Merging Rewards:

Paying for Business Change

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1 Introduction

Spending on takeovers and mergers in the UK in the first half of 2005 totalled £66 billion (KPMG/Dealogic, 2005). In the third quarter of 2005 alone, the Office for National Statistics reports that UK firms spent £7.2 billion on 173 transactions buying other UK companies, including the £835 million purchase of the Resolution Life Group by Britannic plc. Over the same three-month period, UK companies also spent another £7.8 billion acquiring foreign companies, with Barclays Bank's acquisition of the South African retail banking business, Absa Group for £2.6 billion one of the largest deals. Worldwide, Dealogic say that mergers and acquisitions (M&As) worth £1.774 billion had been completed in 2006, with European deals accounting for 40 per cent of the total volume. Recently a number of high-profile deals involving UK firms have been announced, including the £17.7 billion acquisition of mobile operator O2 by the Spanish company Telefonica; the £1.2 billion purchase of Marconi by the Swedish telephony business Ericsson; and the £7 billion merger between Boots and Alliance Unichem, with Boots Healthcare International sold to Reckitt Benckiser for £1.93 billion.

Though rarer, there are also examples of public sector organisations merging, such as bringing together the Inland Revenue and HM Customs and Excise into one organisation, HM Revenue & Customs, employing at the time of the merger more than 100,000 staff; and the creation of the Department for Work Pensions and the Department of Environment, Food and Rural Affairs from other government departments. Local authorities and health trusts have also been reconfigured, often involving amalgamation, Primary Care Trusts are a recent example of this.

Of a different nature but nevertheless generating some of the same challenges is the harmonisation of terms and conditions across an organisation. The most common situation concerns the ending of the status differences between blue and white collar staff to create a 'single status' organisation. Local government is currently nearing the end of a programme to harmonise pay and conditions across councils for comparable posts following the 1997 national single status agreement, with councils eventually given until 31 March 2007 to complete the process. Under the modernisation and pay equality agendas, national framework agreements that require the harmonisation of

pay and conditions have also been implemented in the NHS and in the higher education and universities sector. Here there is a broader bringing together of occupational groups with their different sets of terms and conditions into a common whole.

Single status has also been a feature in manufacturing industry, particularly in engineering, motor manufacture and the utilities sector. In 1994 the now defunct Rover became the first UK-based car manufacturer, outside of Japanese firms, such as Nissan and Toyota, to establish single-status conditions and pay structures for all employees (IDS, 2004a).

Merging terms and conditions following an M&A is referred to as horizontal harmonisation. Companies merge or acquire other firms for a number of reasons. The majority aim to create something greater than the sum of its parts. Some M&As are motivated by market dominance. Others seek to expand into new business areas. Most alliances or acquisitions will increase the size of a business considerably, so it can be a quicker route to growth than organic expansion. And the main objectives of a lot of M&As are operational efficiencies and strategic synergies. Whatever the rationale, research indicates that the majority of M&As are less than a total success, and some are a complete disaster. Alexander (2000) cites the results of a survey of chief executives by *Acquisitions Monthly* showing that only 37 per cent rate their acquisitions as either 'very successful' or 'somewhat successful', and says most academics conclude that around two-thirds of acquisitions do not reach expected performance. The CIPD (2003) says that international M&As are increasingly common. They are particularly problematic with legislative frameworks, ways of doing business and cultural differences providing hurdles not normally encountered in single-country mergers.

According to Alexander one the main reasons M&As fail is poor integration, which he describes as the 'most difficult task of all'. People and cultural issues are often a cause of failure in many business change programmes. A study by Mercer Consultancy found that people issues are largely ignored by organisations during M&As, even though they were regarded by those organisations participating in the research as the most difficult issues to address in a merger or acquisition (Personnel Today, 2002). Cartwright and Cooper (2000) report that between 50 per cent and 75 per cent of key managers voluntarily leave acquired businesses in the first two or three years, and that overall employee turnover rates can be as high as 60 per cent. Hewitt Associates (2003) say the key people management integration challenges are cultural fit, decision making, alignment of compensation and benefits, and organisational structure. The CIPD (2003) identifies the harmonisation of 'contracts, rewards and benefits' as an important phase in integrating the two organisations, warning that: 'to do so is economically costly; not to do so may have a negative impact on morale.'

Harmonisation of pay and conditions to create single status is called vertical harmonisation. IDS (2004a) caution that vertical integration is often harder to achieve than horizontal harmonisation. Cost is usually the main barrier to a smooth transition

to single status. Although IDS (2006) reported that 60 per cent of the councils it surveyed in England and Wales in 2005 had completed moves to local harmonised pay and grading, it also found that cost was the biggest barrier preventing successful single status. The pay analysts say there are numerous examples where the complete removal of distinctions between manual and white-collar staff have been problematic, with integrated pay structures, for example, producing 'winners' as well as 'losers' and sometimes provoking industrial action. 'Organisations without additional funds to call upon find solutions to harmonising pay extremely difficult. Increasing pay levels to the best paid within a grade is the easiest solution, but normally too costly. Doing the opposite, cutting pay to bring it into line, produces industrial strife,' says Reilly (2005). Part of the problem is the difficulty in integrating different approaches to pay and progression, with pay linked to performance appraisal more common for white-collar than for manual staff, while the latter are more likely to be covered by bonus arrangements than the former. And because moves towards harmonisation in the public sector tend to involve relatively large, unionised workforces, the process is often laborious, involving complex job evaluation, equal pay audits and endless negotiation.

2 Background

2.1 Overview

> *'Behind the headlines that corporate marriages generate are rough tactical and strategic waters that HR and compensation professionals must navigate. The journey is by no means simple, but the destination is worthy: the union of two sets of employees and pay structure that can ultimately influence the success of the merger and its return on investment.'*
>
> Wells, 2004

Consultants Towers Perrin (2003) report that transactions placing people management considerations and capabilities centre stage in the integration process have a higher success rate than deals that neglect people management. 'Putting people issues to one side in preference to sorting out processes and structures is a fatal mistake', warns Devine *et al.* (1998). Though the scale and type of HR interventions will depend on the objectives of the proposed amalgamation and the organisations involved, the key is to involve HR as early as possible in the M&A. However, US research in 2001 by Towers Perrin and the Society for Human Resource Management Foundation found that HR involvement in the critical early stages of M&As was uneven, and came too late in the merger process (Wells, 2004). According to Wells, of the four stages in the life of an M&A deal – pre-deal, due diligence, integration and implementation – HR tends to only have a big role in the later stages.

By contrast, HR is likely to be centre stage in moves to harmonise pay and conditions and establish singles status. IRS (2004) reports that to deliver a single-status pay deal for 550 employees, the HR department at Reigate and Banstead Borough Council had to evaluate all jobs, introduce new pay scales, harmonise conditions, bring in competency-based pay and shift from job descriptions to broader role profiles. The negotiation with trade unions over these changes also falls to HR to do (or at least lead on).

Using research by the CIPD, Brown (2004) advises companies to pay attention to people management issues and processes at all stages of the M&A process. At the planning and due diligence (see below) stages, he says firms need to determine the:

- cultural fit between the two organisations
- people strategy for the new organisation
- impact of employment legislation
- human risks that might emerge, such as the loss of key employees.

