the other organisation may become common. As employees experience cultural differences in their daily operations, failures are typically attributed to members of the other company. The result: post merger conflict or “culture clash”.

The degree to which these issues are experienced will in part be determined by the cultural congruence of the two organisations, however inherent cultural differences are exposed and culture related stress, tension and resistance are likely to be highest when employees are pushed to abandon their old culture and learn a new one.

Social identity theory indicates that people draw much of their self concept and perceptions of self worth from their job. They seek validation of their worth through recognition, promotions and reward. The upheaval caused by a merger interrupts the achievement of these goals. During the transition period this uncertainty can fuel both individual resistance to change and also competition between cultures for ascendancy and control.

Understanding the different cultures involved and the force they exert on people provides leaders with a much better chance of effecting changes in themselves and the organisation during transition.

When companies merge, there are a number of options as to how they will work together.

- The two cultures remain separate (e.g. where the company continues to operate as an individual trading entity within a group)
- One culture becomes dominant, usually that of the acquiring company, and replaces the other culture with its own.

- The two cultures are blended selectively taking the best practices of both companies.

It is important to be clear on which of these routes is to be followed. There are numerous examples where a confused approach and a failure to understand the differences in the two cultures that are to be united results in a negative impact on the bottom line.

The Cultural Integration Approach

The first step is to establishing a fundamental understanding and assessment of the cultures of both firms.

Conducting a culture assessment provides a perspective on how the two cultures will react to each other, what the synergies are and the distance between them

(For a detailed description of how to undertake a culture assessment see the Foretel Training Course – Organisational Culture: Diagnosis and Change.)

Culture is a multidimensional, multi level concept and given the complexity of organisational culture it is impossible for a standard preset survey to capture the variety of an organisation's culture at sufficient depth for an effective transition programme to be developed. The assessment should be conducted through a series of one-on-one interviews to identify:

- The norms, beliefs and values
- The underlying assumptions
- The unwritten rules
- The prevailing mental models

The output of this exercise will also enable the organisation to understand where and why conflicts might occur, what the opportunities are for accelerating cultural integration at a strategic level and set the context for developing formal culture change programmes.

Creating the common culture platform

"We know what we perceive: we don't know what we don't perceive. Since there is no way we can know what we don't perceive, we assume we perceive correctly – even if we don't!"

"To see ourselves as others see us"

Acculturation is the process of adjusting or adapting to another culture. Usually this process involves a high level of uncertainty and anxiety that can be decreased by encouraging people to understand the new culture and to be open to differences and similarities. This openness is called *cultural relativism* and it is crucial if the organisation is to create an environment within which both sides of the merger can find common cultural ground. Without this platform the culture change programmes will be subverted and likely to fail.

We referred above to the cognitive process of ethnocentrism which manifests itself in most merger situations. It is impossible to understand the communication of people from another culture if we hold the belief that our culture is always superior to theirs. This leads to seeing one culture as right and the other as wrong.

Creating an environment of cultural relativism creates a cultural awareness that can overcome the problems associated with ethnocentrism. In this environment people understand that the other group has their social norms and that the only way people are going to understand each other is in the context of their culture. No single cultural trait is “right” or “wrong” it is simply different.

The most effective way of creating a sound cultural platform has been shown to be mirroring workshops.

Mirroring Workshops.

This exercise extends the research into developing specific pro-merger cultural behaviours. It starts as research and can then be rolled out as a training course enabling managers and teams to facilitate the cultural integration themselves through greater cultural awareness.

Participants are asked to hold up a metaphorical mirror to the “other” culture so they can learn more about how and why they behave as they do.

