Mergers and Acquisitions

A Board's-Eye View of People Risks in M&A

By Jeff Cox

When managing merger and acquisition (M&A) transactions, business leaders can no longer afford to let people-related issues take a back seat. To drive value, organizations must understand and manage the people risks with the same discipline and rigor as other balance sheet risks. Directors' responsibilities must be aligned in governing deal flow to drive shareholder value, protect the balance sheet, and mitigate risk.

Understanding People Risks

People risks in M&A transactions arise from individuals' inability to manage uncertainty and embrace change, which results in declining organizational performance and loss of transaction value. Poorly executed integrations, the failure to consider culture and organizational fit, and unclear employee communications are prime examples of people risks that undermine deals and destroy value. If unaddressed, these risks can lead to low morale, reduced productivity, the loss of key talent, diminished performance, and revenue and profit loss.

More than ever, the challenge of managing talent—especially in the face of organizational transition—is the biggest concern for dealmakers, according to Mercer's 2016 report, *People Risks in M&A Transactions*. The study draws its findings from survey responses from 323 M&A professionals on both the buy and sell sides; 78 in-depth interviews with corporate and private equity sponsors; and analysis of nearly 450 M&A transactions during 2015, of which over 60 percent were cross-border.

Rising to the Challenge

Our research shows that buyers are increasingly recognizing that the people-related aspects of running a business are fundamental to driving return on investment. As a result, buyers are shifting their focus. When evaluating a deal, buyers are not just looking at customers, products, and access to markets; they're also looking at the people spend and return on investment associated with the deal.

At the same time, over 34 percent of the sellers surveyed report that people-related issues are demanding more time and resources to protect value on exit. Our findings indicate that sellers are spending more time on human resources (HR) issues than ever before, and are facing challenges that include divesting assets with defined benefit pension (and other long-term employee obligations) while maintaining core operational performance during exit.

With average costs of salaries and benefits exceeding 40 percent of total business expenses, board members have a responsibility to understand and address key people risks in a transaction—especially since more than half (55 percent) of corporate and private equity buyers we surveyed report that talent challenges will remain a significant HR issue in future M&A transactions. Employee retention is the No. 1 perceived risk, followed by cultural fit and leadership team concerns such as selection, skills and capabilities, and attraction and retention.

Driving Value

Whether your company is buying or selling, your responsibilities as a board member remain the same: drive shareholder value, protect the balance sheet, and mitigate risk. Adopting a people-focused approach allows you to deliver on these critical responsibilities.

Buyers should conduct talent assessments, develop effective retention strategies, and craft a clear communications and change management plan. Other key actions include enlisting experienced external resources to support the transitional management team and leveraging market-based total reward programs to attract and retain the right talent.

Sellers should consider implementing a retention program for employees who influence key customer relationships to maximize purchase price; leveraging experienced sell-side advisors and separation specialists to expedite the sales process; providing a sensible, appropriately priced (cost-plus) transition services agreement to mitigate reputational risk; and documenting a clear talent management and staffing plan to determine which employees will stay with the parent and which will go to the new organization.

Prioritizing people-related issues at the outset of a transaction makes a material difference. As one director we interviewed observed, "Addressing human capital risks early is fundamental to successful M&A." Only by first recognizing the importance of people risks, and taking timely action to address them, will companies succeed in today's global economy, where talent is now the greatest source of competitive advantage.

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