



Leading through
transition
Perspectives on the
people side of M&A

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Introduction

Mergers and acquisitions (M&A) present both opportunities and challenges for the executive team charged with leading the organization through these transactions. M&A activities drive significant change within your organization and can create complex situations, especially when it comes to managing employee transition. After all, getting it right with your organizations' greatest asset — your people — is critical to Day One success and beyond.

This compendium is intended to provide company leaders with a deep dive into the human capital complexities you are likely to face during an M&A transaction. The articles explore many of the common people-related integration challenges and offer recommendations for how to approach these situations to meet your organization's specific needs.

We have divided the articles into five chapters that span the M&A lifecycle: Due Diligence, Integration Management, Integration, Post-Merger Integration and Divestiture. The articles can be read beginning to end, or individually by going directly to the chapter that pertains to your current interest or situation.

We hope you find this compendium and its breadth of topics a helpful resource. To discuss any of the ideas presented here, please contact:

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Section 1: Due Diligence

Learn as much as you can as quickly as you can in order to make the appropriate decisions.

The Top 10 Myths of Human Capital Due Diligence

By David Carney, Eileen Fernandes, John Fiore and Glen Lipkin



Due diligence is the thorough investigation an acquirer performs prior to purchasing a target company. Insightful and material due diligence prior to consummating the deal greatly increases the likelihood that the acquirer will achieve the expected strategic goals and synergies. It is important to learn as much as you can as quickly as you can, so the due diligence team can make the appropriate decision.

Human capital due diligence is an important piece of the overall due diligence process, yet for some reason it is too often underestimated or undervalued. Thorough human capital due diligence is much more than just benefits and compensation analysis. It is a critical component of an effective merger and acquisition (M&A). The fact is, personnel-related expenses are typically the largest selling, general, and administrative (SG&A) expense items on the income statement of most companies — correctly identifying significant cost increases and hidden liabilities could account for millions of dollars in a transaction.

In a number of ways, the due diligence process is similar to buying a car. It is very tempting to look at a nice, bright, shiny car and say: "I will take that!" But remember — you do not want it just to look good. You will be spending a lot of time with the car, and it needs to run well. And for most individuals, a car is a significant investment. So before you buy, you need to check under the hood, pump the brakes, and kick the tires or you might end up still on foot! Let's take a look at 10 of the biggest M&A — and carbuying — myths.

Myth #1: Human capital, tax, finance, accounting, legal — we all speak the same lingo

I can drive it, surely I can fix it

Human Resources (HR) due diligence is tightly linked to the due diligence efforts of tax, finance, and accounting. Just because everyone on the team is skilled at due diligence does not mean that they necessarily will understand each other's findings. Each functional due diligence team needs to understand all the valuation assumptions, how its work will influence the Earnings before Interest, Taxes, Depreciation and Amortization (EBITDA) pricing model, and how its work integrates into the larger puzzle. Traditional and extended human capital due diligence teams often find it easier to report their findings in their "native human capital tongue," which may be a different language than what the rest of the team expects and understands. Mechanics who fix domestic vehicles are not always the most appropriate choice to fix imports! Because all due diligence findings are eventually quantitative and represented in certain broader financial metrics, the human capital due diligence teams need to be sure that various items, such as pension expense, errors and omissions (E&O), directors and officers liability insurance (D&O), incurred but not reported losses (IBNR), and per employee, per year cost (PEPY), are converted to financial metrics, such as EBITDA and pro forma statements. The often technical human capital due diligence also needs to be represented in the universally understood financial language.

Keys to achieving results:

- Understand on what basis the company is being valued.
- Work closely and communicate effectively with everyone on the team.

It may look like an imported sports car, but it runs like a lawnmower.

Myth #2: Human capital due diligence work is stressful and repetitive — it is not worth the effort

Finding the car of my dreams is not worth the effort, what I have now is fine

Mergers and acquisitions create highly visible opportunities for the acquirer, the target, and the professional services firms that support them. With high risk comes high reward: due diligence projects often entail long hours filled with operational details and a frustrating lack of information. However, those long and intense hours are often offset when a deal closes, and the newly established entity or merged company goes through a seamless transition, and successfully starts realizing the deal rationale.

Conducting human capital due diligence is a beneficial training ground for all parties involved, and the acquirer, the target, and the professional services firms benefit. Going through the due diligence process, all parties benefit from the knowledge exchange in working with highly skilled and knowledgeable project teammates and leaders of their specialty. Human capital due diligence provides clients the benefit of working with industry-leading professionals and benefit from their functional knowledge both deep and broad.

Keys to achieving results:

- Set the tone for your team on the deal. Is it a sprint or a marathon?
- Become a sponge — you'll gain a wealth of knowledge working with accomplished individuals.

Myth #3: Benefits and compensation. What is the big deal? Why bother?

The engine looks nice and shiny; I'm sure the car runs great

It is critical to understand that personnel-related expenses are typically the largest expense item on the company's income statement. Correctly identifying significant cost increases and hidden liabilities could account for millions of dollars in a transaction. Human capital financial due diligence evaluates several areas within HR and other related functions. Human capital due diligence specialists have broad and deep experience in a wide variety of areas — much more than an HR generalist. Legal liability is a technical area with many codes and acronyms, such as PBGC, 280G, 162(m), CIC, Section 75, etc. Due diligence teams need to look at legacy liabilities, such as pensions; post retirement medical, health care, and insurance costs; parachute payments; and deferred compensation plans — to name just a few.

Keys to achieving results:

- Don't underestimate the risks inherent in the "benefits and compensation" line.
- Understanding the feasibility to transfer financial statement risks.

Myth #4: Diligence is diligence, regardless of whether it is for a strategic or financial buyer

Buying a car for myself is the same as buying one for my spouse

Professional services firms thrive on developing effective, innovative, and insightful methods and approaches that can be applied repeatedly to various clients. While leveraging leading practices and sticking with what has worked in the past usually works well, this "one-size-fits-all" approach may not always work in due diligence. M&A deals are divided according to the type of investor buying the company. "Financial" buyers are individuals or investment companies (for example, private equity funds) seeking acquisitions that provide favorable cash flow. "Strategic" (also referred to as "corporate") buyers are companies seeking to acquire other companies to acquire operational economies, additional market share, technology, or some other synergy. Understanding the environment provides the due diligence team with the appropriate focus to uncover material findings. For example, while strategic deals may focus more on culture, leadership, and synergies, financial deals may focus solely on costs.

Keys to achieving results:

- Know and understand your buyer.
- Prepare for the end at the beginning.



Myth #5: A dollar equals a dollar

Cars are maintenance free, no need for me to budget money for repairs and upkeep

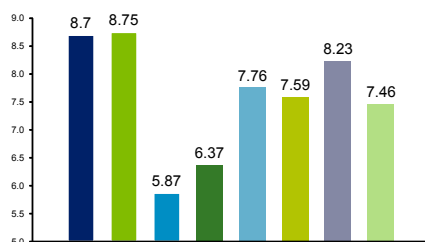
The path to pricing a company is lengthy and complicated. It requires hundreds of pages of financial modeling and a web of strategic and operational analyses. Boiled down to its simplest form, the price that the buyer and seller eventually agree upon is generally a multiple of EBITDA. Because this multiple is greater than one (see below), a dollar is worth more than a dollar because each uncovered dollar could affect the purchase price by \$5-\$10.

Keys to achieving results

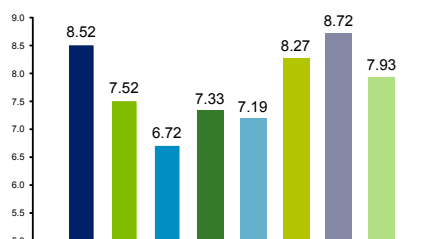
- Understand the general multiples.
- Keep perspective.

Figure 1: Average Purchase Price Multiples – a dollar is worth more than a dollar

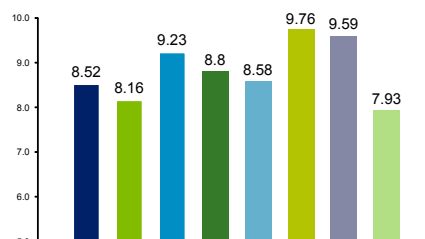
Average purchase price multiples strategic LBOs < \$250M



Average Purchase Price Multiples Strategic LBOs \$250M - \$499M



Average Purchase Price Multiples Strategic LBOs \$ >= \$500M



Source: Standard & Poor's LCD



Myth #6: Size does not matter

SUV or roadster – a car is "just" a car

Great market conditions and enormous amounts of available cheap debt have brought investing into a brave new world. Multibillion dollar strategic buyers and private equity investors alike have the leverage to make deals topping over \$30B.¹

At the same time, while the top end is increasing, there are smaller companies and literally hundreds of private equity funds making countless deals of \$1B or less.² Before focusing on what is material, you need to understand the considerations around the size of the deal. For example, a \$100M payment due on change in control is crucially material as it could kill a \$1B deal. However, in a multibillion-dollar deal, \$100M could be pennies on share value.

Keys to achieving results

- Evaluate the environment and assumptions and have perspective.
- Don't sweat the small stuff (unless the deal size requires it).

