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THE MERGER SYNDROME

– The Emotional Aspects of Mergers and Acquisitions –

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Abstract

Mergers and acquisitions (M&A) are now commonplace in the European economy as companies try to improve their competitive position in a global marketplace. Research indicates, however, that many mergers have not resulted in the expected benefits, in part because organizations have neglected the human resource aspects of the change. Although M&A-transactions are characterized as highly emotional events, research on the emotional dimension of these events is still rare. This is especially the case as far as cross-border activities are concerned. This paper describes the typical effects of the merger process on the people involved and, identifies the necessity of considering the human resource factor within the mergers and acquisitions transactions. Recent M&A studies on human issues frequently call upon the 'merger syndrome' as a typical post-merger phenomenon and a concept used to describe the – usually negative – effects on the attitudes and behavior of employees in the affected organizations. In order to identify the potential causes of 'merger syndrome', I have looked at existing research literature which analyze the" soft" or human side of M&A as often one of the most problematic issues. Drawing on elements provided by the literature on the 'merger syndrome', this paper also introduces an analytical framework for investigating the role of emotions in international mergers and acquisitions transactions. The paper ends up with an overview of existing empirical studies to 'merger syndrome'.

1. Introduction

Reviewing the literature of the last two decades reveals that the human factor was often cited as the 'forgotten factor' in mergers and acquisitions. Considering the increasing amount of M&A literature that incorporates 'soft factors', it seems that people issues can no longer be neglected. Strategic M&A preparations require thinking about both human and financial aspects. In this sense it can be questioned whether it is still appropriate to call the human factor 'the forgotten factor'. Nevertheless the impression remains that people issues are still widely neglected in practice, although the human factors are receiving more and more attention in the

M&A literature. Indifference is also reflected in daily media releases which tend to ignore the human factor when reporting about mergers or acquisitions.

The objectives of this paper are to explore the grade scientific research of the human factor in M&A environment and relevance of emotional aspects in context with the M&A-Transactions. Moreover, I am keen to help understand the emotional dimension and show the necessary research fields in this area. Before concluding the research paper, there is a short overview of possible measures to avoid the full hit of consequences of the 'merger syndrome'.

In the past two decades, business headlines have been dominated by the term "merger mania". Business press reports almost daily about proposed bid or announcement of a takeover or merger. A series of mergers and acquisitions (M&A) has increased substantially in volume and frequency. M&A-market is a very volatile market and develops in waves. The record volume was reached at the end of the 1990-ies and 2000. After a decline, the second most recent wave found its record in 2007. The economic crisis between 2008 and 2010 had negative impact on M&A volume. Despite the stock market turmoil and worries about sovereign-debt crisis that have rattled the euro zone, the region's corporations remain cautiously optimistic about the prospects for the M&A-market. A number of indications suggest that 2012 could be a good year for this market [1]. Boston Consulting Group carried out a survey among European companies. According to that study, companies have been piling up cash levels and see attractive valuations in almost all economic sectors. In conclusion, the executives are ready to concentrate on growth with M&A transactions.

Mergers and Acquisitions

Mergers and acquisitions are different transactions from the legal point of view. Within the literature these two terms are mostly treated synonymously. The New Palgrave Dictionary of Economics defines an acquisition as 'an outright gain of control over one organization' and a merger as 'the joining or gradually blending of two previously discrete entities'. An acquisition occurs when one organization acquires sufficient shares to gain control/ownership of another organization. Takeover may be generally classified as being 'friendly' or 'hostile'. This distinction can be used to describe attitudes of the shareholders and negotiating senior management, rather than the workforce. For the latter, being acquired or merging is essentially only a semantic difference. Regardless of context or the quality of the merger, the merger or acquisition event creates considerable uncertainty.

Mergers and acquisitions are considered as different from any other processes of major organizational changes in terms of the speed of change, the scale of change and the critical mass of unknown variables for the two parties. In general, the merger process consists of three temporal segments: pre-combination, legal combination and post-combination. Mergers differ from acquisitions in term of the speed with which change and integration are introduced. Having made an acquisition, it is usual that the acquirer imposes its own control and business systems. The pre-integration phase continues for many months or years, before the actual physical or cultural integration. This whole phase puts high stress level and pressure on the workforce and leads to some psychological and emotional effects. Even if M&A transactions lead to major corporate changes and are difficult events to manage, there are several motives for firms to consider a merger or an acquisition. The primary purpose is usually to improve overall performance by achieving synergy [1], or the often described "2 + 2 = 5" effect between two business units that will ensure firm's survival and increase the overall competitiveness. Other motives for M&A transactions are based on strategic decisions like product diversification, gaining access to each other's technology or market reach and thus increasing the market share. Creating value for both companies is further M&A justification which is mentioned, especially by the acquiring firm. For the selling or the acquired company the main reasons are lack of critical size and/or financial problems. External factors such as difficult market conditions, easing regulations, increasing availability of capital, the possibility to achieve tax relief, the need to share risk, the existence of complex inseparable problems and increased specialization can also lead to "merger mania" [2].

