

# Whitepaper

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Workplace Relationship  
Development Indicator

## The Psychology of Mergers/Acquisitions (M/A) and the WRDI™

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## Introduction

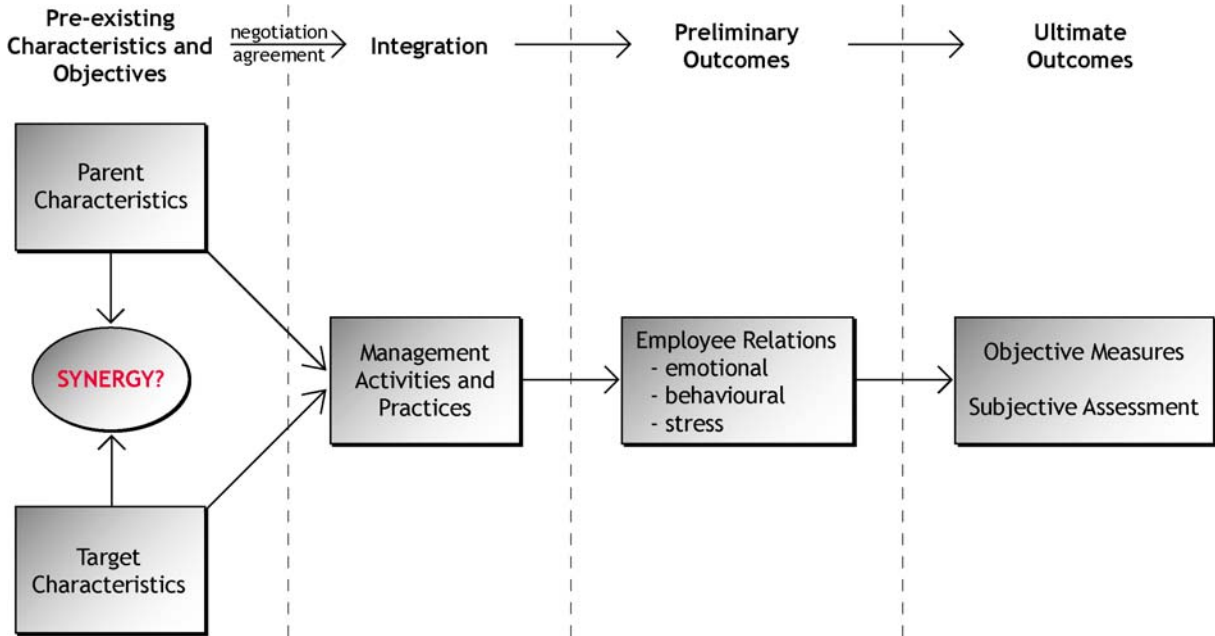
Since the early 1980's, the large number of mergers/acquisitions (M/A), coupled with their high failure rate, has led to substantial interest in the causes of M/A success and failure.

A number of researchers and analysts have suggested that at least part of a M/A performance can be explained by understanding the **psychological processes** of employees during the M/A integration. They advocate that greater energy should be devoted to understanding the issues of "organisation fit" (i.e., the processes of integrating two firms).

A model developed by Bruno and Bowditch (1989), which focuses on the pre-existing factors, and processes involving a broad range of psychological processes in integrating M/A, provides a useful framework for understanding the psychology of M/A. This white paper explores this model, and outlines a scientific approach to providing some objective human capital measures relevant to M/A outcomes.

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**M/A Model – Psychological Factors**

## Terminology

The terms “merger” and “acquisition” are often used inter-changeably. In legal terms, a merger is an amalgamation of two corporations pursuant to statutory provision, in which one corporation survives and the other disappears. An acquisition is property, including a firm, that is procured. Thus, in legal terms, mergers and acquisitions are not easily distinguishable. However, most writers use the term **merger** to imply a marriage of equals, and the term **acquisition** to involve the purchase of one organisation by another, with the purchaser in the dominant role. In this sense, the occurrence of mergers is rare, although many acquisitions are described as mergers to avoid the appearance of dominance by one firm.

## M/A Success: Definition and Measurement

Definitions of M/A success vary widely, but vary around the themes of:

- the use of objective versus subjective measures of outcomes;
- the type or nature of the outcome measures; and
- the appropriateness of measures for different types of M/A.



