Benefits and HR in Mergers and Acquisitions

Kelly Karger
Senior Retirement and Merger and Acquisition Consultant
Towers Watson
Minneapolis, Minnesota

Steve Kueffner
Senior International Consultant and Global Merger and Acquisition Engagement Leader
Towers Watson
Detroit, Michigan

The opinions expressed in this presentation are those of the speaker. The International Society and International Foundation disclaims responsibility for views expressed and statements made by the program speakers.
How HR adds value in an M&A: The big picture

- Companies that judge their merger deals as successful focus more heavily and more effectively on key people issues, such as change and communication, as well as other traditional people issues.

- These same organizations are also more apt to emphasize strategic people management—for example, influencing leader behavior.

- Successful organizations are more likely to measure key people elements of the deal than their less successful peers.
How HR adds value in an M&A: The big picture

- Companies with successful deals are more likely to involve HR earlier, and more heavily, in all phases of the M&A transaction.
- Even in successful deals, there is room for HR improvement in the effectiveness of supporting a number of critical areas.
HR Professionals can contribute at each stage of the deal

**Stage 1: Target Evaluation**
- Finding compatible business ventures and partners

**Stage 2: Due Diligence**
- Ensuring the deal is sound and establishing the value proposition

**Stage 3: Integration Planning**
- Defining the blueprint for all aspects of the merged entities

**Stage 4: Implementation**
- Executing the merger integration plan for the new enterprise
HR Professionals can contribute as stage setters…

- Identify issues/plan for due diligence
- Develop “go/no-go” criteria/templates for assessing people and organizational/cultural fit
- Assess the organizational and people strengths/weaknesses of possible M&A candidates
- Develop HR-specific M&A guidelines
- Educate the Deal Team on critical people and change issues
- Screen candidates for their cultural fit and identify possible implementation issues (e.g., unusually high turnover)
- Work with senior management to determine the integration philosophy
## Carry out pre-evaluation and pre-deal preparations

<table>
<thead>
<tr>
<th>Area</th>
<th>Internal Focus (Pre-deal)</th>
</tr>
</thead>
</table>
| **Project Management**   | • Identify capabilities, tools and technologies  
                           • Identify approach to address capability gaps  
                           • Understand geographical expertise and shortfalls  
                           • Confirm understanding of transaction and integration philosophy  
                           • Identify decision criteria |
| **Key Talent**           | • Identify and benchmark key internal talent                                                                                                                                                                           |
| **Benefit Programs**     | • Ensure understanding of current plans and programs                                                                                                                                                                   |
| **Labor Relations**      | • Understand internal capabilities and geographical reach                                                                                                                                                             |
| **Systems**              | • Ensure understanding of current systems for gap analysis  
                           • Identify internal capabilities                                                                                                                                                                                    |
| **Employee Communications** | • Understand internal capabilities and geographical reach  
                                 • Ensure transaction strategy is understood and communication toolkit builds on overall business goals                                                                                       |
| **Culture**              | • Ensure understanding of existing culture and clarity on transaction strategy and potential implications for existing culture                                                                                   |
# Evaluate targets

<table>
<thead>
<tr>
<th>Area</th>
<th>Focus on Target</th>
</tr>
</thead>
</table>
| Selection Criteria        | - Identify geographical requirements  
                           - Prepare to secure additional capabilities in light of target and transaction requirements  
                           - Develop go/no go criteria                                                                                                                                 |
| Key Talent                | - Review publicly available data, including accounts and proxies  
                           - Develop hypotheses on potential issues                                                                                                                                 |
| Benefit Programs          | - Review publicly available data and filings  
                           - Develop hypotheses on potential issues                                                                                                                                 |
| Labor Relations           | - Review publicly available data and filings  
                           - Develop hypotheses on potential issues  
                           - Identify local country labor law requirements                                                                                                                                 |
| Systems                   | - Prepare to deploy resources as transaction develops                                                                                                                                 |
| Employee Communications    | - Identify geographical implications and gaps                                                                                                                                 |
| Culture                   | - Review publicly available information  
                           - Review national and geographic cultural implications  
                           - Develop hypotheses on potential issues                                                                                                                                 |
Best practices for target evaluation

- Conduct early intelligence gathering
- Compile company plans and programs to be able to compare to target
- Conduct side-by-side analysis on key human capital areas
- Note any issues for integration planning
HR Professionals can contribute as deal enablers…