Beyond these "hard facts", there also more silent and unrecognized psychological motives for M&A transactions. The hidden fear of obsolescence, personal interest of shareholders to enhance fir's value (shareholder value) and management prestige, such as increasing market share and restoring market confidence, are typical examples for this kind of motives [5]. Additional motives found in literature [3] are egoistical needs of powerful individuals to gain collective influence, or simply the urge to follow the current fashion of empire building. Nevertheless, the potential of achieving synergy or other previously mentioned effects does not ensure that possibilities will be realized. Scientific researches show that around 75 percent of the mergers dismiss strategic, financial and operational objectives [9]. Although mergers and acquisitions are usually well planned out in terms of financial, legal and other aspects, the conclusion that has to be drawn is that these poor results have come to be attributed to insufficient human resource planning [6]. Consequently, for sustained competitive advantage to be achieved, it is necessary that the mergers and acquisitions be implemented from a financially and legally sound standpoint as well as from the human resources approach. It appears to be common knowledge that mergers and acquisitions often fail to reach the intended financial goals because of underestimated human factors [7]. It is suggested that 'employee problems' *are responsible for between one-third and one-half of all merger* failure [4]. This does not come as a surprise when considering that between 50 and 75 percent of key managers voluntarily leave acquired companies within the first years post-acquisition, and considering that the employee turnover rates are around 60 percent. Even in friendly and financially successful takeovers, this extremely stressful experience is considered to have negative residual effects on employees' psychological health [3]. Frequently cited reasons for merger failure are poor communications, the lack of any human merger plan, absence of emotional intelligent leadership and thus an ad hoc reactive approach to human problems. In these cases 'merger success' is measured in terms of behavioral indices like employee stress, organizational commitment and morale, job satisfaction, mental and physical well-being, sickness absence or fluctuation rates [ibid].

2. Definition and Causes of the 'Merger Syndrome'

The 'merger syndrome' is a phenomenon first documented by Marks and Mirvis in 1986. In almost all types of corporate combinations – be it a merger, acquisition or spin off, friendly or hostile, domestic or cross-border, most probably there is the human reaction to the corporate change to be expected [5]. The term 'merger syndrome' describes employees' reactions to a merger or acquisition and stands for the general term "Human Factor". Usually the employees of the acquired firm are more affected by the big changes. That is why the 'merger syndrome' is more intensively felt in the "weaker" organization [ibid.]. Primary scientific research about the symptoms of the 'merger syndrome' as a primary cause of the disappointing results of otherwise successful M&A transactions was carried out by Mirvis/Marks. The syndrome occurs by the unavoidably unsettled conditions in the beginning of the deal announcement. It encompasses stress reactions and development of crisis management in the companies involved. The most interesting research results from Marks/Mirvis is that 'merger syndrome' arises even if the partners took some care to devise a thoughtful integration designed to minimize upheaval and provide due consideration for its effects on people [ibid.].

In the post-merger phase 'merger syndrome' effect gets amplified by centralization of decision making and by poor communication with the employees. This phenomenon is presumably due to the fact that in the pre merger planning stage managers are expected to maintain strict silence on the upcoming decisions, and therefore they are rather cautious not to reveal too much information prior to complete implementation [ibid.]. High workload and high uncertainty and expectations tend to lead manager teams of both companies to slide into crisis management mode. This situation is sometimes compared to states of warfare where critical decisions have been made, where the other side's perspective and priorities are misestimated or fully ignored, and where counterstrategies are discussed [ibid.] Employees feel as group members of their own organization and identify with their organizational culture. Being acquired by another company, there is often a loss of identity and the employees' identification with their company and their commitment are therefore likely to change after such a major change. The challenge for people is therefore to cope with this change of social identity [4].