Myth #7: We're HR benefits specialists — there's no need to mix with the bean counters

I do not need to check with other family members before buying a car

In a simple world, everyone sits in an assigned cubicle and works within the scope of his or her own job. But in today's virtual and highly interconnected world, global companies are interdependent — sharing resources, programs, and systems. It is integral to overall due diligence results for the human capital diligence team to work

¹ "M&A Stats," Standard & Poor's, March 2007, Vol 9, No.3.

² Ibid.

side by side with the accounting, tax, finance, and legal diligence teams. Financial and accounting teams will have data HR may not have access to, such as detailed trial balances and cash flow statements. There may be overlap with certain legal and tax issues; so it is important to complement and not duplicate. Working as one team is critical to identifying and managing interdependencies.

Keys to achieving results

- Work together to assemble all the pieces.
- Organize centrally and work as one team.

Myth #8: Online data rooms make life so much easier

Buying a car online takes just two "clicks"

There's no question that advances in technology have dramatically changed the way we work. Software programs and electronic tools are designed to facilitate cooperation and increase efficiency and productivity. On M&A deals, data rooms are an integral part of the due diligence process. A traditional data room is literally an actual room — secure and continually monitored — where advisers visit to inspect and report on the various documents and data available. Often only one bidder at a time is allowed, and in large due diligence processes, teams have to be flown in across the world to remain available throughout the process. An alternative is a virtual data room — an online repository with limited users, controlled access, and restricted functionality for forwarding, copying, or printing. There are pros and cons to both kinds of data rooms, so do not automatically assume that online data rooms will make your life easier.

Online data rooms can control costs, save valuable travel time, and give the due diligence team members the ability to sleep in their own beds at night. However, being able to meet face-to-face with the target, or physically meeting with your team members in a war room, can create an environment that is more conducive to open communication and can lead to additional valuable insight. Therefore, while online data rooms may allow you to work 24x7, both options should be considered based on circumstances of the deal at hand.

Keys to achieving results

- Do not assume all online data rooms are the same.
- Be flexible.

Myth #9: I will get all the data I need

Car brochures tell me everything I need to make an informed buying decision

Due diligence often sounds easier than it is — the team goes in, asks for all the documents, reviews them, writes a report, and voila, DONE! In reality, it is rather amusing (or scary) that multibillion-dollar companies lack documentation ranging from an accurate count and roster of all employees to inventory of all benefits programs, to documented policies and business processes. Even if you do receive the desired documents, it will often be 10 minutes before your report is due. To add to that, it is important to note that timing is everything. The typical conversion rate for document response in M&A years is 1 day = 1 week — kind of like dog years. Therefore, be ready to go with the flow and be alert 24x7 — treat every discussion with management as your one and only bite at the apple. You will quickly learn to live with incomplete data and use your own judgment to fill in the gaps. Just be sure to clearly document the holes and any assumptions you have made.

Keys to achieving results

- Establish a two-way dialogue.
- Work with the target team, not against it.
- Show the target you are serious about the process.

Myth #10: It won't hurt if I just tell a few people what I am working on — it is so cool!

Telling the car dealer how much I am willing to pay doesn't put me at a competitive disadvantage

There is no doubt that M&A projects are attractive and prestigious — high risk/high reward, high input/high output. It provides you with an opportunity to work in a high-stakes, highly visible environment involving top specialists in the field. It is natural to want to share the excitement with friends and family. However, that may be a very costly and detrimental mistake. In today's business environment of extra scrutiny and attention to ethics, the person you try to impress could cost you big time. To control the integrity of the deal price and avoid irrational movements within the company and the market, M&A deals are highly confidential until publicly announced. As professionals, our commitment to integrity is our code and must be honored 100% of the time.

Here is a real-life example of what could happen otherwise. Early in March 2007, the U.S. Securities and Exchange Commission announced that it had frozen \$5.3 million in profits from unusual patterns in trading of a large energy company's options a few days before the February 26 announcement of its leveraged buyout. Regulatory organizations closely monitor activity globally, and irregular patterns on call options and stocks purchases are detected and prosecuted, as in this case. Do the "front-page test" before sharing your excitement about work — how would you react to reading about your actions on the front page of *The New York Times*?

Keys to achieving results

- Integrity
- Integrity
- Integrity

Conclusion

Although due diligence is routinely performed when acquiring or selling a company, it is often conducted too quickly or too narrowly, focusing primarily on how a company has historically performed financially. And while financial, legal, and environmental due diligence is critical to the effectiveness of any acquisition, it is not everything that needs to be considered. A multidisciplinary approach — one that includes human capital — is far more powerful and revealing.

The bottom-line: human capital due diligence is a critical results factor when it comes to M&A. Human capital due diligence can significantly increase the likelihood that a deal will meet its objectives.



Anatomy of Acquisitions

A guide to Human Resources Management contributions in the early phase of a buy-side transaction

By Kevin Knowles



Mergers, acquisitions, spin-ins, spin-outs, divestments, joint ventures, and strategic partnerships each represent business transactions outside a company's normal course of business. A fundamental problem exists in every transaction for human resources (HR) practitioners on the frontline: they contribute too little to the transaction at the point in time where they would add the most value. The objective of this article is to put transaction activities and HR management accountability into a practical context so that HR practitioners can more effectively engage, accept accountability, and contribute to the transaction process from beginning to end.

There are seven flags outlined here that indicate where the effectiveness of the HR contribution is compromised and five points for HR organizations to consider when building competency in nontraditional business transactions. This is not intended to be a detailed review of the HR process, but rather an overview of a portion of the transaction process rarely viewed by HR practitioners. There are many nuances and specifics beyond this discussion that should be explored by any HR practitioner beginning a project.

1. & 2. A transaction project presents unique HR challenges to both the buying and selling companies. If an HR team is unaware of a strategic gap in the company, then consider this red flag number one. If the HR team does not know how the people strategy incorporates nontraditional business requirements, consider this red flag number two.

HR Accountability

Confirm your people strategy accommodates or recognizes the potential for nontraditional business relationships. Acquisitions, joint ventures, and strategic partnerships will demand similar competencies to complete the transaction effectively, but the people strategy will differ significantly.

3. Once a business team has settled on a business transaction as the solution to the problem, searching for a suitable target ensues. If the project is a surprise to the HR team, this would be red flag number three.

HR Accountability

Know the labor market in which your target competes for talent. Alert the HR team, shared services teams, and other HR stakeholders with the potential of a significant project that will test their individual capabilities, as well as the HR organization's standard operating practices.

4. Target company identification is usually based on technical or market factors that close the strategic gap in the existing company's product or market strategy. A preliminary valuation and one-sided assessment of the target begins, and will conclude, when the company is comfortable, economic value is established for the target, and certain terms of an agreement are accounted for (i.e., the negotiation strategy is understood). If the HR team does not have an educated guess at all human capital value drivers with the target before taking a recommendation to the corporate board, consider this to be red flag number four.

HR Accountability

Know your target, its leaders, and their interests and motivations. Know what it will take to retain intellectual capital, restructure the company, integrate infrastructure, and quickly establish new employment relationships.

At this point, HR infrastructure is not on the radar. Stay out of the details and work to the business case. Do not wait for a formal due diligence period. Later this article outlines where all of the groundwork for key decisions that determine 80 percent of the transaction's value will be determined, before you reach formal due diligence and negotiation.

5. The company takes its recommendations to the proper corporate body to get approval to move ahead with economic issues, terms and conditions, and other unique considerations.

HR Accountability

Economics will include such factors as the value of the transaction to employees, the value of any retention to be applied to employees, the rationale for such a value, executive compensation issues, employment relationships, restructuring, impacts to the existing HR infrastructure, etc. If the approving corporate body does not have visibility to these costs, consider this red flag number five.

6. The company's recommendations are approved. The company may now approach the target and begin to implement its negotiation strategy. An outcome of early negotiations is a Letter of Intent or a similar document and an agreement that the two parties will negotiate exclusively for a specific period of time. If the HR team is still out of the loop at this point in time, consider this red flag number six.

HR Accountability

As noted earlier, 80 percent of the groundwork for key decisions is laid before a formal due diligence period. A Letter of Intent may propose the disposition of things like employee stock options, employee benefits, treatment of executives, restructuring, employment agreements, and the disposition of any unique items, such as change in control agreements, promissory notes, or acceleration of equity. There may be some administrative items included here, such as protections under IRS Section 280G(a) and some covenants regarding confidentiality and maintenance of standard operations in the time period between negotiations and due diligence.

7. Upon agreement of the terms, both parties will agree to a formal due diligence process. This will be completed in the period of exclusivity. Concurrent with due diligence will be a variety of critical negotiations.

HR Accountability

As a contributor to formal due diligence, HR validates all of the preliminary work already underway in the project analysis, identifies potential risk to the business plan, identifies liabilities, formalizes an integration framework for HR infrastructure, engages communication efforts, and provides organizational stability for the company.

As a contributor to negotiations, HR will define the employment characteristics for the new team and its executives allocate and structure retention funds, conduct a pro forma restructuring of the company, set terms in the purchase agreement around the disposition of employee equity, treatment of employees postclosing, representation and warranties by the target, covenants to guide operations between signing the deal and closing the deal, and other unique characteristics that arise as a part of the deal.

If HR is evaluating only potential risks and liabilities in the infrastructure of HR services, consider this red flag number seven.