Brown also says HR has a specific role to play during the delivery stage, suggesting they determine, for example, what:

- new roles are needed
- merit-based selection process will be used to fill them
- employee relations, career structures, and appraisal and reward systems need to change
- staff are thinking
- will be required to build a sense of shared purpose and support?

However, research by Towers Perrin (2003) shows that HR is involved in less than half of the due diligence work on compensation/benefit plans of prospective firms and less than a third in designing new post-deal reward programmes.

Horizontal integration between two organisations or vertical integration within one organisation tends to follow similar paths, in terms of overcoming cultural and organisational barriers to change, and designing a pay and grading structure that is regarded as fair and motivating. In both circumstances, effective communication and consultation is vital, as is the need to achieve successful integration within a set budget. Nonetheless, no M&As are the same, so the people integration issues differ depending on the objective of the merger and the parties involved. Similarly, the rationale for single status or vertical integration tends to differ between private and public sector organisations, so giving rise to very different people management problems. Pay equality underpins the single status agenda in the public sector, whereas the harmonisation of pay and conditions in many private sector organisations is primarily driven by the need to more effectively utilise the labour force and reduce costs by simplifying personnel administration.

Despite sectoral differences, according to Armstrong (1999) the pressure for harmonisation has arisen for common reasons:

- New technology – status differentials can obstruct the efficient use of labour, so concessions on harmonisation are usually given in exchange for greater flexibility, and with technological advances effectively de-skilling some white-collar jobs and enhancing some former blue-collar ones, it is harder to defend differential treatment.

- Legislation – equal pay, discrimination and employment protection laws have extended rights to manual workers, perversely only available to manual staff groups, while the concept of equal value has challenged the differentiation between white- and blue-collar workers.
- Productivity – more flexible use of labour can improve productivity.
- Administration – harmonised pay structures simplify personnel administration, so reducing costs.
- Behaviour – single status can improve employee commitment, motivation and morale.

Acas (1982) suggests that organisations pursuing a programme of harmonisation ask the following questions:

- What differences in the treatment of groups of employees are a rational result of differences in the work or the job requirements?
- Is it possible to estimate the direct costs of removing the differences?
- What differences in status are explicitly recognised as part of the reward package for different groups of the labour force?
- What would be the repercussions of harmonisation?
- How do existing differences affect employment relations in the organisation?

2.2 Horizontal integration

Horizontal integration refers to aligning the terms and conditions following a merger or acquisition, with the different groups of employees coming together to form one organisation. Different types of merger and acquisition will have differing people integration and **people management** issues. For example, mergers that are designed to consolidate and reduce costs will have a very different primary driver (reducing headcount and/or payroll expenditure per head) than one whose main objective is expansion or acquiring intellectual capital (CIPD, 2003). Similarly, cross-national M&As will differ from single-country mergers. Faulkner *et al.* (2002), for instance, found significantly different HRM policies in companies of different nationalities. The CIPD (2003) reported that acquisitions involving US firms 'often led to a clear and distinct influence over the way that HR issues are handled', which occasionally caused problems. By contrast, the acquisition of a French business by a UK company had not resulted in many changes to HR policies.

Also, where one of the two parties to a M&A is dominant, which is generally the case, the integration issues will differ from one involving a merger of equals. In the former, the business model adopted is usually based clearly on the dominant partner, though management might use the acquisition as an opportunity to implement wholesale

change throughout the newly enlarged company. Where an M&A is a marriage of equals, decisions will focus on how to integrate their respective strengths into a hybrid of both firms.

Another influence on the post-merger integration is industry sector. Research by the CIPD (2003) suggests that the nature of the sector affects integration: what is required in the financial services or retail is quite different from what is required in oil or utilities. Size also plays a part: it is more difficult to integrate two very large organisations than two relatively small ones. Also the form of organisational structure and what is to be integrated plays a part – head offices are easier to combine if operational activity is distributed and little disturbed by the merger. By contrast, integrating together a whole series of business units will be more problematic.

2.3 Vertical integration

Vertical integration involves ending the status differences in organisations replacing them with common terms and conditions. This is often referred to as single status.

Single-status terms and conditions are generally believed to promote a sense of common purpose and promote flexible working practices (Milsome, 1993). Moves to harmonise terms and conditions between different groups of workers in the same organisation first began in manufacturing industry, with many domestically-owned producers in the 1980s copying the employment structures employed by overseas companies, particularly Japanese ones, establishing manufacturing plants in the UK. A survey of 25 Japanese plants in the UK found that 83 per cent provided single-status terms and conditions (Oliver and Wilkinson, 1992). Modernisation of public services in UK, which has been accelerating since the Labour government was first elected in 1997, has seen whole sections of central and local government, the NHS, and higher education edge towards single status arrangements.

The single-status agreement in local government, which signalled an end to distinctions between manual and white collar employees by merging the administrative, professional, technical and clerical grades with the manual ones, hopes to achieve similar objectives to those sought by manufacturers in the 1980s, especially increasing employees' flexibility and changing long-standing working practices (Suff, 2005a). However, unlike horizontal harmonisation following an M&A and vertical integration in private sector organisations seeking common terms and conditions, the programme to harmonise reward in the public sector has been driven by the need to ensure that pay and grading structures are in line with equal pay principles (IDS, 2006). HR and reward professionals have had to overcome organisational barriers to equal pay. 'In our experience, the real problem is not that of establishing equal value between jobs but of implementing changes to address acknowledged inequality,' says Acas (2005a).

In addition to equality proofing in pay, progression and promotion, IDS (2004b) say the common elements in modernising rewards across public sector include:

- simplified grading structures, based on job evaluation
- harmonised scales for different groups of staff
- new, integrated bargaining structures
- national pay spines
- single status terms and conditions
- harmonising the length of the working week.

2.4 Main people management issues

2.4.1 Due diligence

Due diligence – the process of examining aspects of a company to make sure its purchase would pose no unnecessary risks to the shareholders of the acquiring firm – is a crucial first stage in any proposed M&A. According to Reed Lajoux and Elson (2000), an M&A due diligence exercise assesses the benefits and liabilities of the acquisition, including obtaining information on finances, management and operations, and legal liability. Though people issues – such as talent retention and selection, and terms and conditions – are a key factor in the success of a merger, many organisations do not perform systematic HR due diligence prior to the deal going ahead. Hewitt Associates (2003) report that 40 per cent of organisations participating in a survey had no defined HR due diligence process and less than ten per cent of management time was spent on HR issues during M&A due diligence. However, Towers Perrin (2005) reports an improving picture, with two-thirds of senior HR executives participating in its survey claiming that HR is now involved in due diligence, and more than a third report HR involvement in the pre-planning, pre-due diligence stage.

IRS (2000a) reported on five M&As – the purchase of Bristol & West by the Bank of Ireland; the merger of legal firms Denton Hall and Wilde Sapte; the merger of Halifax Property Services into the Halifax banking division; the merger of Lloyds and TSB; and the merger of Price Waterhouse with Coopers & Lybrand. It shows that in practice there is no common time for HR to engage in the process, with HR at both Halifax and Bristol & West becoming involved from the start of the merger negotiations, while HR only became involved in the Lloyds–TSB merger once the deal was formally signed.