<table>
<thead>
<tr>
<th>Target Evaluation</th>
<th>Due Diligence</th>
<th>Integration Planning</th>
<th>Implementation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finding compatible business ventures and partners</td>
<td><strong>Ensuring the deal is sound and establishing the value proposition</strong></td>
<td>Defining the blueprint for all aspects of the merged entities</td>
<td>Executing the merger integration plan for the new enterprise</td>
</tr>
</tbody>
</table>

- Estimate ongoing people costs (e.g., pension liabilities, special programs for executives or expats)
- Estimate people-related transaction costs (e.g., change-of-control, severance, retention bonuses) and savings
- Assess integration/cost issues for organizational and people-related computer application systems and HR practices and programs
- Estimate people-related savings (e.g., workforce reductions, plan consolidation)
- Conduct a cultural due diligence review (e.g., identify and assess cultural differences)
- Recommend HR policies and programs
- Validate the target company’s intangible assets (e.g., knowledge capital, organization capabilities)
- Work with senior management to communicate a clear vision; develop employee communications strategy
- Begin identification of key talent and retention planning
What is due diligence?

- Due diligence is the systematic, comprehensive, coordinated collection and analysis of target data—soft and hard data
- Due diligence provides:
  - A glimpse into a company (e.g., fast shutter-speed, one exposure, snapshot)
  - A basis for bidding (e.g., thorough, forensic) (ammunition for deal team to adjust deal price and terms)
  - Identification of potential “deal breakers”
  - An understanding of costs and risks related to the company acquired regarding restructuring, leadership selection and development, people-related liabilities, workforce engagement requirements
- Outputs of due diligence
  - Cost analysis of people and programs for pro forma financial analysis
  - Key findings report to evaluation team and leadership team: completed evaluation, integration planning and legal templates
  - Specific areas identified to probe further: a completed outstanding issues template
  - Identification of potential integration issues and synergies
### Defining due diligence concerns—Key questions

<table>
<thead>
<tr>
<th>What are the People Assets we are Acquiring?</th>
<th>Adverse Margin Impacts?</th>
<th>Is the People Cost Reasonable?</th>
<th>Potential Redundancy/Workforce Flexibility?</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Profile key management</td>
<td>• Understatement of ongoing program costs</td>
<td>• Benchmark a few jobs</td>
<td>• Goodwill issues/morale</td>
</tr>
<tr>
<td>• Evaluate organization</td>
<td>• Severance payments</td>
<td>• Benchmark staffing levels in a few functional areas</td>
<td>• Procedure steps, including consultation</td>
</tr>
<tr>
<td>• Skill profile/development programs</td>
<td>• Commitments to future cost increases</td>
<td>• What is the root cause?</td>
<td>• Legal barriers</td>
</tr>
<tr>
<td>• Demographic characteristics</td>
<td>• Collective agreement commitments</td>
<td>• Demographics?</td>
<td>• Union/works councils issues</td>
</tr>
<tr>
<td>• Retention plans for key talent</td>
<td>• Expatriates</td>
<td>• Overstaffing?</td>
<td>• Temporary/contract workers</td>
</tr>
<tr>
<td></td>
<td>• Relocation expenses</td>
<td>• Expatriates</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Adverse Balance Sheet Impacts?</th>
<th>Adverse Revenue Impact?</th>
<th>How Will the People Fit Together?</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Change of control triggers</td>
<td>• Sales incentive plan design</td>
<td>• Cultural barriers</td>
<td>• Compliance</td>
</tr>
<tr>
<td>• Pension, welfare liabilities understated</td>
<td>• Likely employee turnover</td>
<td>• Different job definitions</td>
<td>• Governance</td>
</tr>
<tr>
<td>• Contracts with executives may contain future liabilities</td>
<td>• Retention plans</td>
<td>• Different reward structures</td>
<td>• Illegal payments</td>
</tr>
<tr>
<td>• Book accruals understated (e.g., vacation, sales commission, profit sharing)</td>
<td>• Severance plans</td>
<td>• Incompatible processes and structures</td>
<td>• Discrimination</td>
</tr>
<tr>
<td></td>
<td>• Pending industrial disputes</td>
<td>• Duplicate jobs</td>
<td>• Acquired rights</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Payroll and HRIS</td>
</tr>
</tbody>
</table>
Country-specific issues must be addressed during due diligence