As due diligence concludes and negotiations are completed, the project will be publicly announced, but will not be complete until several weeks or months later when the necessary administrative and legal obstacles are closed and the negotiated value of the deal is transferred from the acquirer to the target.

Know your target, its leaders, and their interests and motivations.

Key take aways

1. Loose documentation of processes

Focus on what is important and how you get there. Do this with a Corporate Development person or your business unit management team. Find experienced HR teams to benchmark against. There are different models for different types of transactions and corporate styles.

2. Develop acquisition competency throughout the HR organization

If you have a shared services platform, find a resource that you can draw on as needed and be confident that you understand each other's requirements in terms of flexibility in the mainstream systems.

3. Build an HR acquisition toolbox

Build a template for your positions in preliminary evaluations, negotiations, structure of contracts, integration plans, communications, restructuring, executive arrangements, retention, etc.

4. Facilitate and lead integration processes

Act as a single point of accountability for HR integration. Line HR must take ownership and accountability for the results of the integration, solve problems, handle the unique deals and surprises, and lead change. The tendency is to abdicate functional integration activities to other people and spread the accountability too far. This will most likely result in a loss of credibility for the Line HR person.

5. Resource projects properly

Transactions are the most intense work most people will ever do. Find people who have tolerance, judgment, open minds, an ability to solve problems, and who are generally fun and interesting. Once you find them, align them to you and reward and recognize them beyond their expectations. You will almost certainly work them harder than you anticipate.

Where's HR?

Positioning Human Resources as a strategic due diligence partner

By Glen Lipkin, Nick Franklin and Lisa Scheiring



The days leading up to mergers and acquisition (M&A) deals are intense. The due diligence team is focused on scrutinizing financials, negotiating terms, and plotting strategies. It is tempting to reduce one of the biggest risk areas — human resources (HR) — into a number-crunching exercise focused on identifying potential financial risks and synergy opportunities, such as maximizing headcount reductions to generate compensation and benefit savings.

But the financial risks related to an organization's people are the tip of the iceberg. While more difficult to quantify, factoring in people-related risks and providing a successful approach is critical to succeed in these areas:

- **Structural risks:** Organization design and selection must be pinned down to prepare for a successful Day One and beyond. This includes planning a phased approach to headcount reductions so that business as usual is not disrupted by the transition.

- **Talent risks:** Talent retention strategies and costs must be factored into the plan. People with critical knowledge and skills must be identified and strategies developed for keeping them onboard. Otherwise, you may lose key people just when you need them most.
- **Cultural risks:** When two companies merge, cultural conflicts are inevitable, which may undermine the best-laid integration plans. It's important to identify cultural differences, such as leadership styles, decision-making processes, receptiveness to change, work-styles, personal interactions, and beliefs around personal success. When a preliminary cultural analysis is conducted before signing, the due diligence team can better pinpoint possible hurdles that will hinder synergy capture and a smooth transition.

As a HR leader, you understand that oversimplifying people-related risks can lead to inaccurate integration planning scenarios, poor synergy predictions, unexpected costs, and loss of critical talent. So how do you become a strategic M&A partner who is engaged early in the deal process? And how do you build a respected HR M&A team that will help your organization capture people-related value in this deal — and subsequent ones? The following four-step approach should be considered in your efforts to get into the game.

Oversimplifying people-related risks can lead to inaccurate integration planning scenarios, poor synergy predictions, unexpected costs, and loss of critical talent.

Step One: Partner with the corporate development team

Typically, your company's corporate development team drives M&A activity by developing the overarching strategy and identifying potential acquisition targets. HR should build a partnership with corporate development so that you will be engaged with them during target screening — or even strategy development. By understanding the deal team's M&A objectives, you can provide insight into potential people-related challenges that could affect their decisions. For example, your company's strategic direction may require adding a new business to the organization's portfolio, growing a current line of business vertically or horizontally, or perhaps expanding into new global markets. Each scenario has a different impact on the people needs of the organization.

With this strategic perspective, your HR team can better support the due diligence team by helping identify information that must be collected from targeted companies to project people-related costs, integration issues, and synergies. Understanding the strategy behind the deal will also provide HR with a foundation for developing an organizational structure for a combined company that will be consistent with the strategic vision.

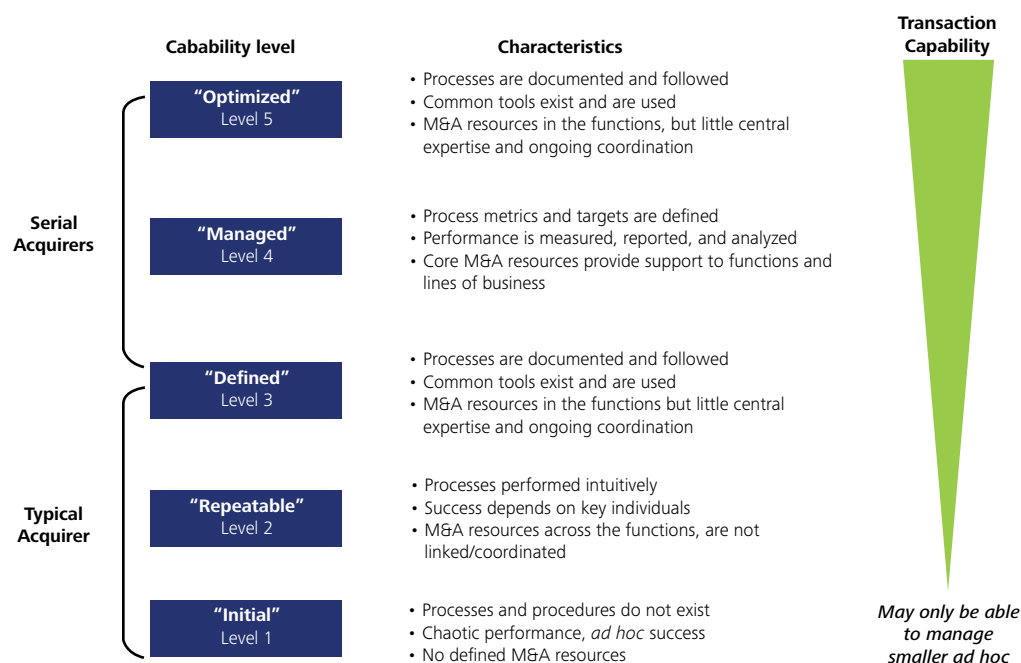
Step Two: Rightsize your HR M&A team

Whether your company is dabbling in M&A or has identified acquisitions as a primary growth strategy, you will need a capable and efficient HR M&A team. But this does not happen overnight; it requires support, training, and time to develop M&A knowledge and experience.

The frequency and complexity of the M&A transactions that the team is expected to handle will dictate the appropriate number of team members and the capabilities and tools they will need to be successful. There is a broad spectrum of possible team models that you can adopt. For example, if your company's strategy is to execute a one-time deal, you may choose to use existing HR staff members on an ad hoc basis. On the other hand, if your company's strategy involves complex, ongoing M&A activity, you may develop a dedicated staff of M&A HR professionals.

Of course, there are many team variations between these two extremes. Figure 1 illustrates the range of possible M&A team capabilities. Inexperienced teams will probably perform at Level 1 or 2, with limited capabilities that could result in inconsistent performance. As the team expands and gains M&A expertise, they should move up the scale in effectiveness and ability to handle more complex transactions. A team's progress can be accelerated by providing outside support with M&A experience, knowledge, skills, tools, and training.

Figure 1: Levels of M&A team capabilities



Step Three: Find high-potential team members and develop them

When selecting individuals for the HR M&A team, it is important to choose people who will thrive in a loosely structured, fast-paced environment. They must be able to work effectively with team members representing other functional areas who are often analytical and financial oriented. Box 2 outlines the qualities and experiences you should look for in team members.

Figure 2: Qualities to look for when selecting HR M&A team members

Candidates for members of the HR M&A team should possess the following behaviors and capabilities:	Candidates should have prior experiences that prepare them for M&A activity. Some examples include:
✓ Collaborative team player	✓ Leader of a functional area that is impacted by M&A activity
✓ Proactive	✓ Project manager for an enterprise-wide strategic initiative
✓ Analytical and detail oriented	✓ Owner of P&L or budget
✓ Ability to work in an ambiguous and complex environment	✓ Member of an international and cross-functional project team
✓ Ability to work under pressure of time constraints, conflicting priorities, and agendas	✓ Employee of an acquired or spun-off organization
✓ Broad knowledge of HR	
✓ Strong communication skills	

If no strong candidates are readily available within your organization, there are several ways to develop internal M&A knowledge and skills:

- **Use external professionals to jump-start the organization's knowledge base:** Many companies wait for the first transaction to surface and use external support, such as M&A HR consultants, project managers, and due diligence assistance, to help guide the integration and simultaneously help them in their efforts to build in-house capabilities. One benefit of this approach is that internal M&A team members gain hands-on training and experience during the integration planning and execution process that can be applied in future transactions. Plus, they gain access to the external professional's knowledge, tools, and processes. Of course, there is a cost associated with hiring external professionals.
- **Hire experienced people:** Another option is to recruit experienced people who can mentor functional teams and share their knowledge and experience with others in the organization. The benefit is that a new hire with M&A expertise can train and guide other team members. However, qualified candidates may be hard to find, and unless there is a constant stream of M&A activity, the ongoing expense of an additional employee may be difficult to justify.