Yet, involving HR as early as possible is important as it enables the organisation to review the significant people and cultural challenges facing it once the deal is finalised. Mercer HR Consulting (2002) recommends that ‘key strategic and tactical

people issues should be analysed and addressed' during the pre-deal stage – before announcing the deal and starting due diligence. Cartwright and Cooper (2000) say the role of HR during the due diligence stage can be summarised as being to:

- Assess the suitability of the match in terms of factors which extend beyond those usually covered by due diligence, such as the legal and financial health, as well as to be prepared to act as 'cautionary counsel'.
- Raise awareness of the people issues and collect as much information as possible relating to human resources.
- Identify potential problems and areas of difference between the two organisations that may present barriers to integration.
- Begin the process of bringing the new management teams together and clarifying their intentions post-merger.

Playing a significant role in the M&A from the beginning of the process will enable HR to be proactive, helping to decide strategy and formulating plans, rather than reacting to decisions made elsewhere and HR staff doing little more than counselling anxious employees.

Early involvement will also indicate whether or not HR is in a position to support the necessary integration processes and manage the post-merger risks, or whether it will need to access additional resource, such as external support.

2.4.2 Corporate culture

No two organisations are alike: each will have its own unique environment and way of doing things. Merging two distinctly different organisations threatens custom and practice norms. It is only likely to be successful if what results from the merger is seen as better than before or, at least, not worse. Failure to establish a new culture for the merged organisation that is supported by the workforce will mean that some staff will continue to identify with their former employer and previous way of doing things, which may lead to conflict and resistance to incorporation into the new company.

HR has a crucial role to play in determining cultural fit – that is, how compatible the cultures of the two organisations are – and identifying potential barriers to integration. Reward can play a significant part, especially if reward is understood in the broadest sense to encompass all parts of the employment deal. For example, Cartwright and Cooper (2000) say that HR can glean an initial, pre-acquisition impression of the culture of an organisation by looking at such things as work environment – a key area of employee satisfaction. For example, a firm that has senior management dining areas and other restrictive facilities suggests an organisation strong on status and hierarchy, whereas one that places managers alongside their teams indicates a more informal, open culture. The level of employee involvement and consultation in change processes is another demonstration of management style

and organisational culture, and the approach used to integrate terms and conditions will signal a lot to employees about management attitudes.

HR can also assist the process of employee involvement by commissioning surveys of opinion during the merger process. IRS (2000a) reports that the use of employee attitude surveys by the HR teams at Denton Wilde Sapte and Halifax enabled them to identify concerns and the working practices staff wanted to retain. To assist the integration of Compaq with Hewlett-Packard in 2002, the new company established a system called 'Fast Start', which involved the new teams in HR and finance, for example, coming together over a few days to discuss the cultural differences between the two companies (Personnel Today, 2003). CSWP, a not-for-profit organisation in Warwickshire, conducted an 'organisation culture survey' shortly after it was formed from the merger of CSWP with the Warwickshire Careers Service and the Coventry-based Quality Careers Service (IRS, 2006). The results showed that the new organisation needed to be brought together better. The senior management team decided that harmonising terms and conditions was a good way of achieving this.

2.4.3 Communication and consultation

Communication is *the* most important people aspect of an M&A or a harmonisation process. Companies need to constantly communicate with staff throughout the merger process and beyond. People tend to feel threatened by change and anxious about the outcome so will seek out whatever sources of information they can on what is happening. According to Pritchett and Gilbreath (1996): 'If you're not filling the communication void, somebody will – with rumours, fear mongering, wishful thinking, warped information and even outright lies.'

Philippa Hird, HR Director at ITV, highlights the importance of communication during the merger integration process: 'We put an enormous amount into communications the whole way through the process (of the Carlton–Granada merger)' (Welfare, 2005). A report on the merger of Glaxo Wellcome and SmithKline Beecham by IRS (2003) also stresses that communication, particularly planning the dissemination of information, was vital to the creation of GlaxoSmithKline. Of the 12 lessons learned during the merger, the company's senior vice-president for human resources, David Jones, said: 'careful communications planning is the key' and that companies' need to be 'honest and open with people'. Lloyds TSB also placed communication top of the change agenda – alongside management structure and fairness – during the merger process. 'We wanted to make sure our message was regular and consistent', the company's head of employee relations, Peter Chadwick, told IRS (2000b).

Consultation is also crucial (the law requires companies to consult staff about certain aspects of a business transfer and about collective redundancies – see section below). ITV extended the network of communication groups that had first been set up in Granada in 1997 to all parts of the company after the merger with Carlton. Though

they operate separately, there is a joint strategy meeting once a year, involving the elected communication representatives and union representatives (sometimes the roles overlap). This feeds into the formal consultation process. 'No change happens in ITV unless we consult over it,' says HR director Philippa Hird (Welfare, 2005). She believes the consultation with staff on all aspects of building the new organisation, such as its structure and its selection criteria, was key to the success of the merger between Granada and Carlton. 'It works for the very reason that if you ask people on the ground about the way things should work you are less likely to mess it up', she comments.

2.4.4 The law

The terms and conditions of employees – not other workers, such as casual staff and contractors – transferring to a new employer following a merger or acquisition are protected under the Transfer of Undertakings (Protection of Employment) Regulations 2006 – which amended the 1981 TUPE legislation. TUPE essentially allows for employees' contracts of employment to transfer across automatically from the old employer to the new one, meaning that the new employment will be on the same terms and conditions that employees had previously received (CIPD 2006a). Discretionary benefits – that are not contractual – do not transfer, however.

The Pensions Act 2004 now provides for the protection of pension benefits of employees affected by a transfer of undertakings, as pensions are not specifically covered by TUPE Regulations.

Unlike the 1981 Regulations, the revised legislation, which came into force in April 2006, allow employers to make changes to existing terms and conditions under certain circumstances. TUPE 2006 contains the following provisions:

- Changes to employees' terms and conditions of employment will continue to be void if the sole or principle reason for them is the transfer itself, or a transfer-related reason that is not an ETO reason – that is, an 'economic, technical or organisational reason entailing changes in the workforce'.
- Transfer-related changes are permitted where there is an ETO reason for them, provided the changes are also agreed with the employees or their representatives.
- Changes for reasons that are unconnected with the transfer are permitted to the normal rules of contract – *ie* that employees' agreement is obtained.

According to the CIPD (2006a), where an employer's reason for altering terms and conditions is to harmonise them across the workforce, which is the usual reason, this will *not* be considered an ETO reason. It advises a new employer wishing to harmonise the terms and conditions of incoming staff with those of the existing workforce to:

- Establish a genuine reason for the proposed changes that is independent of the transfer.

- Apply the changes universally and not just to the employees who transferred into the business.
- Wait as long as possible after the transfer to minimise the risk that changes will be found to be connected with the transfer.

As a result, cautious employers will not tamper with terms and conditions, or, if harmonisation is a critical goal, will integrate upwards – *ie* adopt the highest common denominator.