3. The Conceptual Framework of the Role of Emotions in Mergers and Acquisitions

Signs of human stress are present in all combinations, even the friendliest and best-managed ones. Heightened self-interest is one of the most evident signs of the 'merger syndrome'. Employees are preoccupied how the organizational combination impacts their own individual situation and what are the likely impacts for their incomes, career and even their families. They develop diverse scenarios and figments of imagination about possible implications of the M&A transaction on future benefits, possible spatial changes of the site and headquarters, and on redundancies [6]. Employees start different power games, and start to fight for their positions and privileges, for certain projects, and for "their" products and services [3]. Marks/Mirvis approached higher rates of illness and absenteeism in workforces going through mergers and acquisitions [6]. In 100 firms they worked with, incidents of high blood pressure among employees doubled from 11 percent in the year preceding announcement of the merger to 22 percent afterward. Interviews with executives in the early stages of a merger show rise of health problems, usage of alcohol and drug, sleeplessness. M&A stress affects employees' psychological and physiological well-being. Increasing tension and conflicts at the workplace and at home, because family members worry about their fates and future perspectives are common. These symptoms are present at all levels of the combining organizations and *"...many companies target their stress-management programs at hourly and clerical employees in hopes of reducing stress for the troops."* [ibid.]. To deal with the many tasks of combining, teams of executives in both the lead and target companies typically enter the "crisis-management mode" [ibid.]. Teams misestimate or wholly ignore the other side's priorities and counterstrategies. They cut themselves off from relevant information and isolate themselves from dissent. According to psychologist Irving Janis, all of this is symptomatic and called groupthink, the result of accepting untested assumptions and striving for consensus without reality testing the possible consequences [ibid.]. It feels good to executives as they can take their fate in their own hands and devising plans for surviving the crisis. However, the crisis management only gives them the illusion that they are in control. In truth, they set themselves up for trouble. Managers isolate from employees and the overall communication tends to be formal and unsatisfactory and leaves room for further speculations: What is management trying to hide from us?" [ibid.]. This uncertainty has a negative impact on integration endeavors and the overall productivity within the merged company. Management and organizational behavior research considers the phenomenon of emotions but not directly linked with their role in the process of mergers and acquisitions. The literature draws on elements provided by cognitive appraisal theory, affective events theory and the literature on the 'merger syndrome'. Considering this literature, I set up an analytical framework based on research from Sinkovics/Zagelmeyer/Kusstatscher, which includes the causes of emotions, their role concerning employee attitudes and behavior, and their consequences in the process of mergers and acquisitions.

The defensive, fear the worst attitude is a usual and expected human reaction to the experience of such a major corporate change. The organization members going through a merger or an acquisition are shaken by intensive emotions. The literature mentions different emotions in M&A. In Figure 1 Kusstatscher/Cooper consolidated what different authors mention in the context of a 'merger syndrome'. The emotions range from very negative to quite positive. Most of the affected organizational members feel "*irritated and insecure*" [5, 7]. The employees see the upcoming changes more as a threat then a positive challenge. Usually, there are not many employees who experience joy and pride after the announcement of a M&A transaction, and they are more likely to be found within the acquiring organization. The reaction of uncertainty is often aggression. Employees feel overcome by sense of helplessness, degradation, impotence and worthlessness and respond with bitterness, anger and rage against the decision makers and the acquiring organization [ibid.] These negative emotions often spill over into family life and lead to frustration, depression and to sinking into apathy. Also cases of suicide are known in situations which are perceived as frightening and hopeless [ibid.]. Managers often do not know how to react and what to tell employees in such situations, and tend to isolate themselves from employees. They also think that reporting all the happenings to the staff will increase their stress so they prefer not to say anything. In some cases managers adopt a *"trust us* [6] attitude regarding all those details. The decreasing interaction between managers and employees lead to doubts and distrust which lead to tensions in their relationship. In most M&A cases the buying company is considered as the stronger part and imposes her strategy, procedures and products on the acquired company. Employees who have to accept this react emotionally with aggression or frustration. The internal conflicts for positions, privileges and projects lead again to emotions like *"jealousy, mistrust and suspicion* [ibid.]. The stressful situation and people's high involvement and vulnerability, especially within the acquired company, results in exhaustion. When the first colleagues and friends become redundant and have left the company, grief spreads out among the survivors and they often feel pity for their colleagues and get sense of being guilty. This phenomenon is also known as the “survivors syndrome” [6].