Many countries have local laws and practices that can have a significant effect on the price of a deal—for example:

<table>
<thead>
<tr>
<th>Country</th>
<th>Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>Pension under-funding, Plan tax status, Termination indemnities, Small group insurance costs</td>
</tr>
<tr>
<td>China</td>
<td>Employment laws vary by province, Many benefits are set by law, Unrecognized benefit costs and liabilities, Severance liabilities, Compliance, Unused time off not accrued</td>
</tr>
<tr>
<td>France</td>
<td>Triggering of individual and union rights, Post-retirement medical and life, Termination indemnities, Early retirement incentive plans, Formal and informal severance plans, Employee housing subsidies, Complex labor environment, Individual employment contracts</td>
</tr>
<tr>
<td>Germany</td>
<td>Triggering of acquired rights, Variation in pension valuation methods, Restrictions on asset transfers, Elimination of pension discrimination policies/practices, Implementing retirement plan mergers, Complex labor environment</td>
</tr>
<tr>
<td>Japan</td>
<td>Complex compensation programs, Variation in pension valuation methods, Restrictions on retirement plan changes, Restrictions on asset transfers, Employee housing subsidies, Loans at below market rates, Unused time off not accrued</td>
</tr>
<tr>
<td>India</td>
<td>Termination indemnities, Compliance, Total compensation environment, Complex compensation programs, Loans at below market rates, Unused time off not accrued</td>
</tr>
<tr>
<td>UK</td>
<td>Transfer of Undertakings, Triggering of acquired rights, Pension liabilities include indexation, Difficulties in recovering surpluses, Additional benefits provided by trustees, Funding issues related to multi-employer plans, Management agreements</td>
</tr>
</tbody>
</table>
Best practices for due diligence

- Secure integration budget—early
- Get the right team in place—global know-how is key for cross-border deals
- Ensure decision-making processes are understood, decisions are expedient and outcomes are communicated deliberately and effectively
- Don’t underestimate the complexity—even on a single-country basis
- Talk financials and let business partners make business decisions
- Ensure proper valuation approach and cost modeling
- Clearly articulate the extent of possible synergies
  - Flag wording alterations that limit flexibility in designing or implementing HR programs to support the synergies
- Pay attention to implicit commitments, not just plan rules, and watch for unfunded arrangements such as post-retirement benefits, individual promises and foreign plans
- Ensure that existing employee relations are understood
- Don’t insist on ideal solution—80/20 may have to do
- Don’t expect to be where you want to be overnight—understand priorities and plan on transition time
HR Professionals can contribute to integration planning...

- Outline people vision, strategy and guiding principles; form issues integration teams
- Develop strategy and tactics for organizational and people-related aspects of merger integration, including rewards, workforce management, change management, labor relations, talent retention, productivity enhancement, and feedback and communications programs
- Implement the communications strategy
- Plan and lead the organization design effort; define the organization blueprint and staffing plan
- Manage ongoing and transitional activities of the integrated HR function
- Help the new organization cope with change and manage labor relations
- Monitor employee attitudes and engagement
Three undeniable truths set the tone for the integration planning phase of a transaction

- Regardless of how solid the deal rationale is, how creative the structure and financing, and how good a price was achieved, **not one penny** of value is created until the organizations are effectively integrated.
  - Integration planning starts at target evaluation; as due diligence findings emerge, these are factored in and a full plan is built during integration planning.

- Planning without action is a daydream; action without planning is a nightmare!

- Those who wait until close to plan integration are destined to disengage employees.

**Integration planning begins during the evaluation phase and is continually refined until implementation.**
Best practices for Integration Planning

- Understand the deal structure and implications
- Understand the purchase agreement obligations
- Understand if transition services will be provided and, if so, the services, costs and time horizon
- Define the work required of HR and for human capital integration only after understanding the deal rationale, business strategy and business objectives (financial, customer, operational)
- Know who and where the critical talent is in order to achieve the value of the deal—and invest in retention prior to deal close
- Understand international legal and regulatory requirements as an input to integration planning
- Define the structures, roles and talent needed and skill the integration team members well before the transaction is “in full swing”...learning while doing is not acceptable in transactions
- Define and actively manage the critical path for Day 1 and Day 100
HR Professionals can contribute to successful implementation...