2.4.5 Equal pay

One of the key principles underpinning the modernisation of pay structures, especially in the public sector, is equal pay. This is illustrated by the national framework agreement for higher education, which aims to 'support the achievement of equal pay for work of equal value, with the application of pay points to staff being transparent, consistent and fair.' The same driver for equality was behind *Agenda for Change* in the NHS. Growing concerns about legal challenges to historical structures under equal pay legislation was a factor, not least because over 65 per cent of public sector employees are female, compared with 41 per cent in the private sector. Also, as CIPD (2006b) points out in higher education, local government and the NHS 'there were for decades multiple and overlapping pay systems as well as some embedded discrimination in reward levels between traditionally **male** and **female** roles.' For example, *Agenda for Change* will see 650 different staff grades replaced by eight national pay bands

Reilly (2005) says the inequalities in the local government – as well as other parts of the public sector – have arisen through the lack of, or the use of different, job evaluation schemes and the selective use of bonus schemes, which have tended to boost the pay of the manual, largely male employees. A survey by the Employers' Organisation (1999) found that over eight times as many full-time male manual workers in local government as full-time women received a bonus – 52.7 per cent compared with 6.3 per cent – with almost a quarter of men receiving a bonus worth 40 per cent or more of total earnings.

Historical differences

Acas (2005a) highlights the types of practices in local government that can make it difficult to harmonise terms and conditions and overcome longstanding inequality. It contrasted the male refuse collectors in one local authority who were paid more than the predominantly female street cleaners, even though both jobs are potentially of equal value. The refuse collectors receive a set rate for a given round on given days, and are paid the same whether they complete it in five or eight hours. At the same time, the refuse collectors were entitled to bonuses for 'dirt money' and a lack of complaints. In addition, the team could choose to leave a post vacant and share the savings among themselves. Street cleaners meanwhile were paid an hourly rate with no bonuses. The different pay structures mean it is hard to calculate a comparable hourly rate for the refuse

collectors. Acas poses the following questions: In such circumstances, what does the local authority do? It cannot realistically take the collector's bonus away, but if it pays a bonus to the cleaners, on what basis does it pay? Crucially – and this is the key question – where does it find the money?

Equal pay legislation

The Equal Pay Act 1970 and Equal Pay (Amendment) Regulations 1983 require organisations to maintain a fair and orderly grading structure that is free of gender discrimination. The 1970 legislation – later amended by the Sex Discrimination Act 1975 and 1986 – gives a woman the right to equal treatment with a man where she is employed:

- on work of the same or broadly similar nature
- in a job which, though different, has been rated as equivalent to the man's job by a job evaluation scheme.

Under the 1983 Regulations, a woman can seek equal pay with a male comparator, who, although engaged in different work, does work of equal value in terms of the demands of the job. Employers can justify the difference in pay only where it is due to a material difference. The Employment Act 2002 introduced the equal pay questionnaire, which requires the employer to provide relevant information to a woman employee considering making an equal pay claim. The 1983 Regulations stipulate that a claim will fail if both parties – the claimant and her comparator – are covered by the same job evaluation (JE) scheme, unless the scheme can be shown to be bias on grounds of gender. Only analytical JE schemes are likely to provide a potential defence against a charge of sex discrimination because, unlike non-analytical techniques, the evaluation is more likely to be objective and transparent. By contrast, the focus by non-analytical techniques on the 'whole job' means that the status quo, and any underlying gender bias in the pay structure, is often perpetuated. (Acas 2005b)

2.4.6 Job evaluation

IDS (2003) reported that: 'increasingly, job evaluation is finding a rejuvenated role as a dynamic tool for driving forward changes in organisations' reward structures.'

One reason for the renewed interest in job evaluation (JE) is the drive for equal pay between genders, which was given added impetus by the 2002 Employment Act's introduction of an equal pay questionnaire that requires employers to supply information to help establish whether an employee is receiving equal pay with colleagues of the opposite sex. From an employers' perspective, an analytical JE scheme may provide a defence against equal value claims. Changes to the reward structures in much of the public sector have been based on the introduction of new job evaluation systems.

According to the CIPD (2005), job evaluation is desirable when the number of employees goes above 50 and essential when it exceeds 150. Traditionally, JE has been used for white-collar positions, but has gradually evolved to cover all types of jobs. As

well as potentially providing a defence against equal value claims, the main attractions of JE are its ability to provide a basis for the design and maintenance of a rational and equitable pay structure; to manage internal relativities; and, where an analytical scheme is used, as a potential defence against an equal value claim. And a properly conducted evaluation exercise will ensure the introduction of a new or revised pay structure is equitable.

2.4.7 Retention and redundancy

Retaining the services of the key employees the new organisation can least afford to lose – either because of their role or because they are influential within the company – is another crucial activity for HR. It also has to decide which employees to release. So HR has to motivate and generate loyalty among those individuals the organisation has identified as being important to the future of the business, at the same time as managing the departure of those earmarked for redundancy.

The M&A will give HR the opportunity to reassess roles and job descriptions, as well as clarify performance expectations before placing people in the new structure. The same is true when vertical integration is the aim. *Agenda for Change* (the modernisation of pay terms and conditions for the majority of NHS staff which began its national roll out in December 2004) ties pay increases to changes in working practices, especially the removal of the rigid demarcations between staff, and the creation of flexible teams made up of different clinical professionals (Suff, 2005b). Role redesign is a key feature of the drive to remove demarcations and change long-established working practices.

Amicus Group

The addition of 1066 Housing to Amicus Group provided an opportunity to re-examine roles (IRS, 2006). The Sittingbourne-based housing association replaced more than 300 individual job descriptions with a smaller number (around 100) of role profiles, which included a role purpose, a list of accountabilities and five key competencies. Once the role profiles were determined, staff were consulted through briefing sessions about where they had been placed, and the difference between their new role profile and the original job descriptions. Using mainly salary surveys, market rates were attached to each role profile. The salary rates are essentially spot rates, set at what the organisation calls ‘median plus’, which is described as ‘the point between the median salary according to our research and the upper quartile’. The group could not afford to pitch all rates at the upper quartile, but a few development roles are set at this level for recruitment purposes. Staff were informed of the changes once they were finalised. Colette Benham, HR consultant to Amicus Group, acknowledges that there was some scepticism among staff to the new arrangements. ‘Salaries are always going to be a sensitive area, so people will get wary when you talk about changes that will affect pay. The role profiles were more difficult to sell because we found that people were comparing with each other, and we had some challenges from those who were placed in different role profiles, who had felt they were in similar jobs before,’ she says.

Towers Perrin (2003) recommends that HR gets the 'talent inventory' completed quickly. The selection process to determine who stays and who goes needs to be perceived by everyone as fair. This can be realised through operating a transparent process with overt criteria for selection for the retained jobs. As new teams were established at ITV, the company posted details of the structures on its intranet giving staff details of how to apply for the new posts (Welfare, 2005). Most organisations make the severance or redundancy package suitably attractive to ensure staff deemed surplus to requirements leave relatively quickly and allow the focus to switch to constructing the new organisation.

Understanding the needs and expectations of those it wishes to retain can help to determine an appropriate retention strategy. Cartwright and Cooper (2000) say, for example, that individuals who thrive on autonomy can be motivated to stay by offering them greater responsibility, while those motivated by status can be reassigned a new job title. Some organisations use retention bonuses, which staff receive if they remain with the new company for a set, post-merger period, say six months. At GlaxoSmithKline, for instance, HR developed special compensation plans to ensure the retention of key talent and expertise (IRS, 2003b).