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## 1. Objective Measures

The most common measures of M/A success are financial performance of the combined firm using measures such as:

- ROI (return on investment);
- ROA (return on assets);
- net income; and
- measures of stock price fluctuation.

Measures in other areas include:

- marketing (market share); and
- human resources (turnover, absenteeism).

Whilst objective measures are easy to obtain, they do have limitations. For example, financial performance measures are affected by many external factors, including industry and economic fluctuations, and other activities in which a partner may have been involved. Additionally, accounting practices vary over time.

## 2. Subjective Measures

Most common among empirical investigations are self-report survey instruments attempting to assess M/A success in terms of individual employees' job satisfaction, commitment, and stress.

Subjective measures can be selected or created to tap into precise areas or domains, but bias can be an issue depending on whether staff originate from the present or target firm, or whether individuals stand to gain or lose from the M/A, either financially or status wise.

## 3. Alternative Outcome Measures

In addition to M/A ultimate success, some authors are concerned with other types of M/A intermediate or penultimate outcomes - usually those of emotional or behavioural consequences to M/A members. These intermediate measures are of interest because they are believed to cause ultimate outcomes.

Often mentioned in this category are:

- stress related variables (uncertainty, anxiety, feelings of job insecurity, betrayal);
- emotional variables (morale, satisfaction); and
- behavioural variables (turnover, absenteeism).



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## Synergy and the Achievement of M/A Objectives

Mergers of related businesses, particularly in a marriage of equals, are usually consummated because either one or both organisations are seeking **synergy**. Synergy is achieved when the combination of two organisations creates higher performance than the two organisations operating independently.

There are various types of synergy viz:

- financial (e.g., capital at lower rates);
- vertical (e.g., product or supply from one firm is coordinated with another);
- market (e.g., complementary product lines or customer bases);
- technical (e.g., importation of research and development skill and ability or technical processes); and
- horizontal (e.g., savings from redundancies in marketing, sales, operations, research, and/or administration as a consequence of continuing with a completion that provides the same product or service).

The wide variety of reasons for M/A suggests that M/A success must be evaluated differently for different types of M/A, including the timing at which those measures should be made. M/A with higher degrees of integration take longer.

Overall, no single objective or subjective measure is appropriate for all M/A, and given that different constituencies may hold different objectives and expectations, even for a single M/A, the appropriateness of measures may vary between evaluators of the same M/A.

## Conceptualisation of the M/A Process

### Table I - Framework for the Psychology of M/A

There are four (4) broad categories of variables which help conceptualise the nature of the M/A process viz:

- pre-existing characteristics of the organisations (includes tangibles and intangibles), and the relationships between the firms;
- integration process variables which represent the activities and practices employed by management during the combination process;
- employee reactions to management practices during the M/A (which are viewed as preliminary outcomes of the M/A process); and
- ultimate outcomes compared to the original M/A objectives.

These variables and their various components are represented by the following Table.

<b>Pre-Existing Characteristics</b>	<b>Integration Process Variables</b>	<b>Employee Reactions (emotional and behavioural outcomes)</b>	<b>Ultimate Outcomes</b>
<b>M/A Characteristics:</b> M/A objectives relative size hostility  <b>Parent Characteristics:</b> culture arrogance past acquisition experience  <b>Target Characteristics:</b> prior performance size importance  <b>Organisational Fit:</b> culture style management personalities reward and evaluation systems	<b>Communication:</b> openness formality source content media accuracy philosophy work-related  <b>Speed of Change</b>  <b>Control Mechanisms:</b> cultural imposition target involvement  <b>Conflict and Resistance Management</b>  <b>Human Resource Interventions</b>	<b>Stress Related Variables</b>  <b>Emotional Variables:</b> satisfaction morale commitment  <b>Behavioural Outcomes:</b> involuntary turnover voluntary turnover absenteeism refusal to relocate work slowdown lowered goals employee theft employee sabotage	<b>Objective:</b> ROI ROA net income divestiture stock price market price  <b>Subjective:</b> assessment by parent assessment by target assessment by others

## Pre-Existing Characteristics

### I. M/A Characteristics

#### a) M/A Objectives

Certain variables that exist prior to the M/A consummation can have a direct, indirect, or moderating effect on the M/A outcomes. The issue of the type of synergy sought by merging or acquiring firms impacts on the integration process because different types of synergy require different types and levels of integration between M/A partners. Mergers for reasons of market synergy often require some integration, which take the form of streamlining the workforce through lay-offs of redundant staff. Horizontal M/A require the greatest degree of integration because both former competitors duplicate all functions with each other.