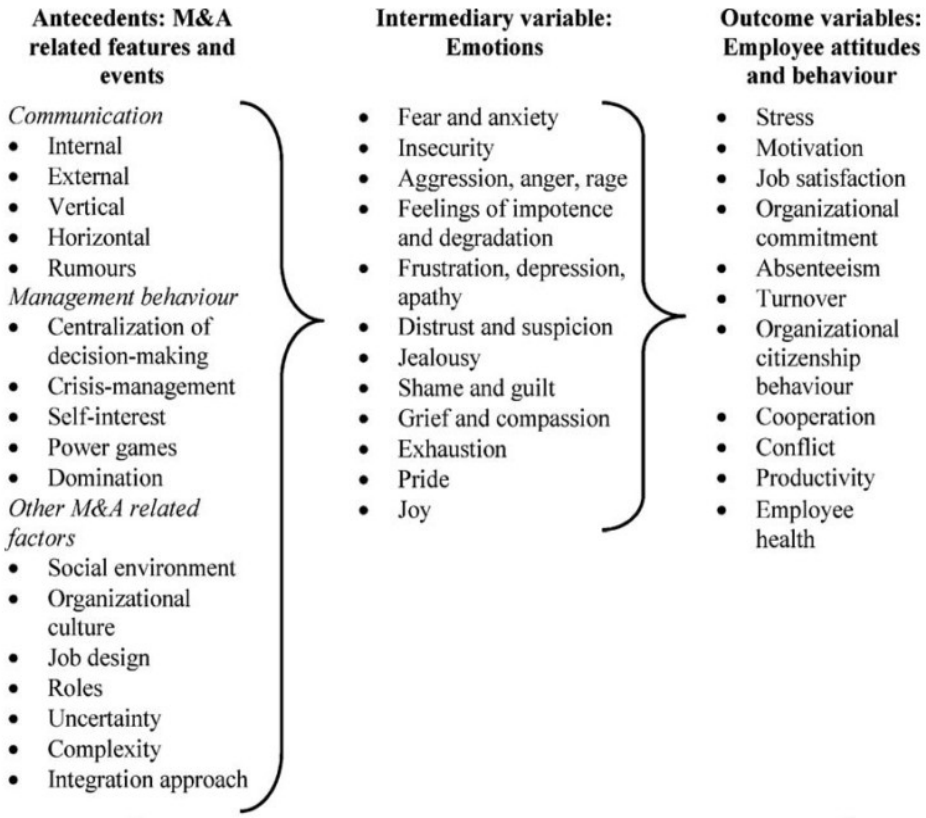

Figure 1. Conceptual framework of the role of emotions in mergers’ and acquisitions [7]

The consequences of the ‘merger syndrome’ are decreased motivation, lower job satisfaction and reduced commitment towards the company. These states are expressed by reducing working input to a minimum amount. Further issue is the searching on the market for job alternatives. Usually the best qualified employees leave the company and contribute with that step to further uncertainty and not seldom to a massive employee escape [4, 7]. The residual employees, in order to cope with all these challenging events start to talk, gossip and distract each other from their work. This gets reinforced when top-down information is not clear or considered to be insufficient. The rumor mill starts and worst-case scenarios boom because no news is usually decoded as ‘bad news’ [4, 5]. The phone bills increase while the overall job performance suffers. Sometimes information and know-how are consciously held back as a consequence of mistrust and suspicion. In such an atmosphere team work, cooperation and integration of the acquired company becomes difficult. The partner-organization and even co-workers are sometimes rather seen as competitors than partners. The tensions in relationships between people on the same hierarchical level inside and across the companies, and in superior–employee relationships are likely to increase.

Also in relatively well prepared M&A transactions the managers and employees feel an extremely high degree of stress due to the high level of uncertainty, the increased work load and high expectations of success. Stress symptoms and decreased well-being and deteriorated health are the consequences which appear in the post merger time. The symptoms are higher blood pressure, headaches, visual problems, tingling in arms and legs, indigestion, muscle tension, sleep problems, change of eating habits, increased smoking, use of alcohol or drugs, careless driving and proneness to accidents, excessive and rapid mood swings, lack of concentration, increased irritability and anxiety [5]. The literature describes further health risk factors that affect all dimensions of health [4, 6, 7] For the employees physical fitness, social support, stress management skills are supposed to be strengths factors which influence physical and mental well-being and lead to positive working energy. The positively oriented and healthy employees influence companies' organizational and financial health. One of the main reasons why most of those affected have difficulties coping with the M&A is the fact that what they have perceived as their identity is being transformed into something new: the organizational culture of both merging partners is altering. Mergers and acquisitions can therefore be seen as a change of social identity.