2.4.8 Pay, grading and benefits

Different pay and grading structures in the two merging organisations or where employees in the same organisation are covered by separate pay structures will need to be aligned. Other differing terms and conditions, such as different holiday entitlement and access to flexible working arrangements, will, in most cases, also require amending so that the workforce of the merged company all receive a similar level of benefits. According to Towers Perrin (2003): 'disparate benefits and compensation policies need to be integrated to align the company's employees with the senior management team's business objectives.'

Designing a common pay structure has often proved the hardest thing to accomplish during a vertical integration process. 'There are numerous examples where complete removal of distinctions between manual and white-collar staff has proved to be problematic. In some instances, key conditions, such as working hours have been harmonised, and status distinctions, like separate canteens or parking, ended; but pay structures remain separate,' says IDS (2004a). LRD (2005) reports that cost was delaying progress in developing new common pay and grading structures in local government, with some councils experiencing disputes due to the impact of job evaluation on pay, bonuses and conditions.

Though complete harmonisation of terms and conditions may be desirable, it is not always financially feasible or, in the short-term, logistically possible. Homebase retained its existing pay and conditions when it acquired the much larger Texas chain of do-it-yourself stores in 1995 (IRS, 1999). Former Texas employees were gradually moved to Homebase terms and conditions as their stores were converted to the new

format. e-reward (2002) reports that rather than go through a protracted harmonisation process when Norwich Union merged with CGU, the company initially confirmed staff on legacy terms and conditions before embarking on a radical redesign of its pay structure, which eventually replaced pay matrices with a total reward structure – including two broad bands, seven generic occupational groups and 19 career families – intended to reward high performers.

HR, and particularly compensation specialists, will have to devise a scheme that is fair but cost effective. Generally, this involves designing a completely new reward structure, though it can mean switching all employees to the existing terms and conditions in one of the two organisations. Even where aspects of the existing compensation arrangements are retained, the M&A provides an opportunity to get rid of any anomalies and to better link rewards to business goals. This is because the merger may factor in finance for a reward overhaul – an injection of money that might be denied in normal circumstances. For example, the post-merger integration between Lloyds and TSB involved the introduction of a whole new set of terms and conditions, based on a broadbanded pay system, as part of the vision to create a wholly new organisation (IRS, 2000b).

3 Pay and Benefits

3.1 Overview

The results of a pan-European survey of over 200 HR professionals by Mercer HR Consulting (2005) found that around a quarter (26 per cent) believe harmonising employees' pay and benefits is the most challenging aspect of a M&A. Around one in four (24 per cent) respondents participating in a CIPD (2000) survey said reward strategy was critical to the viability of a merger deal or to changing merger plans.

A key feature of HR's involvement in the due diligence process is to gather comprehensive data on all aspects of reward, and to ensure that the costs of harmonisation are included in the deal. Ultimately, changes to benefits and remuneration policies and processes should have no adverse impact on staff. One benefit that potentially poses a significant problem in an M&A situation is occupational pensions. Under-financed pension liabilities and increasing uncertainties surrounding defined-benefit pension plans can scupper an M&A. Private equity group Permira ditched its plan to buy WH Smith after failing to come to an agreement with the retailer's trustees about how to fill the £250m black hole in its pension fund.

Once the M&A has been agreed, as well as its impact on their employment prospects, employees will quickly want to know what affect, if any, it will have on their existing terms and conditions. Some of the questions on employment conditions that individuals will want swift answers to include:

- How will my terms and conditions change?
- When will I get a new contract?
- Will existing bonuses/share option schemes be maintained?
- Will sick pay arrangements change?
- What will happen to performance-related pay?

Though staff will want to know what is happening to their terms and conditions, organisations tend to take their time sorting out pay and benefit issues. If employees'

terms and conditions in one of the two companies are superior, however, there will pressure in the other for improvements, which, if not forthcoming, may trigger an increase in staff turnover. BGB, for example, experienced increasing restlessness among former Enron Direct staff that their bonus scheme and pension entitlement was less favourable than was provided to BGB employees (see case study section 4.2). Consultants Hays recommend that benefit packages are not immediately and unconditionally changed, saying that it is preferable to introduce a loyalty bonus to maintain stability throughout the harmonisation phase rather than move too quickly.

3.2 Reward strategy

The CIPD (2003) say that pay and benefits is the one issue where there is likely to 'obvious tension' when two companies merge. Pre-existing differences will quickly emerge, and will have to be addressed if people from the two organisations are going to work effectively together. TUPE Regulations, which protect most pay and benefits, mean that harmonising down to the lower-paid employees is a non-starter. Harmonising up to the better-paid employees may not be financially viable. Homebase, which paid £290 million to acquire Texas DIY in 1995, estimated that immediately harmonising the pay of Texas employees, who were generally paid less than Homebase staff, would cost around £10 million (IRS, 1999). Similarly, AstraZeneca put the cost of harmonising pay and benefits across the newly merged business at around £8 million a year (see case study section 4.1).

The potential costs of rapidly harmonising terms and conditions, means that differences tend to remain for some time after the merger. 'Most of the companies studied have adopted a highly pragmatic approach' to harmonisation, reports the CIPD (2003). Its research cites the example of an IT services business that has grown almost entirely through acquisitions, and, as a result, has 23 different sets of terms and conditions covering its 18,000 strong UK workforce. According to the report, this is not the approach the company would have chosen had it not had to comply with TUPE. It also cites the case of 'BritOil', a UK firm involved in a number of acquisitions, which has allowed pre-existing arrangements to continue. One deal resulted in the slow integration of pay (over two years) because the individuals' salaries in one of the firms were linked to overall business performance, whereas the pay of their colleagues in the second company was based on sales and customer-based targets. IRS (1996) found that the integration of employees' terms and conditions following the merger in 1995 of the then Halifax Building Society and Leeds Permanent Building Society was put back to a later date, with staff continuing on their existing terms until a new package was negotiated.

Eventually terms and conditions tend to be harmonised, often through the introduction of a wholly new pay and benefits package. After 18 months of operating two separate packages, British Gas Business (BGB) could no longer justify keeping staff previously employed by Enron Direct, which BGB had acquired in 2001, on different terms and conditions and rolled out a new package across the whole

company (see case study section 4.2) IRS (2000a) reports that Denton Wilde Sapte allowed nine months to pass post-merger before implementing a new pay and grading structure, while PricewaterhouseCoopers introduced a new structure for all employees within 12 months of its merger. The broadbanded pay system established at Lloyds TSB was implemented within 18 months of the merger. Vertical integration can be a lengthy process. IRS (1989) reports that tipping trailer manufacturer Crane Fruehauf expected its harmonisation programme to take five years to complete.