- **Build internal capabilities over time:** Relying on internal staff members who learn by trial and error allows individuals to build knowledge and experience over the course of several transactions. Leadership must be willing to accept that the team's initial performance may be inefficient and ineffective, increasing the overall transaction risk; however, the incremental cost of using internal staff is relatively low, and the team's performance will probably improve as they gain experience.

Step Four: Standardize the due diligence process. Tools, tools, and more tools!

A structured approach to the due diligence process can help the HR M&A team to function at a high level. If this transaction is likely to be the first of several, creating standardized processes can enable them to thoroughly and consistently evaluate targets. Examples of ways to make the due diligence process more efficient are:

- **Document current processes.** Compile and document your organization's compensation practices, benefits systems, HR systems, and HR policies for easy reference. Have readily available detailed information about your organization's operating model, payroll, and HR technology. By having a clear picture of current operations, it will be easier to evaluate the cost to migrate the target organization's processes and systems.
- **Create tools to improve efficiency.** Customized tools and templates can help expedite information gathering during the due diligence process. Some useful tools are:
 - Standard data requests for collecting information from target organizations
 - Detailed checklists of all due diligence tasks to be performed
 - Templates for side-by-side comparison of compensation and benefit plans
 - Outline a standard due diligence report that will be completed following a thorough review of a target's people-related risks, including quantitative data to be incorporated into the deal team's financial analysis and qualitative information to provide executive leadership with an overview of the target's top HR risks

Conclusion: Arrive early and come prepared

You and your HR team can provide a valuable perspective on the people-related risks that may otherwise be overlooked. By partnering with the deal team early in the due diligence process and developing an effective HR M&A team, you can help identify and mitigate financial, as well as structural, talent, and cultural risks inherent in the transaction. Armed with complete information, your organization will be in a stronger position to negotiate a price that more accurately reflects the costs and synergies associated with the deal.

Section 2: Integration Management

Anticipate the challenges of integrating two disparate sets of people, processes, and systems.

Taking the lead during a merger

How leaders choose to communicate during a merger is key to realizing the value of the deal

By Eileen Fernandes, Kevin Knowles and Cydney Roach



In the current climate of merger mania, the reality is that the majority of mergers will not live up to expectations and many will fail altogether. Most often this failure is not attributable to the structure of the deal, but to cultural conflict and poor communication.¹ The key, is strong leadership communication from Day One.

How leadership chooses to manage and communicate the people component of merger and acquisitions (M&A) change is key to maximizing the value of the deal. Employees are, after all, those who will implement the changes to realize the merger vision. As top industry surveys have proven, of all the human capital issues involved, communication ranks as the top critical driver of merger results.²

Why leaders fail to prioritize

So if communicating the vision and strategic rationale of the deal to employees is such an imperative in capturing merger value, why don't leaders give it a higher priority in their merger responsibilities?

- Unlike many other merger related leadership activities, communicating with employees is not a legal requirement.
- When leadership time is being allocated during a merger, communicating regulatory compliance and presenting the deal to the financial community and all external stakeholders takes highest priority.
- At the best of times, leaders can be reluctant communicators. Given the intense time pressures that prevail during mergers, they are quick to find reasons to allow internal communication responsibilities to slide.
- Executives can be even less inclined to communicate with employees when they do not have answers to many of the typical questions employees have about their future, or when they must deliver difficult messages related to workforce reduction, a common reality of mergers. Of course, that is precisely when leaders should not be silent.

¹ IABC survey, 2002

² The People Problem in Mergers, McKinsey Quarterly, Number Four, 2000; IABC survey, 2002

Better leadership visibility

Here are some tips on how to facilitate leadership visibility in communicating and driving merger integration goals:

- Explain the value they can unleash in helping employees live the change that will achieve these goals.
- Win confidence from leaders by presenting metrics that demonstrate the importance of communication with data derived from focus groups or change-readiness surveys.
- Most of the leadership on the core integration team comes from finance or operations. If you can provide percentages and charts, they are going to feel better about what you are purporting than if you approach them with a broad-based narrative for communicating.
- Explain you will need their buy-in to push the kind of messages that are truly strategic, and that managers will then cascade those messages, adding more granular detail and tactical execution instructions to augment them.
- Manage employee expectations and establish credibility with open, honest communication; painting too rosy a picture of the integration process will create more obstacles than achieve ends.
- Face difficult issues, such as workforce reduction squarely and candidly.
- Do not avoid communicating if you don't have all the answers.
- Establish or reinforce two-way communication and feedback mechanisms; during this intense period of change, you'll need the input to measure how well the integration is being implemented and how thoroughly the merger vision is being accepted.
- Create a positive sense of urgency to drive employees towards integration goals.
- Identify quick wins that will prove to employees that the integration strategy is working. Communicate and celebrate when those quick wins are realized and recognize those who helped achieve them.

Finally, offer leaders the following list of guiding principles when they formulate their merger communication strategy.

- Define a core message set — including strategic rationale for the deal, a vision of the new company, and key supporting facts — as early as possible.
- Stick to core messages, presenting one aligned identity to all stakeholders, internal and external.
- Be highly visible and especially communicative from the moment the deal is announced.
- Explain the line of sight between merger goals and what employees can do to help.

Ultimately, leaders need to be reminded that communication has the power to drive the realization of integration goals.

Stacking the deck

By Carolyn Vavrek, Jessica Fleming Kosmowski, Alejandro Danylyszyn and Anna Kwan



A large number of mergers and acquisitions (M&As) often fail to achieve the financial or operational targets the deal architects expected before closing the deal. Even more startling, fewer than one in ten transactions are viewed as "successful" by executives and insiders in the new organizations.¹

Why do so many transactions fail to capture the expected value? And why is success so elusive?

Some deals fail simply because they never should have been done in the first place. But a much larger number fail because of poor integration planning, and execution, or because the company did not properly anticipate the challenges of integrating two disparate sets of people, processes, and systems. In some cases, failure might be inevitable. But in most cases, we believe the biggest obstacles can be tackled through an improved approach to merger integration.

Increase the chances of achieving your desired results from a merger or acquisition by improving how you plan and execute integration activities.

Intelligent integration

Merger integration is a complex challenge, and there are no magic formulas for achieving your desired results. Every deal is different and dynamically unfolds in a rapidly changing business environment. However, our experience suggests that companies can greatly improve their chances for a positive outcome by putting more emphasis on integration planning and operational analysis early in the deal life cycle. This new approach — what we call "Intelligent Integration" — consists of three major elements:

- **Accelerated planning** – Committing to a more comprehensive operational analysis and integration planning during the due diligence phase can enable the deal architects to anticipate, identify, and mitigate people, process, and technology risks. This increased discipline can also prevent bad deals from being done — or at least reduce expectations for mediocre deals.
- **Value blitz** – An intense and focused effort at the start of integration planning can help leaders identify key deal value drivers and set priorities for the overall integration.
- **M&A scorecard** – A clear and balanced set of performance measures can highlight what integration teams should focus on, measure, analyze, and report to stakeholders. An effective scorecard can help define success, monitor progress, and keep the integration on track.

In theory, each of these elements can be implemented individually — but the combination can produce powerful results, enabling a company to dramatically increase its chances for success at every stage of the merger life cycle.

¹ Mergers & Acquisitions: Dangerous Liaisons – the integration game' by Deborah Allday from the Hay Group in the UK, published on June 12, 2007

Benefits of intelligent integration

For most companies, Intelligent Integration represents a significant shift from current practices. This approach can increase the chances for an effective merger by helping the company to:

- Identify potential deal breakers while there is still time to get out of the deal
- Accelerate the resolution of cultural, operational, or systems issues
- Focus integration effort and investments where they can drive the most value
- Develop objective measures to guide and measure progress and performance
- Accelerate synergy capture

Accelerated planning

During the early stages of most mergers, the main focus is on assessing the financial viability of the deal. The integration effort does not really kick into gear until the transaction is about to close or shortly thereafter. In particular, very little effort usually goes into integration planning during the due diligence phase, or even after the letter of intent is issued.

The integration effort intensifies as the close date approaches, and reaches its peak shortly thereafter. Over time, the required level of effort and investment gradually decrease. However, it is not uncommon for the integration to drag on for many months or even years after close. There are a number of problems with this traditional approach.

- Major challenges and risks with the deal may not be discovered until very late because of insufficient operational analysis and integration planning

during the due diligence phase. Sometimes the leaders who can spot the big operational risks are not even in the know until well after announcement.

- Critical knowledge and activities often get lost in the hand-off from the deal team to the integration team, increasing the cost and risk of integration. As the pace of deals quickens, this risk can increase exponentially.

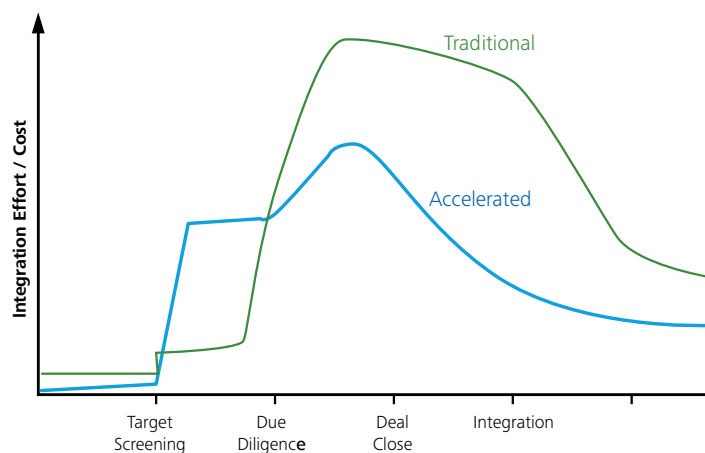
Companies can more effectively mitigate these challenges by getting an earlier start on operational analysis and integration planning.