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The integration process may be viewed in three areas viz:

- |  |   |
|--|---|
| i) <b>procedural integration</b><br>(initial and easiest part)                         | - involves combining the accounting systems and meeting the legal requirements of the M/A |
| ii) <b>physical integration</b><br>(medium difficulty)                                 | - involves combining product lines, production systems and technologies                   |
| iii) <b>managerial and socio-cultural integration</b><br>(most difficult and critical) | - involves resolving differences in cultures and managerial viewpoints                    |

M/A vary in the degree to which they seek integration. Integration creates complex problems in merging procedures, physical assets and culture. Furthermore, perceptions of why a M/A was sought affects employee attitudes and emotion, and in turn, behaviour.

*b) Relative Size*

Research has suggested that relative organisational size influences the integration processes and M/A outcomes. Employees from smaller firms may express feelings of psychological dominance imposed by suitors. Those involved in mergers of equals have reported higher levels of expectation in the four (4) areas of:

- career opportunities;
- job security;
- autonomy; and
- power.

*c) Hostility*

Hostile mergers pose dangerous threats, and as such, pose added difficulty in respect of the integration process. Target resistance is increased by hostility, with the target becoming a more cohesive unit in response to a perceived external threat.

## **2. Parent Characteristics**

*a) Parent culture and arrogance*

“Strong thick” cultures - those with strong consensus on beliefs and values, as well as strong socialisation of members into those beliefs and values - are particularly likely to impose these on targets. Consequently, parent culture is likely to affect its integration efforts.

Furthermore, some parent firm’s exhibit characteristics of arrogance and presumption that they know what is best for the target as well as a presumption that the target is incompetent.

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b) *Target characteristics.*

In general, the target characteristics are likely to be less important than the parent or M/A characteristics in predicting the M/A performance. The strength of a target's culture is likely to predict its resistance to a parent's imposition of control when the parent's culture is inconsistent with its own.

### 3. "Organisational Fit"

The literature suggests that a major determinant of successful integration and subsequent synergy, is the organisational match or "fit" between the two M/A partners. Organisational fit issues fall into two closely related domains and two less closely related areas:

- culture;
- management style;
- management personality; and
- organisational systems.

Organisational culture consists of both objective and subjective components. **Objective** aspects consist of the tangible artifacts of an organisation (e.g., office decor, types of company cars, etc.). **Subjective** culture includes the shared goals, roles, norms, ideologies, and values held by the organisation and its members. It is manifest in such shared facets of organisational life as its identification of corporate heroes, leadership style, decision-making practices, feelings of "family" among workers, degree of encouragement and mentoring from management to subordinates, and other characteristics of the personnel and their relationships.

Elements of subjective culture are more likely to pose problems when integration is attempted. Management attitudes towards risk, the power and control mechanisms, and the degree of responsibility for decision making, are key areas where cultural clashes can be important. Ignorance of cultural differences at the time of M/A negotiations can result in many problems faced at integration.

During negotiation, issues of strategic fit (i.e., shared or complementary business strategies, financial goals, etc.), tend to dominate the attention of the M/A team, while the organisational fit issues - specifically the cultures of the organisations and the psychological match between workforces, are often neglected. M/A which attempt a high degree of integration (i.e., horizontal M/A), blending product lines, dissolution channels, research and development functions and financial resources, are more likely to suffer the effects of "culture clash". Culture clash issues can be alleviated by well designed conflict resolution mechanisms, open culture - related communication, and recognition of the time needed for accumulation.



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## Integration Process Variables

Integration processes are important contributors to the M/A performance. Generally integration processes are the result of decisions by parent and sometimes target firms about the conduct of assimilation, and can be thought of as mediators of the relationships between the M/A, parent, and target characteristics, and M/A success. Previous work has suggested five (5) major areas of integration processes:

- communication processes,
- speed of change,
- control mechanisms,
- conflict and resistance management processes, and
- human resource interventions.

### I. Communications Processes

The issue of communication is one of the most popular themes in the M/A literature. Communication is often viewed as having a substantial influence on M/A outcomes.