- Align total reward systems and other HR policies, programs and practices with selected HR systems and business requirements
- Manage the staffing and selection process to ensure the best talent is retained
- Manage ongoing change management, employee communication process and other people-related transition programs (e.g., redeployment, relocation, outplacement and severance processes)
- Advise executive management on dealing with various transition issues such as cultural, leadership, productivity, work environment and communication issues
- Monitor progress of merger integration regarding organizational and people-related objectives and ensure momentum is sustained
- Execute organization blueprint and staffing for HR function
- Ensure capture of synergies via incentive plans
100 day implementation planning and support

- Assess priorities from risk assessment and focus on what is critical
- Set up 100 day team and change sponsors
- Include dedicated board and senior management time
- Plan resource inputs and support required
- Plan how and where to involve managers and staff in both organizations
- Decide performance measures to ensure:
  - Business as usual is maintained
  - No short-term drop in performance
  - Quick wins are identified
- Focus on communications effort
What goes wrong in the first 100 days?

- Ineffective change process—wrong actions in wrong order
- Lack of sensitivity to employees
- No communications strategy
- Lack of leadership—no clear vision or objectives
- Culture clashes not managed effectively
- Information systems fail to meet needs
- No clear accountabilities and performance measures
HR will face many challenges and opportunities throughout the integration process

<table>
<thead>
<tr>
<th>Challenges</th>
<th>Opportunities</th>
</tr>
</thead>
<tbody>
<tr>
<td>✗ Helping with the overall company integration while also transforming their own function</td>
<td>✗ Making transformational progress in dramatically shorter time period than possible under “normal” business</td>
</tr>
<tr>
<td>• Often realigning before the vision, strategy, and leaders have been established</td>
<td>• Shifting resources within the HR function from transactional and administrative work to more strategic and consultative roles</td>
</tr>
<tr>
<td>• Managing multiple organizational roles with limited resources</td>
<td>• Leveraging technology (e.g., to enable employee and manager self-service applications and processes)</td>
</tr>
<tr>
<td>• Supporting HR employees as they try to support the merger efforts, manage their “day job” and deal with the ambiguity of the staffing process</td>
<td>✗ Taking advantage of an opportunity to interact with other functions more than during “normal” business and increase visibility of HR function</td>
</tr>
<tr>
<td>✗ Building a business case for investing time and money in redesigning the HR function</td>
<td>✗ Demonstrating HR’s project management expertise and business acumen regarding the transformation and organizational change, thus setting the stage for a strengthened role in the new company</td>
</tr>
<tr>
<td>• Delivering on aggressive synergy targets, while trying to build an HR function that meets business needs</td>
<td></td>
</tr>
<tr>
<td>✗ Managing the difficulty of integrating technology solutions that meet the needs of the new business from two very different existing technology platforms</td>
<td></td>
</tr>
</tbody>
</table>
Best practices for implementation

- Avoid short-term fire fighting superseding integration process
- Ensure change sponsors are equipped to lead
- Be careful of integration team isolation
- Support keeping the leadership team aligned and monitor key leader behavior
- Create room for innovation
Understand the core of each legacy company’s culture and the future state culture

<table>
<thead>
<tr>
<th>How</th>
<th>How</th>
<th>What</th>
</tr>
</thead>
<tbody>
<tr>
<td>Culture Emerges or Transforms</td>
<td>Behavioral Norms Impact Cultural Descriptions</td>
<td>Outcomes</td>
</tr>
<tr>
<td>Mission, objectives, values and strategies</td>
<td>Leadership: directive vs. inclusive</td>
<td>Safety outcomes</td>
</tr>
<tr>
<td>Brand promise</td>
<td>Strategic planning: long vs. short term</td>
<td>Quality of products/service</td>
</tr>
<tr>
<td>Leadership words, actions, focus, recognition</td>
<td>Expenditures: investment vs. cost orientation</td>
<td>Process efficiency</td>
</tr>
<tr>
<td>Country/regional economics, politics, cultural norms</td>
<td>Employee performance: engaged vs. passive</td>
<td>Customer experiences</td>
</tr>
<tr>
<td>Organization structure, function and processes</td>
<td>Decisions: action vs. analysis</td>
<td>Business partner relationship</td>
</tr>
<tr>
<td>Total Rewards</td>
<td>Information sharing: open vs. guarded</td>
<td>Business results</td>
</tr>
<tr>
<td>Organizational and individual performance measures</td>
<td>Power: performance vs. position based</td>
<td>Shareholder value</td>
</tr>
</tbody>
</table>
Understanding national cultural differences is essential to the success of the transaction