4. Phases of Emotional Reaction

Mirvis (1985) has suggested that the psychological response to merger can be understood within the framework of the Kubler-Ross model of personal bereavement. According to this, the employee reactions will pass through four stages [6]:

Stage 1 – Disbelief and Denial

Shock is the first reaction of the individual, the employee denies that the merger or acquisition will ever happen despite circulating rumors or a bid announcement. Even when the deal is actually signed, the individual may strive to convince him- or herself that nothing will change.

Stage 2 – Anger through rage and resentment

When the reality and the merger or acquisition becomes reality, feelings of shock and disbelief are replaced by anger and resentment towards those considered responsible (often the senior management of the company).

Stage 3 – Emotional bargaining beginning in anger and ending in depression

As fear and uncertainty about individual job future develops, this anger often turns inwards. The individual becomes angry with him- or herself for not anticipating the event and may come to resent the commitment and loyalty he or she has invested in company. Often individual employee becomes increasingly nostalgic for what was in the past and may worry that his or her existing skills and areas of expertise are not transferable to the new company. These feelings may subsequently subside to be replaced by depression.

Stage 4 – Acceptance

The individual recognizes that what is past is gone forever, and accepts that he or she must face up to the new situation.

Until there is an acceptance that any attempt to deny or resist the situation is futile and unproductive, a positive approach will not begin to develop. Fixation a Stage 1-3 will result in preoccupation and unproductive behaviour, or even cause the employee to leave the organization. Similarly, acceptance may imply behavioral compliance but not necessarily renewed organizational commitment.

An further model from Marks/Mirvis shows the interaction of merger imposed stress and the commitment of the employees. Stress, commitment, and loyalty are stated as important factors for an organization because they all relate to turnover and absenteeism, which can reduce productivity.

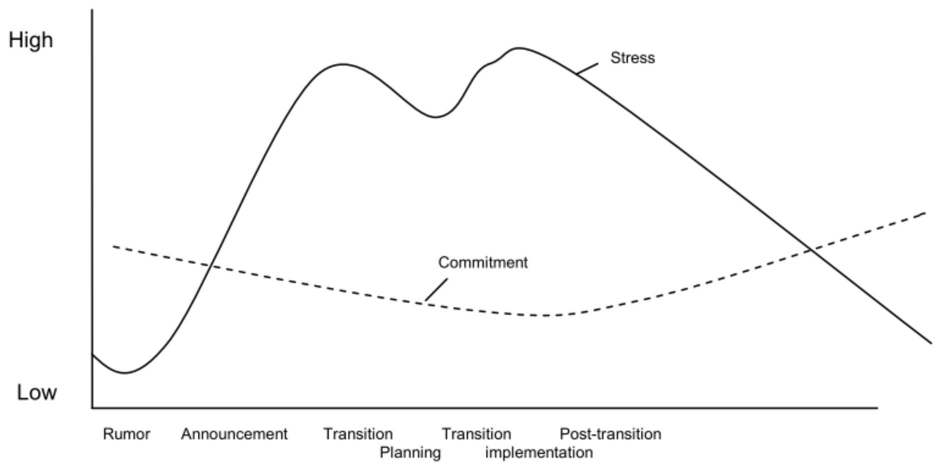

Figure 4. Stress and commitment cycles in mergers' and acquisitions [ibid.]

The inverse relationship between stress and commitment that is caused by corporate changes connected with downsizing of the workforce is probably destined to occur. However, the transition can be managed in a manner that reduces stress and the negative impact on productivity. "Every adult person finds himself in specific situations with respect to work, his recreation, his family life, his community life, etc., situations that call for adjustments. Adult education begins at this point" [ibid.] Employees can be more open to new concepts during periods of stress merely as a means to regain some control over their environment. Change is unavoidable, but if it is also traumatic, adults often look for activities and learning experiences to help them cope with the change. Human resource management can help employees identify and make the best use of learning activities by utilizing adult education theories that can improve organizational effectiveness and facilitate change.