#### *a) Communication openness*

Most studies advocate the use of open, honest, and immediate disclosure of information to employees facing a merger. Lack of open communication is believed to contribute to “ineffective” merger outcomes, including increased political behaviours and rumour activity, uncertainty and anxiety over job security, decreased productivity, and increased turnover, not to mention the negative influence of communication on the M/A process on expectations, anxiety, and morale.

High quality, high quantity communication provided by top management is reported to reduce ambiguity, and consequently staff will experience less stress and perceived personal threat, and maintain pre-merger levels of anxiety and productivity. However, advocates of openness have failed to recognise that differences exist amount individual managers, as well as the presence of multiple, conflicting goals in a M/A, which can otherwise result in political behaviour.

A more political perspective on communication openness suggests other alternate explanations on M/A success. Firstly, ambiguity in communication may have positive effects. Communication is often defined as the strategic use of symbols to accomplish goals, but communications goals are rarely unitary and may even be inconsistent and contradictory. Consequently, the amount and type of information disclosed to others, needs to be strategically managed, often through ambiguity. By avoidance of clarity and specificity concerning planned changes, the communicator can preserve future options, save face, and avoid accusations of incongruence at a later stage of the changes.

Secondly, communication varies in importance to different members within an organisation. Thirdly, open communication may not decrease rumour - spreading, and in fact, may well enhance it (the absence of formally communicated information means there is little to talk about).



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Therefore, recommendations offering high degrees of communication as a general strategy for improving M/A success may not necessarily be appropriate. The blanket endorsement of openness as a “magic bullet” for easing the M/A integration is questioned by a number of researchers. Openness as a panacea in M/A relations is also questioned. Communication is necessary but not sufficient in eliminating employee uncertainty and suspiciousness regarding the motives of managers during the M/A.

Other aspects of communication include;

- consideration of formality and source;
- content;
- media;
- accuracy; and
- communication philosophy.

## 2. Speed of Change

Speed of the M/A completion is related to the nature of the M/A, and the types of synergy sought. Some perspectives favour a “go slow” approach and the speed of integration may increase anxiety. On the other hand, others describe a “window of opportunity” occurring during the first 100 days following a M/A when employees expect organisational change.

## 3. Control Mechanisms

The degree to which parents impose directives or patterns on targets can be viewed as a continuum, viz:

- |                               |  |
|-------------------------------|--|
| <b>pillage and plunder</b>    | - parent unilaterally imposes its culture and system on the target |
| <b>one-night stand</b>        | - target assets are broken apart and sold                          |
| <b>courtship/just friends</b> | - some cultural and operational differences are allowed to exist   |
| <b>love and marriage</b>      | - firms practices and cultures become blended                      |

Generally, imposition of any type creates resistance from target members and increases the potential for negative emotional, attitudinal and behavioural outcomes. Two aspects of imposition of control have received a large amount of attention - cultural imposition and reduction of target managers’ autonomy.

### *a) Cultural Impositions*

Highly related M/A (horizontal) tend to follow a cultural imposition plan rather than an integration plan as the acquiring firm has knowledge of the product or industry, and seeks to reduce duplication of function.

Reaction of loss and perceived cultural domination after a M/A is believed to contribute to increased employee anxiety and increased resistance towards the



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parent's integration attempts. Individuals tend to view their own organisation and its culture as better than its partner and emotions can generally run high at this time, preventing objective analysis of the positive aspects of the partner.

Another issue is that of organisational identity and corporate image - what makes the company special, what it is, and where it is going. An organisation's name often changes in a M/A. Name change, while appearing rather simple, carries an enormous amount of information to those within and outside the organisation regarding its values, goals, size and span of operations. In situations of high-integration M/A, where cultural change of some degree is expected, a change in corporate name quickly communicates management intentions of fundamental alterations to organisational identity. The organisation's name represents a very basic and elegantly simple element of its identity, which, when altered, conveys a potentially widespread change in all other aspects of the corporation.

*b) Target Involvement in Decision Making and Integration Planning*

One major concern expressed by executives affected by a M/A is not their level of participation in the process, but their freedom to manage the day-to-day activities. Their restricted autonomy is reported to be a major cause of voluntary turnover.

#### **4. Conflict and Resistance Management Processes**

Most scholars agree that conflict is an inevitable outcome of M/A. M/A involve uncertainty and as this uncertainty becomes resolved through integration, individuals will contest decisions which contradict their interest. Greater conflict is likely to be associated with higher degrees of integration.