The objective is to equip people with a methodology for creating rapport between teams by:

- Discovering things they have in common
- Identifying similarities and differences
- Identifying those things about the other culture that they like and admire
- Educating people as to how to put themselves in the other culture’s shoes to understand where they are coming from
- Providing a common language that enables successful cross culture communication
- Providing teams with conflict management strategies that enable them to overcome conflicts and issues.
- Providing a problem solving methodology that enables the creation of shared goals

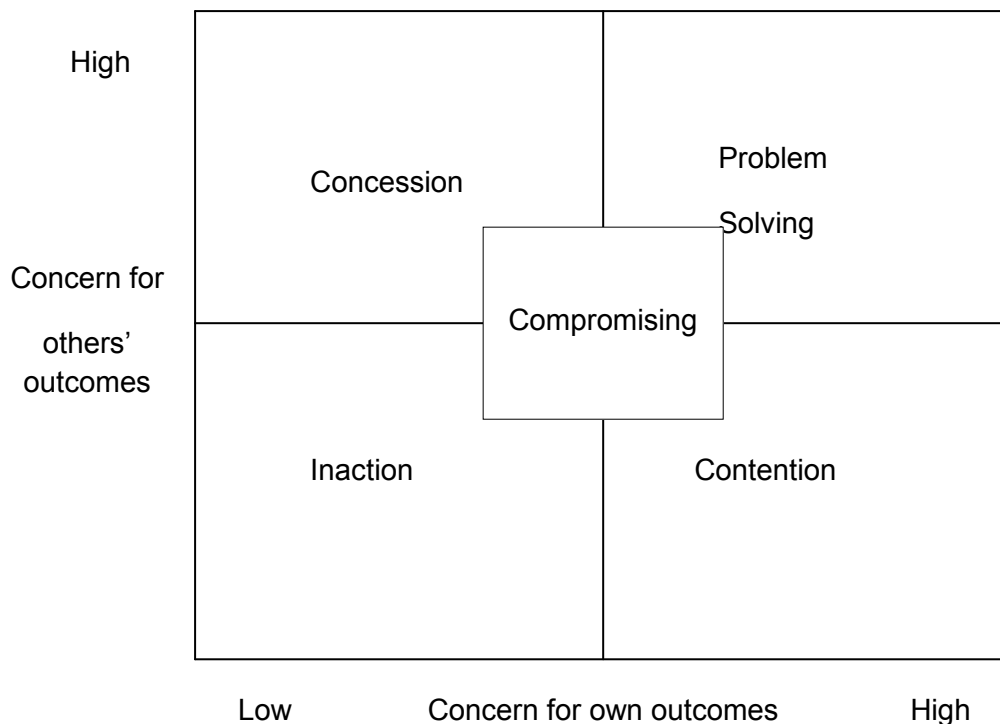
Conflict in a management context has been defined as “a perceived divergence of interest or a belief that the parties’ current aspirations cannot be achieved simultaneously” (Pruitt and Rubin 1994). This definition highlights the key point that conflict is often a more about perceived differences than fundamental contradictions; that is, in many cases conflicts can be resolved if people are willing to look for commonalities and solutions for mutual gain.

In this paper we have talked a lot about the potential for conflict however not all conflict is bad. Conflict can either be functional or dysfunctional. Dysfunctional conflict occurs when people focus on differences in personalities rather than the issues in the conflict. Too much conflict leads to political infighting and a lack of team work. However, a moderate level of conflict is desirable as it tends to energise people to share ideas, to challenge each other, to examine situations from different perspectives and to encourage mutual understanding. It is therefore not the elimination of conflict but the successful management of conflict towards a positive end that is important.

Mirroring workshops enable organisations to use conflict positively and productively. Conflict is beneficial when managed in the right way, when the outcome is win/win and the relationship between people is strengthened. This requires that conflict is brought out into the open with:

- Full exploration of the issues
- The identification of real concerns
- A clear process that enables teams to problem solve

The following model shows the different states:



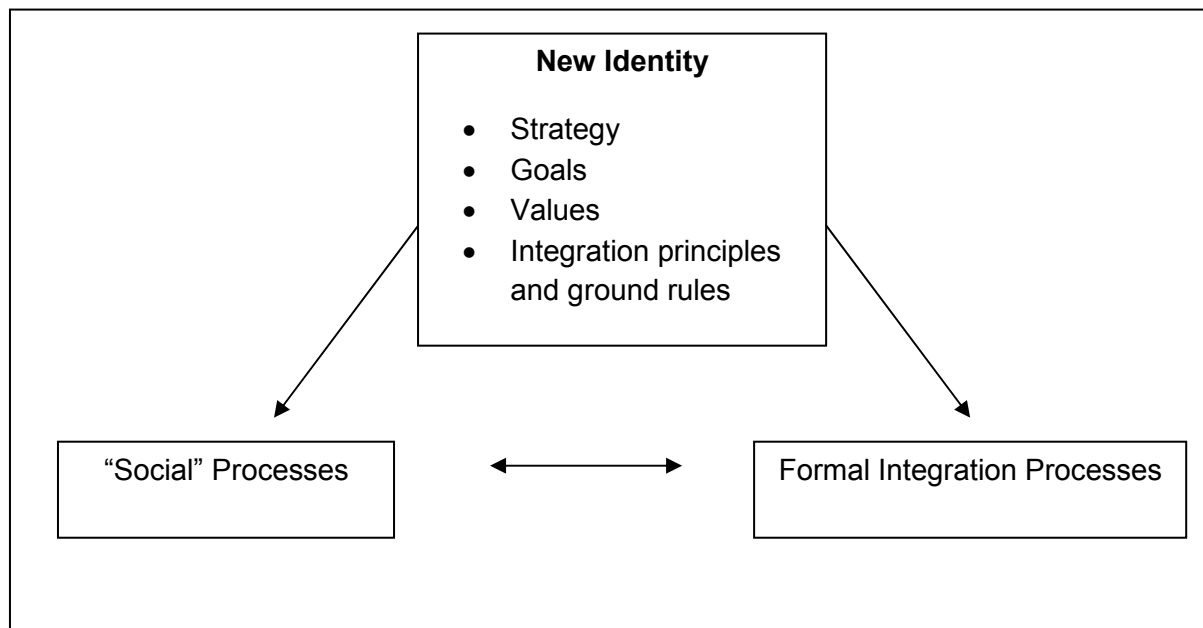
Section 4 – Clarity of Direction

“The lesson to be learnt from the more successful mergers is that the change process goes through a series of phases that in total usually require a considerable length of time. Skipping steps only creates an illusion of speed and never produces satisfactory results”.

J Kotter

There are two crucial areas where early clarity on direction is required; the organisation’s strategic direction and the change direction. People cannot begin the journey of transition psychologically or physically unless they have some view of the destination and the guidelines or rules that must be followed on the way.

In merger situations where there are often externally imposed time pressures there is a tendency for management teams to jump straight into solution mode; to identify the practical things that need to be done to integrate processes and systems. It is vital however to create time at the outset to build the people engagement and commitment platform which these activities will be dependant on for successful implementation.



In most mergers one side or the other will, at various times, feel at a disadvantage. Even in the most evenly matched merger situations one side will likely be perceived (rightly or wrongly) to be in the ascendancy - it is their name or their CEO that has been chosen for the new business. It is important to ensure the side that considers themselves to be in the weaker position are provided with a positive social identity. Because this often fails to happen they dis-identify with the new organisation in an attempt to maintain self worth. Implementation then becomes conflict laden as both sides strive for control.

In acquisition scenarios, this striving for personal identity and self-worth can be equally destructive. If individuals being adopted into a new organisation feel their social identity and self-worth is under attack by the other culture, this will perpetuate a cycle of mistrust, denial, rebellion, and isolation which will also tend to reinforce stereotyping by members of the acquiring company.

Whether augmenting an existing identity or creating a new collective culture, the organisation must first ask itself what it is seeking to become in the eyes of the expanded populations of customers and employees:

- How do we intend to react to customers' needs, wants and preferences? What do different customer groups need to see in our proposition if they are to be converted to the new identity? In short what is the customer strategy of the organisation?
- What shared values and cultural beliefs are needed to support this strategy? What behavioural differences should we expect to see where employees have internalised these values? In short what is our culture strategy?

The identity will develop most effectively when it is shared across the organisation through formal and informal "social" processes. A variety of studies attest to the benefit in reducing intergroup bias and tension through socialisation activities such as:

- Induction programmes
- Training
- Cross visits
- Retreats
- Celebrations

As well as these formal activities, encouraging employees to create their own informal socialisation rituals has shown that employees will, of their own volition, develop a joint organisational culture that can be enhanced and shaped using the more formal integration methods.