This accelerated approach focuses more operational analysis and integration planning effort on the target screening and due diligence phases. By the time the letter of intent is issued, the company should already have a deep understanding of the operational challenges, cultural and organizational differences, and systems redundancies it will need to overcome.

Accelerated planning offers a number of specific benefit opportunities:

- **Reduces hand-off risk.** Because detailed integration planning and pre-close preparation are conducted in parallel with detailed due diligence and final negotiations, the integration team has direct experience with the deal and is less reliant on the deal team for key knowledge.
- **Improves deal price.** An improved understanding of the operational and integration challenges can help the deal team value the deal more effectively and negotiate a better price.
- **More realistic targets.** A deeper understanding of the postmerger challenges enables the company to set reasonable synergy targets and market expectations.
- **Avoid bad deals.** Accelerated operational analysis and integration planning can help the company identify deal-breakers—operational issues and integration challenges that make a merger inadvisable. If the deal does not go forward, the cost of this accelerated analysis may appear to have been wasted—but compared to the cost of executing a bad deal, it is likely a drop in the bucket.
- **Reduce overall cost and effort.** An accelerated approach shifts much of the analysis and planning to earlier stages of the deal, spreading integration costs more evenly across the merger life cycle. In our experience, in most cases, this increase in upfront costs is more than offset by reduced cost and effort in the integration phase.

Figure 1: Traditional vs. accelerated approach



Source: Deloitte Consulting LLP

Value blitz

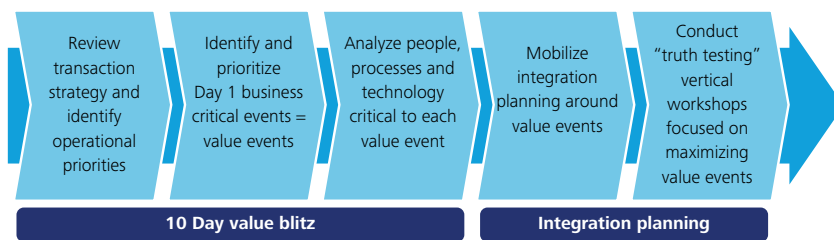
No matter when integration planning occurs, the first steps are the most critical. Unfortunately, many integration planning efforts start out in chaos, with leaders bouncing from one fire drill to the next without a clear set of priorities.

A more strategic approach is to have a small team of key decision makers step back and quickly assess which integration activities are likely to create the most value – and then steer the overall effort to focus more time and effort in those key areas.

For example, a company that is merging to expand its market share should focus on integration activities that relate to customers, such as customer service and contract renewals. In contrast, a company that is basing its merger strategy on innovation should focus greater attention on the people, processes, and technology that drive R&D and new product launches. This focus on value events helps drive rapid performance improvement on Day One and beyond.

A value blitz is usually conducted during the first 10 days of integration planning. Figure 2 shows the typical steps in the process.

Figure 2



The team for a value blitz should be small, in most cases five people at most. It should include leaders from the business as well as key enabling functions, such as finance, operations, human resources, and IT. It is ideal if each member of the team has prior integration experience and a grounding in operational execution. It also helps if they can stay involved through all phases of the integration life cycle — from value blitz to planning to execution — in order to maintain continuity and direction.

We have found that in most cases, the key focus areas that emerge from this "value blitz" will revolve around "value events" — business transactions or interactions with the potential to drive unusually high business value and help the company get a competitive edge in the marketplace. These events differ from one business to the next, and are inextricably linked to the company's business and M&A strategies.

If possible, the value blitz should occur prior to the deal signing and include at least one member from the due diligence team. This can help the deal team make a clear and efficient hand-off.

Useful tools for the blitz include critical event checklists and templates, process and system integration accelerators, and synergy capture estimators. With these in hand, the team can be productive from the outset.

Figure 3: Sample scorecard

Focus area	Scorecard metric	Integration goals	Business unit 1	Business unit 2	Business unit 3	Status
Financial	Operating margin	Grow margin by 2%	+3%	+3.5%	+2.8%	●
	Operating income	Grow margin by \$3 MM	\$1.0 MM	\$0.7 MM	\$0.1 MM	●
	Cash conversion cycle	Compress cycle by 2 days	+2 Day	+1 Day	1 Day	●
Customer	Average customer profitability by segment	Increase profitability by 3%	+3.4%	+2.9%	+2.7%	●
	Revenue synergies	Grow revenue by \$15 MM	\$7.0 MM	\$1.4 MM	\$9.0 MM	●
	Customer attrition rates	Reduce attrition rate by 1%	-1 %	+5%	-4%	●
Growth	Customer acquisition rate	Increase acquisition rate by 2%	-6%	+7%	+7%	●
	Product pricing	Increase pricing by 2%	+7%	+7%	+7%	●
	New product/service pipeline	Increase product pipeline by at least 30 products	26 final phase trial	29 final phase trial	33 final phase trial	●
Process	Cost synergy	Reduce costs by \$2 MM	\$0.2 MM	\$1.0 MM	\$1.0 MM	●
	Order backlog	Reduce order backlog by \$2 MM	\$1.0 MM	\$0.5 MM	\$0.7 MM	●
	Production efficiency (yield)	Increase yield by 2%	3%	-7%	0%	●

Detailed integration planning, centered around the value events, can occur once the value blitz is complete. Integration teams should make regular reports of progress on the value events to help keep the company's top integration priorities in sharp focus. These value events would be key metrics reported in the M&A Scorecard.

A value blitz is a good example of the need to "go slow to go fast." It takes patience and discipline to make it happen, but the small investment of time and effort is likely to pay for itself many times over during the course of the integration.

M&A scorecard

Merger integration is complex and time-consuming, and many companies struggle to measure and deliver the merger value their investors are expecting. An M&A scorecard can help to keep things on track by focusing attention on key performance areas, and by making it easy to monitor progress and results.

A comprehensive M&A scorecard should provide a clear and balanced view of what integration teams should focus on, measure, analyze, and report. It can also be helpful in defining success.

- Implementing an M&A scorecard involves four steps:
- Translating the merger vision and strategic rationale into operational goals
- Identifying and agreeing on key M&A metrics
- Linking the M&A metrics to performance targets for key individuals
- Monitoring integration activities and adjusting the plan and strategy as needed

The scorecard should include a balanced mix of metrics, not just financial ones. The focus areas in the scorecard should be driven by the business strategy, merger strategy and value events, but other components to consider include:

- Objectives and goals for the integration
- Integration and/or divestiture initiatives
- Key metrics (e.g., customer experience, customer retention, customer profitability, revenue)
- Analysis and real-time feedback to drive continuous improvement, innovation, and growth

An M&A scorecard should be used to keep the deal "honest" and make it easier for leaders to stay focused on delivering the value all parties want from the transaction.

It should also help measure integration effectiveness across different deals by establishing a core set of standard metrics that can be used from one transaction to the next, which boards could then use to measure C-Suite performance.

Stacking the deck

Although companies often have legitimate reasons for delaying their integration planning activities, our experience suggests that sooner is almost always better. Intelligent Integration (1) places more emphasis on operational analysis and integration planning early in the deal, (2) focuses on business activities that drive the greatest value, and (3) provides a scorecard to define and monitor success. This three-pronged approach can significantly improve a company's chances for success in every phase of the merger life cycle.

Merger integration is fraught with risks and challenges, and there are no guarantees. However, an effective approach to integration planning and execution can help stack the deck in your favor in every phase of the merger life cycle.

Thriving in a pressure cooker

Leading your merger integration team through the toughest project of their careers

By Kevin Knowles and Laurel Vickers



After weeks of heads-down concentration, followed by the adrenaline rush of the chase, you are poised to sign a merger agreement that will position your organization for future growth. The team you have in place to manage the deal has crafted the acquisition strategy, screened targets, and completed due diligence. Up to this point, it has just been you and a handful of other company leaders involved. Soon you will expand the ranks to prepare for the daunting challenge of integrating two organizations.

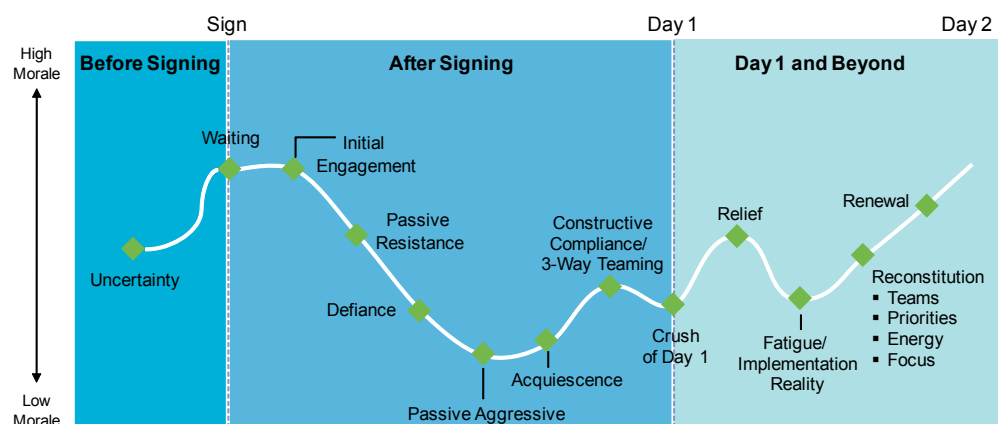
What happens when you pull your most valuable people from their day jobs and dedicate them to a project of this magnitude? How will they cope with the pressure? How can you help?