The basis of most conflict in a M/A has been attributed to a lack of knowledge and understanding of others concerns and organisational culture. Conflict can arise from several other sources viz: differences between technologies of companies, loss of autonomy, perceived inequities, and conflicting cultures.

Various management development approaches can be used to prevent and/or resolve conflict:

- formal transition programs;
- transfers between firms;
- establishment of homogenous decision making procedures;
- efforts to build trust; and
- provision of consistent information to all by standardising management information systems.

A delineation of both differences and similarities between organisational cultures provides a starting point for forming a common ground and beginning the formation of a new organisation, thus salvaging a potentially destructive relationship. A collaborative approach has been suggested as the best conflict resolution mechanism, with the assistance of a M/A consultant.



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## 5. Management and Human Resource Interventions

Various human resource interventions in the M/A process abound including:

- management development programs; and
- employee support programs.

Some of these interventions, such as management development programs and support programs, are likely to affect integration success.

## Emotional and Behavioural Outcomes

### 1. Stress Related Variables

The M/A literature is filled with discussions on the relationship (assumed) between M/A occurrence and increased employee anxiety. The loss of control and uncertainty about what is going on increases fears of loss of power, control, influence and status, and threatens job security, increasing stress and anxiety. All of these reactions can in turn produce undesirable behaviours (e.g., absence, turnover, poor productivity, etc).

The greater uncertainty associated with hostile mergers, as well as the probable greater level of conflict, are thought to contribute to higher levels of employee stress. Probably target employees feel higher levels of stress as they face larger and possibly more negative change, with lower level staff being more affected.

Stress management workshops and individual counselling are regarded as effective measures to relieve stress. Beyond that, integration teams can be formed to work on specific projects.

### 2. Emotional Outcomes: Satisfaction, Morale and Commitment

M/A can influence the target staff's emotional reaction to work, particularly in respect of job security, communication and participativeness. Conversely, for acquiring companies, job satisfaction often increases.

### 3. Behavioural Outcomes: Turnover and Other Variables

Turnover is the most common behavioural outcome of a M/A. It may be the case that turnover (voluntary or involuntary) however, does not necessarily have a negative effect on M/A performance, but if terminations are conducted too hastily or in an insensitive manner, integration problems for the parent may be created.

Often individuals in high level positions possess knowledge of the target organisation's culture or operations that would prove useful to the parent implementing integration plans. Organisational leaders from the target firm may be regarded as corporate heroes by their employees, and their involuntary removal by



the new parent may communicate an undesirable message of corporate ruthlessness and callousness, damaging the image of the parent, and increasing resistance towards integration and highlighting the imposition of culture.

Conversely, in a declining performance target as a result of poor management decisions, the removal of top management is often necessary and desirable. Statistics show that 50-75% of key managers from acquired organisations voluntarily leave the new organisation within a few years following the union, and this may well be regarded in the longer term as a failure of the M/A. The attrition of top performers often undermines the achievement of M/A goals.

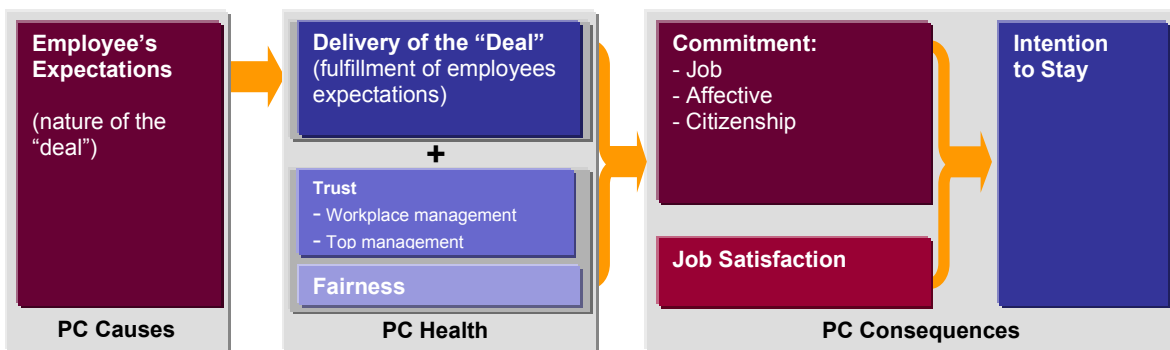
Surveys indicate that most top managers blamed;

- loss of autonomy;
  - loss of day to day freedom; and
  - poorer organisational performance following the M/A;
  - as the major reasons for leaving.
- as the major reasons for leaving.