Taking time to determine the best approach to integrating terms and conditions allows the new company to complete its review of posts and audit of staff, and to develop a pay and benefits strategy that fits both the aims of the new enterprise and is targeted at key employee groups. The aims of the new integrated employment package at the Halifax, following its merger with the Leeds Permanent Building Society, were to help the organisation deliver its business objectives and provide the flexibility to enhance quality customer service as well as assist in its planned conversion into a plc (IRS, 1996). The merger of the Inland Revenue and HM Customs and Excise was an opportunity to restructure and reform the existing pay systems, with pay ranges, for example, shortened to allow speedier progression, and the pay band minima raised substantially for the lowest level staff (see case study section 4.3).

Time will also allow organisations to assess whether or not retaining differences in all, or some, terms and conditions is a long-term solution. IRS (2000a) found that the Bank of Ireland has retained broadly separate pay and grading structures at the Bristol & West since it acquired the former building society in 1998, though other terms and conditions, such as holidays, have been merged.

3.3 Pay

Benchmarking salaries is the first step in determining how best to solve differences in pay between workers in the newly established organisation. Following the merger of Carlton and Granada, for example, ITV carried out a remuneration review to benchmark management salaries against other companies in the broadcasting sector (Welfare, 2005). BGB used local data to benchmark the pay of Enron Direct staff and found that salaries had fallen behind the local median. Halifax began the process of integrating employees' terms and conditions following its merger with the Leeds Permanent Building Society by reviewing the practices and procedures existing in both organisations (IRS, 1996). A comparison of salaries paid to Homebase and Texas DIY staff following the former's acquisition of its bigger rival found that Texas staff were generally paid less.

Gaining a view of pay differences relative to the market, of course only provides an input into consideration of the next steps. Where two organisations position themselves differently against the market, a decision has to be taken as to the model the new company wants to take. This may result in choosing the pragmatic option – the cheapest or least difficult to implement. It may cause either a re-evaluation of

corporate perspectives and a change of stance, or it might mean the assertion of the lead partner (or acquirer's) reward strategy.

The integration of terms and conditions in a horizontal or vertical integration situation commonly leads to the introduction of a wholly new reward package. Following months of negotiation and using the Hay job evaluation method, employees at the Halifax, for example, were assimilated into a new 11-grade salary structure – previously the Halifax had operated a 12-grade, and the Leeds Permanent a 15-grade system (IRS, 1996). Salary levels were based on current market data and the new system provided an improved mid-point for the majority of pay grades, as well as a significant improvement in the way in which staff move through their pay range. Lloyds TSB also decided to create an entirely new set of terms and conditions rather than base pay arrangements for the new organisation on either the historic Lloyds or TSB packages (IRS, 2000b). It introduced a new eight-tier broadband pay system, with job families created, also using the Hay job evaluation method. The new system kept individuals' salaries at existing levels, ensuring that nobody was worse off overall under the new arrangements.

Most local authorities have used job evaluation to develop a new harmonised pay structure. IRS (2005) reports that South Gloucestershire Council extended the Hay scheme that already covered its white-collar workforce to its 3,500 manual employees and other occasionally-graded white-collar staff. It piloted the scheme to demonstrate its robustness in dealing with such employees. Under the higher education national framework agreement for the modernisation of pay, the allocation of staff into the new grading arrangements is based on the outcomes of institution-wide job evaluation/job analysis arrangements. Bonuses can present difficulties in moves to single status, not least because they may be discriminatory. Some councils (for example, West Sussex County Council, IRS, 2000d) have opted to consolidate bonus payments. Affected individuals will have the bonus element consolidated into their protected salary, but the grading of their jobs will be unaffected, so the unequal bonus effect will gradually disappear. Others have tackled inequality by introducing new bonus schemes.

Homebase took an alternative approach, preferring to gradually move Texas DIY staff to rates of pay enjoyed by its own workforce (IRS, 1999). Managers of Texas stores, for example, were often paid whatever was necessary to fill a post. To limit the immediate financial cost to the business, the move was spread over several years – parity was not achieved until March 1998, following the 1995 acquisition – with Texas staff receiving slightly higher annual pay settlements each year to move them closer to Homebase pay rates.

HMRC, which emerged from the merger of the Inland Revenue and HM Customs and Excise, has taken a middle path, introducing a new pay system but allowing staff to remain on their existing terms and conditions. Under the scheme, HMRC employees can choose to remain on their existing terms and conditions or opt to move onto the new system. Staff can decide to opt in at any time over the three-year lifespan of the

pay deal agreed with unions, though it will be increasingly less attractive to remain on existing terms and conditions. Pay ranges for opted-out employees will not rise higher than equivalent HMRC levels and anyone opting in at a later date will do so at their existing salary level, so will not benefit from any interim changes to pay under the new system.

3.4 Benefits

As well as different salary rates and pay structures, there are usually major differences in benefits. A review of the existing benefits in the Halifax and the Leeds Permanent Building Society found that while the two organisations operated broadly similar terms and conditions, there were important differences, including in holiday entitlements, working hours, area allowances, pensions, staff mortgages, car supply scheme, health insurance and policies connected with childcare (IRS, 1999). AstraZeneca uncovered quite significant differences, with staff in the Swedish-owned Astra receiving relatively few benefits compared with their colleagues in the British-owned Zeneca.

AstraZeneca decided to follow the example of PricewaterhouseCoopers and adopted a flexible benefits package to resolve the differences in the two companies' benefit provision that reflected their respective cultures. Whereas the Zeneca workforce was relatively 'benefits rich', enjoying higher holiday entitlement, for example, their colleagues in Astra generally had higher basic salaries. AstraZeneca rolled out its flexible benefits package, called Advantage, in April 2001. Under the scheme, a fund – based on the actual cost of each benefit – is calculated for every member of staff based on their existing contractual terms and conditions. It includes a core package of benefits that everyone is entitled too, but everyone has enough in their fund to purchase the same level of benefits they had previously be given. So, former Zeneca staff can choose to convert some of it to buy the holiday entitlement they had previously received or spend it on other benefits or convert it to cash. The company also used individuals' Advantage fund as the comparator to set salary rather than existing base salary. IRS (2000c) reports that the insurance company Zurich Life introduced a flexible benefits system to smooth the harmonisation of its terms and conditions following its complex merger.

The Halifax took opportunity to simplify and improve some employee benefits after its merger with the Leeds Permanent (IRS, 1996). The four levels of holiday entitlement available for each grade under the existing arrangements in both organisations was replaced with two for each of the new grades, while all staff switched to the concessionary mortgage scheme in operation at the Halifax.

4 Case Studies

4.1 AstraZeneca: merger in 1999 of Swedish company Astra and UK firm Zeneca

UK-based Zeneca and Sweden's Astra AB formally merged in April 1999, creating one of the world's largest pharmaceutical companies worth around £41 billion. At the time, the company said it was committed to the fast and effective integration of the two companies into a single, coherent and new organisation, as well as delivering the synergy benefits promised by the merger. A key area of focus was on retaining and attracting the best talent. The company said this would be achieved by building a culture which values, recognises and rewards outstanding performance in all aspects of its business.

4.1.1 Quickly and efficiently

Though the executives of both Astra and Zeneca had agreed the terms of the merger in December 1998, HR could not really get going working on the process for bringing the two organisations together until the companies formally merged almost five months later. The instruction from the board to HR was to integrate the people aspects of the merger as quickly and efficiently as possible. HR adopted the Pareto Principle (80–20 law) to ensure it focused on the 20 per cent of things that initially really mattered, such as retention and recruitment, and integrating terms and conditions, leaving the remaining 80 per cent to later.