Integrating two organizations is a huge project — possibly the highest risk and most visible project your company has tackled. It is easy to become fixated on financial reports and Gantt charts plotting the multitude of tasks required to combine operations and squeeze value from diverse systems, processes, and employees.

But it is equally important to attend to the human side of the integration project. The transaction can be undermined by disruptive behaviors and emotions of the people you are counting on to plan and execute the integration. Based on our experience of working with hundreds of integration teams, we have found that there is a natural emotional rhythm that accompanies the life cycle of the project, as illustrated in Figure 1.

Figure 1. Typical behaviour experienced while in the "Pressure Cooker"

The integration team will experience a variety of moods during the course of the transaction that reflect the challenges and pressures faced at each stage of the deal.



Fortunately, there are actions that can help mitigate the low points and reinforce the high points. This article outlines what leadership should consider doing to guide and support the people who make up the integration team, to enable them to plan and execute a smooth transition while capturing the value promised to your stakeholders.

Before signing: Preparing to cook

Probably at this point, only you and a few others know for sure that a deal is in the works. While you may be tempted to wait until you have a signed agreement before beginning integration planning, now is the time to jumpstart the process by establishing the integration team structure and roles.

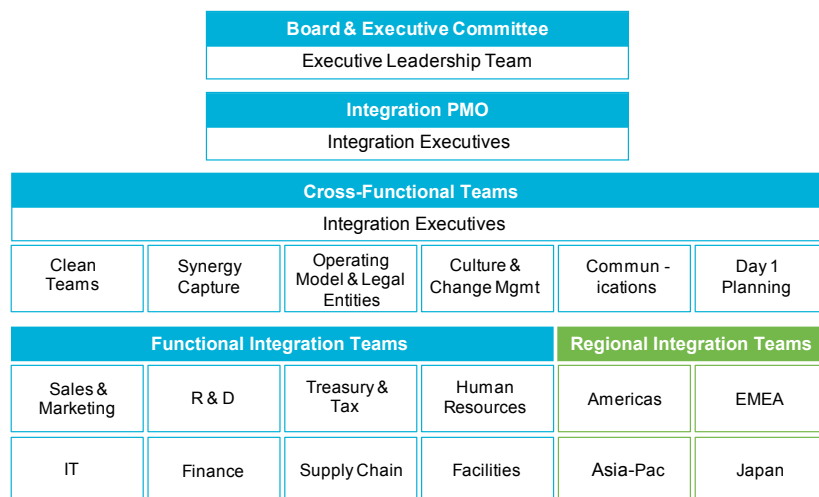
Be aware of the mood: You can be almost certain that functional leaders are aware of industry or office rumors about a possible acquisition. Speculation creates uncertainty, and the people you are counting on to lead the integration may decide to take a recruiter call and consider opportunities outside the company. Of course you must comply with confidentiality restrictions, but you can reduce their fears — and set the stage for a successful transaction — by engaging key functional leaders in the integration planning process early on.

Mind shift required: A successful integration requires leaders to embrace a new vision for their organization, rather than focus on their personal and functional area needs. They must adopt a collaborative project mindset that will allow them to champion change and participate

in planning and executing complex interdependent activities within a tight timeframe. There are some key actions you can consider taking in your efforts to achieve the mind shift:

- **Establish the integration team structure.** At this early stage before signing, focus on establishing the roles and responsibilities of the top tiers of the core integration team. Create a flexible team structure that allows roles to be added as needed or as confidentiality restrictions loosen. Figure 2 shows a typical integration team organizational structure and roles.
- **Identify core integration team members early.** Once roles are defined, identify the best people to fill them. The size of the core team will vary depending on the size of the organizations and complexity of the integration. For typical midmarket transactions, a good rule of thumb is 10-20 functional leaders, representing a wide range of perspectives who possess the skills and desire to lead during transformational change. The integration team should be forward-thinkers capable of garnering support from different functions within the organization and bringing people together to achieve the end-state vision.
- **Reach agreement on the team's guiding principles.** Hold an initial meeting with the core team members and share executive leadership's strategic vision and goals behind the transaction. Direct them to get a head start on integration planning by formulating the team's guiding principles and the decision-making governance model they will follow. This will allow the team to get prepared and help them be productive once the agreement is signed.

Figure 2. Typical Integration Team Organizational Structure and Roles



- **Steering committee:** Leadership, representing both organizations, sets the integration team's overall direction, targets, and timing, and approves major decisions.
- **Integration leader:** The integration team leader reports to the steering committee and facilitates quick decision-making and execution of the operating strategy. The leader is also identifies functional interdependencies and keeps integration team members aligned.
- **Integration management office (IMO):** PMO team members coordinate and drive integration activities across functions and geographies. Experienced acquirers may have in-house IMO expertise, but many buyers look to a professional services firm to provide structure, discipline, and manpower to help them in their efforts to coordinate integration planning and execution.
- **Core integration team:** Functional leaders coordinate all cross-functional integration activities and drive the synergy capture process. Ideally, the core integration team includes representatives from both organizations working in a "two in the box" structure.

After signing: Reaching full boil

With the transaction agreement signed, the integration team can expand its ranks and begin to outline the work that must be completed to strive for an issue-free Day One.¹ They can also begin preliminary planning for attaining the organization's end state, when integration is complete and the transaction's strategic goals and synergy targets are achieved.

The IMO should drive a rapid-fire cadence, which requires the team to plan and execute integration activities under tight deadlines. Simultaneously, team members must anticipate and mitigate integration issues and risks that arise, often with limited information. As Day One approaches, the workload will continue to intensify, requiring the team to expand to include middle managers and others needed to accomplish the many tasks required to make Day One a success.

Show of trust can result in a morale boost for the functional area, as well as help identify and groom future leaders for the organization.

Be aware of the mood: At the time that the agreement is signed, the core integration team has been patiently waiting to begin the work of integration; they are usually cooperative and willing to do whatever it takes to make the transaction a success.

As the team begins to grasp the magnitude of the integration work ahead — on top of the pressure of maintaining their day jobs — some members may passively resist conforming to the project's highly disciplined processes and strict deadlines. A few may even become defiant or passive aggressive. But as Day One approaches, successful integration teams realize that the organization's future depends on their performance. A shift occurs as the team pulls together and disruptive individuals acquiesce and rejoin the team or separate, if necessary. Together, the newly cohesive and motivated team can focus on accomplishing all the tasks required in the pre-Day One rush.

Mind shift required: An integration project takes most people far beyond their comfort zone. In the past, most team members probably relied on their individual knowledge and skills to drive their success; a project of this scope requires them to depend on each other to achieve success. Likewise, they may be accustomed to having plenty of time and resources to dedicate to thoroughly investigating alternatives before making a decision. During the fast pace of integration, they will be required to make decisions on the fly without complete information, usually with no looking back. Team members must develop tolerance, and eventually respect, for the structure and discipline required by the IMO so that all work is complete and interdependencies addressed for an issue-free Day One. There are some key actions you can consider taking in your efforts to achieve the mind shift:

- Set realistic expectations during a team launch meeting. The meeting that launches the integration team sets the tone and expectations for the rest of the project. The integration leader should:
 - Acknowledge that team members were chosen because of their value to their organization.
 - Share executive management's vision for the future organization and the strategic goals for the transaction.
 - Clearly describe the work demands and expectations for accomplishing Day One and end-state goals so team members are not surprised by the heavy workload and grueling pace.
 - Set the team's expectations by explaining that their integration responsibilities may extend well beyond Day One.
- **Provide support for their "day jobs."** During the weeks or months leading up to Day One, an integration project becomes a full-time job on its own. When team members are concerned that their normal responsibilities are being neglected, their frustration and resentment will likely increase, and could affect the success of the project. Leadership is responsible for setting expectations and structure around resource planning and budget allocations for the integration. Using these guidelines, the integration team should develop a detailed resource model that is aligned with the integration objectives, while maintaining business as usual. Options the team should consider

¹ Day One is the day the two companies or organizations become one, usually the day of legal close.

include offering opportunities to lower-level managers to assume larger roles within their functional areas by taking over some of the integration team members' day-to-day responsibilities. This show of trust can result in a morale boost for the functional area, as well as help identify and groom future leaders for the organization. Another consideration is to hire temporary or contract employees at the lower levels so that people are not stretched too thin.

- **Keep a finger on the team's pulse.** Leadership's role in an integration project is complex. It is important to provide the team with the resources, timelines, schedules, and templates so they are effective and efficient. But, there is an artful side to integration leadership as well. An astute integration leader will know when it is time to push the team hard, and when it's best to back off and encourage people to catch their breath. Strong interpersonal skills are required to know how to pull the team up when morale dips or address disruptive behavior. There are no firm answers; the integration leader must manage the team's work pace so it maintains the momentum needed to cross the finish line on Day One.