## M/A and the WRDI™

The WRDI™ is an employee self-report survey, based on a model of the psychological contract (i.e., employer / employee relationship). The WRDI™ provides both a measure and a diagnosis of employees’:

- job satisfaction;
- affective commitment (or emotional attachment to the organisation); and
- intention to stay (which is the strongest predictor of retention or turnover).



**The WRDI™ Model of the Psychological Contract (PC):  
Causes, "Health" and Consequences**



The WRDI™ has application at various stages of the M/A process as described below.

### I. Pre M/A Phase

In the pre M/A phase, the WRDI™ should form an integral part of the **due diligence** process. Where permitted to do so, the prospective parent firm uses WRDI™ survey findings of the target firm’s employees to assess:

- the retention risk of key talent / critical employees;
- general workforce alignment; and
- relational wealth or capital of the workforce.

#### a) Retention Risk – Key Talent

The Assessment of Workforce Alignment (AWA) Report, based on the WRDI™ findings, reports on the overall retention risk and alignment of key talent. More specifically, the AWA Report (which is generated from approximately 20 of the WRDI™ 90 questionnaire items), predicts::

- how many employees are likely to be “at risk” of leaving, or likely to leave the target organisation; and
- how many employees are misaligned (i.e., have poor “fit”), with either the organisation and / or their job.

A sample of the AWA Report summary information is set out below.

### Audit of Workforce Alignment (AWA) Report

#### Executive Summary

Retention Risk	Management	Sales	Operations	Technical
Stayers	77	73	111	37
At Risk	18	27	41	11
Leavers	7	15	27	2

Alignment	Management	Sales	Operations	Technical
Engaged & Satisfied	71	59	80	35
Engaged but Dissatisfied	14	25	39	12
Disengaged but Satisfied	11	14	29	3
Disengaged & Dissatisfied	6	17	31	0



Please Note:

Not shown here – WRDI™ Organisational Development and Individual (Career Development) Reports. The Organisational Development Report provides the diagnoses of what lies behind the AWA Report findings (refer WRDI™ model).

This critical information therefore provides a basis for:

- managing retention risk;
- enhancing alignment; and
- planning for future HR resourcing needs.

Shortly following the M/A consummation, targeted interventions can be applied, both at an individual and organisational level.

*b) Workforce Alignment (by workforce segment)*

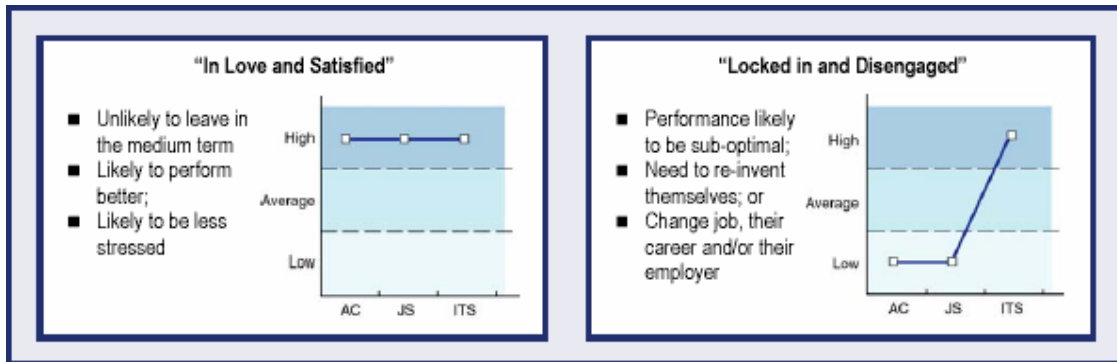
The approach foreshadowed to key talent can also be applied to the workforce at large. Similar AWA Reports can be generated for the general workforce by segment. It is possible to have low turnover but a workforce which is “stuck” (i.e., locked in and disengaged – dissatisfied with both the organisation and their job). Either this workforce is too afraid to move on (i.e., the “walking wounded” who consider their external employment prospects to be bleak), or alternatively, are staying for the wrong reasons (e.g., superannuation payout).

The implications of this workforce misalignment are:

- diminished performance;
- greater workplace stress; and
- diminished customer satisfaction.