"Acculturation on-boarding" is the new buzz word for the technological systems that seek to support and accelerate these social processes. Of particular interest in these new tools is the use of social networking technologies (a form of corporate Facebook) enabling people with common interests across the organisation to find each other and share information, solutions and ideas. In the same way that teenagers manage their socialisation rituals through this technology so it accelerates socialisation in an organisational merger.

Key to establishing clarity of direction is the creation of a strategic change office whose principle purpose is to ensure the effective management of the change process across the entire organisation to meet the strategic direction and business imperatives. The key outputs of the strategic change office are:

- The communication and understanding of the organisation's vision and identity and communication to other stakeholders (suppliers, local communities etc.)

- Defining the change process and how it will operate
- Establishing the guiding principles that drive the planning of implementation teams.
- Developing the ground rules on how decisions will be made and conflicts resolved
- Establishing the cross functional teams that will implement the integration projects
- Setting stretching implementation goals - it is important that a balance be achieved between the degree of stretch desirable and a realistic pacing of integration. However it is vital that the organisation is pressurised through strong and comprehensive goal setting. This enables teams to gather around key goals and concentrate on how they should be achieved rather than infighting.
- To set and manage against key financial benchmarks
- To agree critical changes to the integration plan

It is essential that appropriate management information systems are developed to monitor the effectiveness of the change process. At the highest level the MIS needs to be able to assess the cumulative effect of multiple change projects all impacting the organisation at the same time, and at a lower level ensure that projects do not develop a life of their own such that key parts of the integration become disconnected.

Finally it is important to give detailed consideration to the informal networks of both organisations. In all businesses there are two organisations: one that is shown on the formal organization chart and another that exists in reality. The latter is made up not of job titles or formal lines of authority but rather of 'influencers' and other individuals within a variety of social networks. These informal networks have an impact on how employees think and behave. They can be both positive and negative, but to attempt to drive change through without recognising them creates two problems:

- The danger of losing key people not identified as such on the organisation chart but who are key nodes on the informal network. These people are vital sources of process knowledge as to how things actually work rather than how they are depicted in process diagrams and procedures. Often these people who feel largely unrecognised for the contribution they make are amongst the first to leave in a period of uncertainty. Worse still they are often released in error as part of downsizing and a large amount of crucial organisational knowledge leaves with them.
- A different community but equally valuable are the influencers and opinion formers. Harnessing their good will and encouraging them to act as role models is often vital in getting wider organisational "buy in".

Conclusion – Putting it all together

Central to the success of a merger is the effective winning of ‘hearts and minds’ to the desired organisational values. A clear expression of the sequence of events that will lead to the optimal cultural state is needed to map this journey. This change plan should detail the actions and processes that will create a unified, invigorated, engaged and committed workforce. The following table maps the appropriate management actions and processes against the employees “psychological journey”:

Psychological Issue	Sources of Problems	Predicted Outcomes	Management Actions
Anxiety	Uncertainty and anticipated negative impact on career and job	Low productivity Self-centred behaviours	Top down communication Counselling processes
	Prolonged anxiety and uncertainty	Mental and physical illness Lack of motivation	Ongoing two way communication / feedback Speeding up transition
Social Identity	Loss of old organisational identity	Sense of loss, anger, grief Denial and resistance to change	Disengagement efforts (“grieving” meetings) Goal setting
	Interacting with members of other organisation	Intergroup bias and conflict Acts of non compliance	New identity Cross organisational teams and working
Acculturation	Adjustment to different culture	Cultural stress and resistance Inter-organisational stress and conflict	Detailed cultural assessment Mirroring workshops Social networking
Role conflict	Ambiguous and conflicting “roles”	Low productivity Low job satisfaction	Two way communication “Role” clarification focus
Job Characteristics	Changes in post merger job environments	Commitment Absenteeism / turn over	Post merger job design Job transfer training / counselling
Organisational Justice	Perceived fair treatment of surviving and displaced employees	Sense of unfairness and a fall in trust	Fair and objective HR policies Equal participation