Linear-Active, Multi-Active Reaction Variations

Assess both organizational and national culture

Several types of measurement can help identify and assess an organization’s culture

<table>
<thead>
<tr>
<th></th>
<th>Qualitative</th>
<th>Quantitative</th>
<th>Interactive</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Methods</strong></td>
<td>• Meetings</td>
<td>• Surveys</td>
<td>• Focus groups</td>
</tr>
<tr>
<td></td>
<td>• Interactions</td>
<td></td>
<td>• Working session</td>
</tr>
<tr>
<td></td>
<td>• Interviews</td>
<td></td>
<td>• Dialogues</td>
</tr>
<tr>
<td></td>
<td>• Document review</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Timing</strong></td>
<td>• Throughout, but primarily in due diligence</td>
<td>• Primarily during the integration phase</td>
<td>• During integration</td>
</tr>
<tr>
<td><strong>Tools</strong></td>
<td>• Consistent data collection instruments</td>
<td>• Change readiness surveys</td>
<td>• Dialogue guides</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Culture comparison surveys</td>
<td>• Team-building techniques</td>
</tr>
<tr>
<td><strong>Roles</strong></td>
<td>• HR, Deal Team and ITLs with early access</td>
<td>• HR, ITLs (execution)</td>
<td>• HR</td>
</tr>
</tbody>
</table>

Identifying the “right” cultural assessment methodology to accelerate integration is critical
Best practices for Culture

- Each company must recognize the value of a distinctive shared company culture that:
  - Supports outstanding performance
  - Exceeds customer expectations
  - Incorporates the best of each culture
  - Recognizes weaker or clashing elements and plans to manage these
  - Allows for incorporation of benchmarked best practice
- Allow employees to provide input and give them the opportunity to buy into shared company culture
- Understand that culture change is part of the broader business/organization changes; not a separate initiative
Best practices for Culture (continued)

- Face employee resistance and emotions head-on; don’t hope employees will “get used to things eventually”
- Model desired behavior
- Don’t impose a “one size fits all” philosophy on how the change is implemented and fail to recognize cultural differences across regions/functions
- Don’t underestimate the amount of leadership time and development needed, but define leadership more broadly than just the senior team
- Ensure that all culture surveys and assessment methods are followed by effective communications
Retention programs are generally a necessary investment to promote stability among key employees

- Approximately half of all companies going through a corporate transaction implement a financial retention program (more prevalent in the US than Europe and larger companies are more likely to use retention programs)

- Typical objectives of transaction-related retention bonuses are:
  - Provide continuity of key management
  - Ensure that employees critical to the ongoing operation of the business are retained
  - Minimize distractions over possible loss of employment, and provide a level of financial security during periods of uncertainty
Retention programs are generally a necessary investment to promote stability among key employees (continued)

- Most programs provide for a cash or stock award payable at the end of a specified period (generally between six months and two years)
  - Cash programs are the most common form of an award
  - Stock-based programs are generally reserved for executives or top talent and for retention periods that span more than one year
- Arrangements are often tiered by organizational level
Retention programs are generally a necessary investment to promote stability among key employees

- As retention periods lengthen, award multiplies typically increase to offset greater opportunity costs to key employees
- Payment can be tied to performance criteria; however this dilutes the retention value of the program
- Most plans pay retention awards at the end of the retention period, although if this is longer than a year, payments may be made in installments
- Retention periods vary, but typically range from as short as six months to as long as two years
- Typical award sizes:

<table>
<thead>
<tr>
<th>Employee Group</th>
<th>Typical Range of Retention Bonuses as a Percentage of Base Salary (For Each Year of Retention)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executives</td>
<td>50%-150%</td>
</tr>
<tr>
<td>Middle Management</td>
<td>30%-75%</td>
</tr>
<tr>
<td>Professional/Non-Exempt</td>
<td>10%-40%</td>
</tr>
</tbody>
</table>

In selected industries, such as financial services, prior year’s bonus may be used as a reference for denoting the retention award versus a percentage of base salary,
Questions?