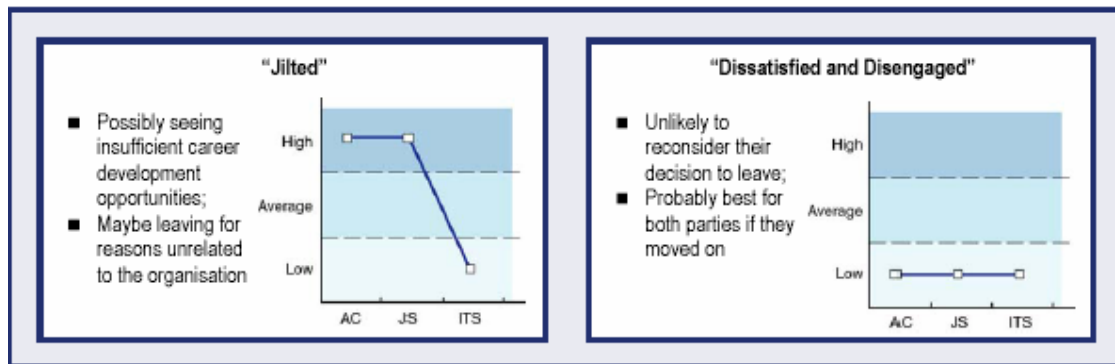
The AWA Report “teases out” various categories of both Stayers and Leavers, as set out below.

**Categories of Stayers:**



Note: AC = Affective Commitment; JS = Job Satisfaction; ITS = Intention to Stay

## Categories of Leavers:



### c) Relational Wealth

The extent of the relational wealth of the target firm provides the suitor firm with some guidance relating to the speed of integration and associated issues likely to be encountered when the M/A is consummated. Relational wealth:

- helps employees tolerate the changes that are required periodically to reconfigure the organisation;
- enables organisations to retain competent people and redeploy existing resources towards new strategic goals.

However, relational wealth cannot be easily acquired and cannot be imitated. The establishment of "healthy" psychological contracts (where high levels of trust exist between management and employees), underpins the building of relational wealth within an organisation.

The extended WRDI™ survey findings provide vital information on relational wealth, with the identification of deficits by workforce segment (e.g., unmet expectations, lower levels of trust and / or fairness, etc.). Additionally these extended WRDI™ survey findings provides an indication of workforce segment job "fit" and organisational "fit", which also form part of the overall assessment of relational wealth of the organisation,

The above information forms a basis for targeted interventions and associated costings, including the possible re-negotiation of psychological contracts with various workforce segments, consistent with the new business needs of the combined entity. In cases where the relational wealth of the target firm has been eroded or depleted, then this is likely to impose some constraints on the parent firm, in so far as the speed and extent of integration.

## 2. Post M/A Phase

Following the M/A, the WRDI™ should be used progressively to:

- assess workforce alignment (i.e., both employee – organisational "fit" and / or job "fit");
- predict turnover by workforce segment (including talented employees); and



- assess relational wealth.

As in the pre M/A phase, the AWA Report and extended WRDI™ survey information serves as a basis for progressively managing retention risk and enhancing alignment, with targeted interventions applicable both at an individual and organisational level, and building healthy psychological contracts with workforce segments (where applicable).

## Acknowledgements

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The WRDI Institute is one of the world's leading authorities on human capital, workforce alignment and retention. The WRDI Institute provides HR measurement and solutions in the following areas:

- Human Capital Assessment;
- Retention (including key talent retention risk assessment);
- Talent Management;
- Career Development;
- Organisational Development, including Workforce Alignment and Performance Enhancement;
- Industrial / Employee Relations (EBAs); and
- Post Recruitment Assessment.

The WRDI Institute has developed a suite of white papers on the following contemporary workplace themes:

- Creating "New Deal" Employment Relationships;
- Managing Your Human Capital: The Ultimate Determinant of Organisational Performance?
- Improving the Bottom Line: A Diagnostic Approach to Enhancing Workforce Alignment Through Career Development;
- About Turnover and Retention;
- Retention Intervention: A Strategic Approach;
- The Psychology of Mergers / Acquisitions;
- Employer of Choice: Putting Substance to the Rhetoric!
- The Balanced Scorecard and the WRDI™;
- Managing Expectations: Strengthening Recruitment Practices and Enhancing Retention.

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