The pace of integration demanded by the board meant that there was little time for any 'gold plating'. Decisions on the best way forward had to be taken quickly. Rather than design an entirely new redundancy package, for example, HR simply decided to allow individuals made redundant to choose the best, given their own personal circumstances, of the three schemes operating across the two businesses. Zeneca itself had been established following the demerger of ICI's pharmaceutical operations in 1993, so most UK staff remained on some terms and conditions, including redundancy, inherited from ICI. Astra had two redundancy schemes: one covering

staff at its Loughborough research and development site, and one for its sales and marketing operation.

4.1.2 Total reward solution

Both Astra and Zeneca operated entirely different benefit structures and took a completely different approach to base salaries. Whereas Zeneca offered a wide range of benefits, Astra's offering was limited. And while base salaries at the Swedish-owned operation were relatively high compared with comparable jobs in Zeneca, employees of the UK firm enjoyed a much better holiday entitlement. So, the Zeneca workforce was relatively 'benefits rich', with salaries generally below the market median. By contrast, Astra's terms and conditions were more 'cash-oriented', with relatively high salaries and few benefits.

It was estimated that harmonising terms and conditions by adopting the highest common denominator principle – raising everyone's pay and benefits to the highest – would increase paybill costs by £8 million per annum. Instead, AstraZeneca chose a total reward solution to bring parity, as well as to ensure no negative impact on individuals' pay and benefits.

Working with consultants from Hewitt Associates and having seen Price Waterhouse adopt a similar approach when it merged with Coopers Lybrand, AstraZeneca developed a flexible benefits package called 'Advantage', which was rolled out in April 2001. Under the scheme, a fund – based on the actual cost of each benefit – was calculated for every member of staff based on their existing contractual terms and conditions. The scheme includes a core package of benefits that everyone is entitled to, including 22 days holiday, for example. However, Zeneca employees, who typically had a much higher holiday entitlement, have enough in their fund to purchase up to another 9.5 days holiday, though they can choose to convert it to cash or spend it on other benefits, such as critical illness cover. Similarly, Astra staff can choose to spend some of their remuneration on additional holiday entitlement. Employees select their benefits annually each May.

Instead of harmonising salaries by raising them across the company, individuals' Advantage fund was used as the comparator to set salary, rather than existing base salary. This ensured that the value of the more comprehensive benefits package provided to Zeneca employees was taken into consideration.

In addition to changing benefits and salaries, AstraZeneca also had to resolve differences in pension entitlement and approach to bonus payments. At the time of the merger, Astra still operated a final salary pension scheme, while Zeneca had closed its defined-benefits scheme to new members in 1996. The merged business has taken similar action and closed the Astra scheme to new members, replacing it with a company-wide defined contribution scheme.

Pre-merger, Astra paid a flat-rate cash bonus to all employees, while Zeneca's bonus arrangements were linked to individual performance and included both cash and equity schemes. The AstraZeneca bonus scheme is similar to the previous Zeneca arrangement.

4.1.3 Getting the figures right

The introduction of Advantage was a wholly new experience for both organisations. At the time, flexible benefits were still relatively rare in the UK and almost totally unheard of in Sweden. However, it has proved a popular move and did so right from the start. Though most people tend to leave their benefits package unchanged when a flexible scheme is first implemented, this was not the case at AstraZeneca, with around 70 per cent of employees making changes when Advantage began.

Both companies strongly promoted the scheme. Initial staff concerns centred mainly on how their individual fund had been calculated, so HR personnel were available to explain how the calculation was arrived at and reassured them as to its validity.

Four years later, there are still some cultural differences in the benefits staff select. Employees previously employed by Zeneca still tend to take more holiday than those who had worked for Astra, for example. For the company, administration of Advantage has increased overall paybill costs, but the rise is considerably less than the estimated £8 million cost raising everyone's pay and benefits. And changes to the tax system since AstraZeneca established Advantage – such as an 11 per cent saving on childcare vouchers – means that flexible benefits arrangements are now very cost effective.

4.2 British Gas Business: acquisition of Enron Direct in 2001

British Gas Business (BGB), which provides gas and electricity to businesses and is part of the energy company Centrica, acquired Enron Direct from the stricken US energy supplier Enron for £96 million in December 2001.

Enron Direct, with around 160,000 European business customers, mainly in the UK, employed almost 300 staff at its Oxford base. The challenge was to integrate the business with the much larger BGB operation, retaining key staff and Enron Direct's core strengths, particularly its entrepreneurial competence.

According to Jill Shedden, HR director at BGB, HR was involved in the acquisition right from the beginning, carrying out the usual due diligence exercise in the first few days after Centrica took the decision to potentially acquire Enron Direct. Due diligence covered, for example:

- pension scheme and pension liabilities
- fixed bonus issues

- staff skills, capabilities and experience
- management team
- organisational culture.

Enron Direct was a highly profitable business, with a very commercially astute workforce. Its strengths included the ability to get products to market quickly, therefore being more responsive to its customers' needs. BGB was very keen to retain the Enron Direct staff and to allow the company's strengths, such as its entrepreneurial culture, to continue to flourish. The aim was to combine the two businesses under a new identity without losing the unique strengths of either, explains Shedden. She says it was as much about using Enron Direct to push through cultural change within BGB as it was about integrating the new business.

HR painted a vision of what the new business would look like and how it would be achieved, which it called the 'continuum'. An eight-foot notice board was erected illustrating the continuum, timescales and progress. BGB pursued a deliberate strategy of allowing the existing Enron Direct management team to continue to run the business in the first few months following its acquisition. The only major visible BGB presence was a general manager, who was assigned to assist the existing management team.

BGB adopted a two-stage approach to harmonising terms and conditions. After six months, the Enron Direct workforce was given a substantial salary rise following a market comparison exercise that revealed their pay had fallen below the local market median. Within 18 months new terms and conditions were rolled out across the whole business. According to Shedden, BGB could no longer justify the differences in pay and benefits between the two businesses. She says that there was increasing restlessness among former Enron Direct staff that their bonus scheme and pension entitlement was less favourable than was provided to BGB employees. Shedden explains that because HR had established an effective communication and listening infrastructure at Enron Direct it was well placed to detect the growing discontent and act quickly to prevent it posing a serious problem, such as losing staff.

Communication was assisted by BGB's open and visible management style and this was transferred to Enron Direct. So, for example, groups of Enron Direct staff were invited to discuss business issues and concerns with the BGB team overseeing the transition. Shedden says it is important to respond quickly to concerns. Managers and team leaders from both organisations were brought together regularly to share information and to break down barriers.

Retention of key people was the biggest issue faced by BGB at Enron Direct explains Shedden. The duplication of roles was speedily resolved so any insecurity among the workforce was removed. 'We had to quickly make up our minds whether we wanted them or not,' she says. 'We did not want to create uncertainty.' HR adopted a selection process that identified the best person for the job. Several Enron Direct personnel,

including many of its HR team, moved into senior positions within the new integrated business.

Shedden was also involved in Centrica's acquisition of the AA in 1999, and which it has subsequently sold. She says the company learned much from the purchase of the motoring organisation, particularly that the buyer does not always know best and should be prepared to spend time understanding what already works well and do everything to retain it.