Day One and beyond: Releasing the pressure

As Day One approaches, the team is focused on checking off every item to be accomplished for a smooth customer and employee transition. When the team has performed well, Day One is a busy, and rewarding day. The team makes sure that everything is executed as planned and business continues uninterrupted — customers' orders are filled, employee pay is distributed, and e-mails are answered. The two organizations are now functioning as planned.

But there's still a lot of work ahead: synergy targets must be met, and all the temporary work-around solutions must be replaced with truly integrated systems and processes. The integration team must be reconstituted — new members recruited and existing ones reenergized. By this point, the "us and them" mentality has dissipated — all team members now represent one organization.

Be aware of the mood: The team experiences a huge sense of relief and accomplishment following the flurry of work leading up to Day One. The mood is upbeat and celebratory. But following this rush of excitement, expect fatigue to follow when the team realizes that another push is coming — it is now time to execute the integration plans.

Mind shift required: The team must adjust to a revised pace and longer timelines — more of a marathon to reach the organization's end state, rather than the sprint towards Day One. After working on quick fixes that allows the combined company to function on Day One, the integration team must recognize their unique opportunity to make a profound and lasting impact on the future of the organization. There are some key actions you can consider taking in your efforts to achieve the mind shift:

- **Celebrate success.** Whether it is a simple champagne toast in the conference room or dinner at the best restaurant in town, executive leadership should host an event to celebrate and acknowledge the contributions made by the integration team. This is also an opportunity to recognize individuals who made exceptional contributions.
- **Reflect and regroup.** Bring the team leaders together to reflect on what went well and what they will do differently next time. Before any departing team members leave, be sure that their knowledge and tools are captured and documented for future use. These lessons learned may be applied during the ongoing integration execution or during future acquisitions.
- **Take a break.** Once Day One is accomplished, everyone deserves some extra time off to catch up on personal activities, spend time with their family, or simply sleep until noon.
- **Reset expectations during a team end-state planning meeting.** This meeting signals an important shift in the team's focus toward fulfilling leadership's end-state vision and meeting synergy targets. The integration leader should kick off this planning session by acknowledging team members' past contributions and introducing new team members. Ideally, executive leadership should be present to reinforce their vision for the future organization and the importance of the integration team's role in fulfilling this vision.

Making it all worthwhile

Following Day One, the integration team's job is to actualize the original vision set forth when the transaction was conceived, meeting the synergy targets, and capturing the value promised to the organization's stakeholders. When leadership has done its job well, the organization has an added bonus: a highly functioning integration team who understands and supports the end-state vision, with the collaborative work style, discipline, and broad perspective needed to achieve even better results from the next pressure cooking transaction.

Getting past the hostility

Five key strategies designed to help integrate reluctant employees following a hostile takeover

By Kevin Knowles, Kimberly Storin, Danielle Feinblum and Stephanie Meyer



Prepare yourself for the unknown. Overcoming the challenges associated with acquiring and integrating an organization after a bitter proxy fight and hostile takeover will test your leadership abilities, as well as those of your management and integration teams. It is very likely that this transaction will demand a higher level of strategic thinking, flexibility, and innovative problem-solving than any transaction your organization has ever tackled.

Many of these challenges directly affect employees. Be prepared to defuse tension as you ask the acquired organization's leadership team and employees to commit to your company's terms and conditions, values, and mission. To further complicate matters, your team will have limited information about the target organization, its leadership, and its employees, which hinders integration efforts.

There is good news, however. We have found that executive leadership can increase the probability of retaining top talent, delivering growth, and capturing synergies in a hostile takeover scenario by incorporating the following five people management strategies.

Five key people management strategies

Strategy #1: Use time wisely

Engaging in a hostile takeover means leadership will have limited access to information about finances, employees, organization structure, and company operations during due diligence. As a result, extensive due diligence and development of a synergy capture strategy and plan cannot occur until postclose. Use the time prior to transaction close to develop an integration strategy and project management structure. This will help enable a quick ramp-up once the transaction closes, accelerating synergy capture.

- **Develop integration scenarios.** Expedite the integration process by crafting a primary integration scenario, as well as various alternatives. Launch the integration team before the transaction is signed. Begin with a draft operational model and governance structure. Identify integration teams from your organization and aggressively conduct one-sided planning. After close, swiftly engage a broader two-sided planning and implementation team. It is important to maintain flexibility and fluidity, as new information gathered postclose will surely impact the integration plans and roadmap.

Use the time prior to transaction close to develop an integration strategy and project management structure.

- **Prepare for Postclose due diligence.** Create a comprehensive checklist of all data and practices necessary for quickly assessing and controlling the business on Day One.¹ In one-sided planning teams, prepare people to physically take ownership and accountability for all aspects of the acquired business. Usually the transition of ownership is uneventful, but rigorous planning for all scenarios is necessary.
- **Understand applicable regulation and labor laws.** If the target operates in countries where your organization does not have operations, it is wise to spend time prior to close researching local labor laws to expedite Works Council approval or other labor processes.
- **Hot topic scenario planning.** Work with your leadership team to develop contingency plans in case the integration does not go as planned. For example, how would the leadership team handle a mass exodus of the acquired employees? What happens if the approval is significantly delayed? What if there is significant negative media coverage? A comprehensive scenario planning exercise can prepare the integration team to shift gears quickly as the situation changes.
- **Engage employees.** Take steps to identify top talent early and create targeted strategies to keep people engaged, transfer unique knowledge, and keep a laser focus on key priorities. After the close of the transaction, review the most recent management performance talent assessments to identify managers with influence across the organization. Implement aggressive change management and communications tactics to leverage these managers to help set the tone for the integration and communicate informally with employees.
- **Cultural differences may impede employee engagement following a hostile takeover.** One way to identify potential areas of cultural differences before the close is to scour industry blogs, recruitment boards, employee web pages, and other public domain references. Understanding cultural similarities and differences across the two organizations can help you design and launch initiatives that will resonate with employees.

Strategy #2: Stabilize the organization

Employees acquired in a hostile takeover will usually have intensified fears about job security, a changing work environment, and the future of the company. Your top priority should be to address employee concerns and minimize uncertainty in order to maintain business as usual. To help accomplish this, consider quickly announcing the top leadership team and actively engaging employees as part of the new organization.

- **Select leaders.** Given the lack of communication with target leadership prior to close, leadership selection must become a priority immediately at close. It is important to consider loyalties that exist within the target company. For example, if you decide to let a leader go, will loyal employees follow? Will the departure have a major negative impact on morale? Or could the appointment of a leader to a position have a positive impact on morale and how can you leverage that potential goodwill?

Once the leadership team is identified, gain their commitment and focus through the use of new employment agreements and a performance-based retention program.

Strategy #3: Accept no leadership dissent

Proxy fights can be long and drawn out, giving the target company's leaders time to voice negative opinions regarding the takeover and your organization. Once the transaction is closed, it is important to quickly rally them around the organization's mission, vision, and strategy.

To understand their interests and concerns, consider holding one-on-one interviews with key leaders throughout the target organization as soon as possible after close. Use the information gathered to develop materials for leadership alignment sessions and communication materials. Additionally, a Leadership Summit held immediately after the close can provide an opportunity to influence



¹ Day One is the day the two companies or organizations become one, usually the day of legal close.

leaders from both organizations. Encourage leaders to be vocal about the positive aspects of the transaction while maintaining a sense of realism, since some employees may view this as an artificial effort. This balance is essential to establish a transparent line of communication with employees. Aligning leadership and arming them with key messages and tools that help them to be relevant, credible, and authoritative can help to change perceptions among the employees. However, if a leader vocalizes negativity and undermines the ability to engage the broader organization, then quickly remove that leader from the organization.

Be prepared for challenges both before and after close.

Strategy #4: Communicate to influence

Managing external and internal communications is critical to success during a hostile takeover. Negative media coverage during the proxy battle may have negatively influenced customers, partners, community, and employees. Postclose, it is imperative to establish transparent, timely, and consistent communications with key stakeholders to reverse any negative perceptions.

- **Consider timing.** Timing of communications is especially important following a hostile takeover. Tightly manage the information disseminated to the media so that employees and customers do not first hear about it in the news. Directly hearing information from leadership can help establish trust and credibility with employees and customers, which is key to maintaining business as usual during the integration.
- **Communicate often and in a variety of ways.** Make sure all employees receive critical information by using multiple communications vehicles, leveraging existing mediums (i.e., e-mail, portal, leaders, and scheduled conference calls) and cascading through managers during team meetings where possible. Additionally, encourage regular feedback from employees by hosting forums where employees can ask leadership questions either live or virtually. Swiftly address this feedback and actively communicate resolution.

- **Remember your current employees.** Following a hostile takeover, it is easy to overlook the needs and concerns of current employees. Current employees can be highly vocal following an acquisition and can influence perceptions of acquired employees. Factor them into your communications planning and get them involved in the development and delivery of targeted initiatives and messages when possible.

Strategy #5: Recognize that some things are out of your control

A hostile takeover will present leadership with unforeseen challenges, many of which can be prepared for during the scenario planning exercises. Yet even with detailed scenario planning, many things will be out of your control.