5. Empirical Studies According to the 'Merger Syndrome'

There have been few studies carried out in order to conduct the human factor in the M&A-Transactions. In 1980-ies, Egon Zehnder and the London Business School carried out a survey of forty acquisitions in United Kingdom. While all forty companies conducted financial and legal audit, including the pension arrangements of the acquisition target, not one made any attempt to carry out an assessment of the company's human resources potential in the future.

In 2004, Cooper/Kusstatscher performed an empirical study with four organizations from different studies [5]. The interviewees were invited to comment on their personal emotional state and critical issues in the management of M&A processes. Factors were sought which, according to their perspective, had a significant impact on the outcomes of M&As. Cooper/Kusstatscher concluded that the behavior of the M&A managing people and their integration strategy notably influence the emotional state of employees. And since emotions are the driving force for actions (according to the definition of emotion), employees' emotional states influence their readiness to contribute to merger or acquisition success. The study also revealed that in many cases organization members identify with their pre-merger company. It takes a long time until the employees of the two companies really feel committed to the newly merged company, and until they develop a 'we' feeling [ibid.]. Beneath the usual difficulties measuring employees' emotional states, the authors name confidentiality problems before the official M&A announcement. In this phase it is difficult to gain access to companies in the pre-merger or during-the-merger stage. Therefore a retrospective study of emotions appeared to be the closest they could get researched.

Recent empirical research was performed by Sinkovics/Zagelmeyer/Kusstatscher [7]. The research was based on responses from the three hierarchy levels which were enriched by observations and field notes (interview behavior such as gestures to indicate irony/humour; cultural indicators, such as architecture, configuration of cafeterias/meeting rooms) and secondary data (newsletters, newspapers). The study showed that not only the acquirer/acquiring situation accounts for emotional well-being, but also–and more importantly– the way how the M&A process is managed. Another interesting finding is the fact that awareness of emotions (i.e. expressed attitudes towards emotions) was significantly more frequent amongst interviewees of companies where negative emotions were predominant. It can be concluded that people dominated by negative emotions are more aware of their emotional state and experience a stronger urge to reflect and talk about emotions than other people. Study findings indicate that specific attention needs to be given to the correspondence between management communication and management behavior and the assessment of the quality of communication by superiors and subordinates. The limitations of the study were the high degree of confidentiality and the retrospective approach. As the cases were retrospective studies of emotions, the authors could only apply perceptual measures of emotion. The three studies considered in this chapter show that M&A transactions necessarily involve unpleasant decisions. However, the findings reveal that employees' reactions mainly depend on the way how bad news is communicated and how individuals are treated by the management. Purely 'logical' and 'rational' communication of the reasons for merger is not always sufficient to convince employees. Avoidance or attempts to reduce the intensity of emotions does not help. Consequently, managers need to accept that emotions play a critical role in M&As.

6. Conclusion

M&A-Transactions are critical phenomena. From an economic perspective, M&A-Transactions are frequently events, which reshape entire industries. From the firms perspective, M&A-Transactions often represent the single most important economic decisions in the life of a firm, bearing great opportunities as well as great risks. From an employee perspective, M&A-Transactions are source of uncertainty and change. The M&A-Transactions are characterized by high number of merger failure and negative implications for the employees affected. Numerous articles and studies acknowledge the high emotional factor of such transactions and call for an increased awareness of psychological and human factors. Despite a long list of this research documents, the knowledge on assessing the human factor in M&A-Transactions is still very limited. Key questions about success factors get contradictory answers. Other questions still need to be resolved.

First, it is difficult to separate the emotions from other states such as moods or enduring emotional states arising from a temper. This leads to terminological ambiguities and consequently the categorization of 'emotions' might be criticized. Second, the emotions are difficult to measure and this sets limits to the theoretical survey questions that can be addressed in a field research. Third, it might be difficult to gain access to companies in the certain stage of merger. Therefore, solely a retrospective study of emotions might be possible. According to the retrospectivness of the studies, future research is encouraged to employ a longitudinal perspective where emotions can be measured concurrently along to the integration activities.

Based on my literature research, I identified a gap what is the key to unlock synergy potentials considering the employees of the merging firms. The concrete measures and concept how to meet such problems are rare and not fully researched, so that there is no – at my best opinion – clear concept which describes best practice solution. Also there is no study that investigates cooperation between employees of merging firms in the aftermath of an M&A-Transaction. As the M&A environment gets more active, the necessity of researching the human factor is highly necessary.

However, because of the complex and high sensitiveness and the difficulties of getting access to companies, the concrete approach to this topic might possibly remain just wishful thinking.

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