4.3 HM Revenue & Customs (HMRC): merger in April 2005 of the Inland Revenue and HM Customs and Excise

On 18 April 2005, the direct and indirect taxation bodies, the Inland Revenue and HM Customs and Excise, formally merged to form HM Revenue & Customs (HMRC). At the merger the new body employed more than 100,000 staff and, among others, is responsible for collecting the bulk of tax revenue as well as paying tax credits and child benefit. At the same time as integrating two distinctly different organisations, HRMC is charged with making efficiency savings under the Gershon Review that will involve a reduction in the workforce and, consequent on the Lyons Review, the relocation of many workers from London to other parts of the UK. HMRC is also restructuring the way it functions, with the emphasis shifting to focusing more on its customers.

The merger followed a review of organisations dealing with tax policy and administration, and the Chancellor announced plans to merge the Inland Revenue and HM Customs and Excise in his 2004 Budget. HR in both organisations began preparing the ground, particularly on how to harmonise terms and conditions, some nine months before the formal coming together. To aid the process the HR functions in both organisations were united on 1 November 2004.

4.3.1 Focusing on culture first

Before beginning work on terms and conditions, the main focus of HR activity was identifying the best HR and management strategy for the new organisation. As both the Inland Revenue and HM Customs and Excise were well-established organisations with a long history and their own deep-rooted cultures, the aim was to adopt a style that combined the strengths of both while carving out a distinctive culture for the new service.

The Inland Revenue had a 'centralised' HR and management strategy, whereas HM Customs and Excise used a 'decentralised' approach. The new combined organisation has largely adopted the approach used by HM Customs and Excise which affords line managers a prominent role in people management. The model of HR delivery is still being completed but is likely to combine the consolidation of administrative services into shared services, and the embedding of business partners in business units.

4.3.2 Terms and conditions

Harmonising terms and conditions was particularly complex, and governed by the need to adhere to the principles of the Cabinet Office Statement of Practice (CSOP) which ensures TUPE-like protection, as well as having to comply with equal pay legislation. The aim was not to harmonise up to the best in the two former organisations as this was financially unsustainable, but to find a mechanism that would accommodate both the TUPE and EPA requirements without having the same impact on paybill. The new pay and benefits package also had to be flexible enough to accommodate a rapidly changing organisation.

The reward team charged with devising a new system has developed a mechanism that allows individual members of staff to either remain indefinitely on their current terms and conditions or move to a new HMRC pay and conditions package covering pay, grading, allowances and leave. This 'opt-in' arrangement (see below) was fundamental to the three-year pay settlement agreed with unions.

Creating the new HMRC pay and benefits package was also an opportunity to restructure and reform the existing pay systems. Several pay ranges, for example, have been shortened so that progression, which has long been a concern in the civil service, will be quicker in future. The pay band minima were also raised – by around 16% for the lowest level staff, bringing them well above the National Minimum Wage threshold.

4.3.3 Opting in or out?

Under the pay agreement, HMRC employees were able to choose to remain on their existing terms and conditions (ie of their former departments) or opt to move onto the new system. Individuals had to decide whether or not they will benefit from the new system. HMRC put in place a variety of tools – including an intranet briefing pack, question and answer documents, a telephone helpline and a dedicated online mailbox address for advice – to help them make their decision.

Staff can decide to opt in on the effective date of the pay award during the three-year lifespan of the pay deal, though it will be increasingly less attractive to remain on existing terms and conditions. Pay ranges for opted-out employees have been frozen during the three-year period and will not rise higher than equivalent HMRC levels in future. Anyone opting in at a later date will do so at their existing salary level, and may not benefit from any interim changes to pay under the new system. A major assimilation exercise was undertaken in June 2006 (there will be another in June 2007 for staff who decide to opt in from 2007), which moved individuals opting in to the HMRC system on to a point in the HRMC pay range based on the number of years of satisfactory or better performance in the grade. This ensured that staff from both former departments and staff from other Government departments were given equal treatment. (The two former departments had very different pay/grading structures).

Though there has been extensive communication with staff regarding the new pay and benefits package, HMRC continues to work with the trade unions to generate support among the workforce. Raising the pay band minima for the lowest paid staff as well as introducing speedier pay progression has helped to get union buy-in and they recommended that staff accept the deal.

Whether or not individuals opt into or out of the revised scheme, they will still be subject to a revised performance management system that is closely linked to the HMRC pay system. Under TUPE it is only contractual issues, such as grading, pay and leave that are covered, whereas the new organisation is free to implement new non-contractual elements, including revised people management policies.

5 Conclusions

Horizontal harmonisation is often a priority for merged organisations as they try to create an effective new organisation from the two or more businesses joining together. Harmonising long-established terms and conditions – vertical integration – is often much more difficult. This kind of integration can often founder as employee groups seek to protect their position vis-à-vis other groups and hold on to long-established pay arrangements, such as bonuses not always available to others.

HR needs to be brought into both the horizontal and vertical integration process as early as possible. People and cultural issues are the biggest hurdles to a successful M&A, so HR involvement in the planning and due diligence stages that accompany an M&A is crucial. Due diligence should uncover issues that will require immediate attention, and the integration of terms and conditions of employment is one area that can produce tension between the parties. Though HR should take its time to develop its reward strategy for the new organisation or to establish single status, it may be required to implement interim measures, such as a loyalty bonus or raising pay rates in one of the two organisations/employee groups, to bring them more in-line with salaries in the other, to ensure key staff do not leave.

Most terms and conditions of employment are covered by TUPE Regulations, which means harmonising down to the lower paid employees is a non-starter. At the same time, harmonising up to the better-paid employees may not be financially viable – though this will depend mainly on the numbers involved (both in terms of employees and the differences in salaries). The pursuit of single status and an end to the inequality of pay and conditions in the public sector has, in many cases, opened a can of worms, with numerous councils facing legal challenges. Existing bonus schemes, for example, are often vulnerable to equal pay challenges – particularly those that cover predominantly single sex groups.

Developing an integrated pay and benefits package should be pursued once the talent and role audit, and, if applicable, reduction in headcount, has been completed. Benchmarking existing terms and conditions is the starting point to developing a viable solution to the integration of pay benefits. The most common strategy is to develop a wholly new set of terms and conditions that do not disadvantage anyone,

though some organisations simply switch staff from their existing terms to what is on offer in the, usually, larger of the two businesses, possibly buying out certain benefits that are no longer regarded as core. Whatever strategy is adopted, most organisations use the M&A as an opportunity to review existing arrangements to ensure the reward package is aligned with business objectives, and to remove anomalies and improve aspects that are of concern to staff, such as pay progression.

More and more companies, particularly where an M&A involves the amalgamation of two fairly large businesses, are introducing flexible benefits to harmonise benefits throughout the new organisation without substantially increasing costs. The creation of a benefits' pot or fund enables individuals to purchase the same level of entitlement as under their existing terms and conditions, thereby avoiding a negative impact on anyone, irrespective of the scale of their current provision.

Whatever reward strategy is selected, it will need to be considered fair by employees and in some cases this will demand greater transparency than in the past.

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