For example, timing of the court's decision and shareholder voting process may be delayed, making it difficult to estimate when the transaction will close. Create an integration plan that is robust, yet flexible, and allows for multiple activities to occur simultaneously. Empower the integration team to make decisions in order to address any unexpected delay, acceleration, or challenge.

Be prepared for challenges both before and after close. Prior to close, you may hear rumors of leadership and employee attrition to competitors. There must be a solid retention strategy and program in place beginning Day One to help retain critical talent. After close, you may uncover surprises related to missing or inaccurate employee data. It is important that you are prepared to begin engaging new employees on Day One, regardless of the challenges in the back office.

When the hostility passes

Acquiring an organization through a hostile takeover presents leadership with unique organizational and people challenges. By recognizing and addressing these challenges early and aggressively, you can help the business and the integration teams maintain focus on the key objectives throughout any proxy fight and court approval process. When the transaction does close, the integration team should be prepared to ramp-up quickly to integrate the people, the business processes, the technologies, and ultimately accelerate synergy and growth objectives.

Section 3: Integration

Prevent costly turnover and lost productivity through effective leadership, communications, and implementation of the integration plan.

Human Resources Management handbook for acquisitions

By Kevin Knowles and Eileen Fernandes



Human Resources (HR) Management has several essential functions in the execution and delivery of an acquisition or divestiture. These include:

HR's mission in supporting acquisitions:

- Identify, evaluate, and dispose of transaction-related concerns
- Serve as the primary point of contact for HR processes
- Deliver a single coordinated employment solution for acquirer, acquired, or divested company

HR Management support of an acquisition supports six primary objectives:

- Execute the transaction
- Maintain organizational focus
- Retain key skills
- Accelerate employee engagement and affiliation
- Recruit new talent
- Effective transfer of unique knowledge

Core HR merger and acquisitions (M&A) processes:

1. HR infrastructure and systems

- Compensation
- Cash
- Stock
- Executive
- Benefits
- Talent management
- HR information systems (HRIS)/Payroll

2. Effectiveness

- Organizational development and change management
- Workforce transition
- Leadership development

Human Resources Management contributions

HR's role during the transaction is to lead decision processes, execute the transaction, and prepare the company for integration. A representative of HR should be assigned to the transaction and take accountability for transaction decisions, as well as build relationships with the target company.

HR's primary collaborators in a transaction are business unit management, transaction leaders, finance and control representatives, and legal representatives.

Acquisition transactions begin with preliminary assessment (pre-due diligence) of a target and conclude with the execution of all items in the Purchase Agreement. The following are four primary areas where HR supports a transaction:

1. Pre-Due diligence

- Valuation
- Retention cues and capability
- Assessment of leadership and culture framework

2. Due diligence

- Validation
- Assess risk and liability
- Integration planning and readiness

3. Retention planning

- Employment arrangements
- Criticality assessment of individuals and jobs
- Agreement to retention framework and concepts

4. Process and agreement support

- Preliminary terms (term sheet, letter of intent)
- Purchase agreement
- Stock repurchase agreements
- Stock option conversion
- References related to "termination with cause" or other employment

Pre-Due Diligence

Acquirer establishes a set of working assumptions that drive the business case and preliminary negotiating points. HR support at this stage addresses preliminary expectations involving retention of unique knowledge, skills and people, organizational impact and risks, and transaction support. The primary focus of pre-due diligence involves valuation, retention, leadership, and culture.

Valuation. The valuation process establishes a range of economic value. Valuation factors include the book value (assets, liabilities, and projected cash flow) and the market value (earnings, market potential, comparable transactions) of the company. Before an acquirer bids or discusses value with outside negotiators, it is necessary to understand other significant financial consequences resulting from the transaction. For HR M&A, the preliminary valuation concerns are costs related to integration risks, retention costs, severance costs, and costs related to either engaging or separating executives.

Retention cues and parameters. Cues to be considered at this preliminary stage of data collection and validating assumptions are industry practices, verbal information shared by the target, any preliminary data provided by the target company regarding its capital structure, compensation practices, or philosophies, and other actions related to pay at or near the time of an effective transaction.

Assessment of leadership and culture in the preliminary stages of assessment, a review of leadership and culture is limited to public sources. In the case of companies listed with a public exchange, significant data can be mined from filings with the respective securities authorities. For privately held companies, most public references will be on the target company's Web site, in trade show documents, industry articles featuring target company management or lead technical individuals, recruitment Web sites, or public chat rooms. It is also useful to determine the capital structure of the company and understand where equity ownership resides in relation to the founders, management, technical employees, and sales/marketing employees. If applicable, a review of the venture capital investment timing and the placement of executives might lead to some conclusions as to the state of relationships inside the company and the level of support the management team may have from other key employee groups.

An adverse data search can also yield useful information on target company principals. An outside security firm or internal security resources can deliver this information by searching public sources for credit information, public records involving criminal behavior, and financial transactions.

Preliminary data should reflect the educated interpretation of the focus and motivation of target company's management team, it is guidance to the public and to its employees, the environment in which the company operates, the staffing levels and demographics of the company, and the priorities of leadership and management.

Valuation concerns

- Risks to integration
- Retention
- Severance
- Executive arrangement

Due Diligence

The primary objective of due diligence is to assess the risk of a transaction effectively achieving its stated business objectives and to quantify any potential liability that may result as a consequence of the transaction. To effectively understand the potential risk and liabilities, all assumptions and pre-due diligence efforts should be validated and an informed estimate should be established for risks, costs, and resources required for integration.

Assess risk and liability. Proper due diligence occurs when an acquirer gains access to a target company's data and key personnel. Due diligence is the acquirer's time to assess real and potential risks of entering into a relationship with the target company, as well as to assess real and potential liabilities. Areas of particular HR focus include retention, compensation, recruitment, payroll, HRIS, benefits, retirement planning and savings, pension, employment practices, immigration, and regulatory compliance.

Validation. The first data received just prior to a data room exercise is likely the capitalization structure. Capitalization data will identify the economic value of the transaction by investor and employee. Valid retention and risk assessments can be derived from capitalization data. Important evaluations include the transaction value by employee and postclosing liquidity by employee.

In addition to a review of the target company's data, due diligence is an opportunity to validate the assumptions derived from public sources regarding leadership and culture. It is critical that an acquirer representative personally interview each member of the available management and executive teams. During due diligence, it is most likely that only a select few individuals from the target company will be available. In most cases, preliminary interviews are limited to the executive staff and key functional staff. Interviews are useful tools for gathering information, but they are also invaluable in establishing rapport, trust, and credibility with the target's executive team. This is the time to set expectations and



to begin taking inventory of the trade-offs necessary to reach an agreement with the target company.

Integration planning and readiness. General planning for integration efforts should begin prior to due diligence. During due diligence, HR M&A representatives should begin coaching business unit HR representatives on the process of integration and on key integration tasks and resource requirements. The exercise of due diligence will highlight many of the HR concerns for integration. Upon scheduling due diligence, HR M&A should confer with the extended HR integration team (e.g., payroll, compensation, benefits, HRIS, sourcing, organizational development). At the conclusion of due diligence, all relevant due diligence materials should be made available to the extended HR integration team. Within one week of the conclusion of due diligence, the entire HR integration team should be assembled to establish a project plan. This working session should include the HR business unit representatives, HR business unit executive, HR M&A, representatives of all HR core processes, and representatives of the target company's HR organization. Beyond this working session, the collective HR integration team should agree on a time schedule to revisit the project plan and on critical path items at regular intervals as it makes sense for the team. It is recommended that the team convene not less than once a week via conference call for the first six to eight weeks.

Validation avenues

- Capitalization structure
- Interviews
- Documentation
- Key negotiation issues

Due diligence education

- Process
- Tasks
- Resources

Retention planning

Criticality and probability of retaining knowledge, skills, and people vary by project and person. The sole objective of planning a strategy for retaining acquired employees is to increase the probability that an acquirer can (1) effectively transfer specialized knowledge and experience from acquired employees and (2) reduce the level of criticality of any particular employee's unique knowledge over time.

Framing a retention strategy. Considerations in framing an effective retention strategy include existing agreements or requirements already determined by the target company, the level of existing liquidity for employees, the existing value in terms of stock or cash bonus plans or sales plans, the existing base compensation levels, the point of the year in reward and recognition cycles, the business unit strategy, and management's tolerance for risk. Retention frameworks should be firmly agreed upon at or before the Purchase Agreement is signed. Some examples of retention factors to be considered include:

- A Change-in-Control Agreement may already be in place requiring a full or partial acceleration of employee cash or stock subject to performance or time restrictions,
- Target company incentives that are contrary to an acquirer's interests [i.e., short-term cash incentives],
- Disproportionately vested in cash or stock, resulting in negligible posttransaction value,
- Excessive and/or immediate value for future key contributors.

Employment arrangements. During due diligence, it is important to confirm the level of resourcing required for the new entity. The result will be a level of severance, employment offers, and executive arrangements. In every case an acquirer will have a select set of individuals who should have agreements at the time of signing the Purchase Agreement specifically addressing noncompetition, nonsolicitation, and other employment characteristics. An acquirer can secure such agreements with a traditional employment agreement document or as a subset of the Purchase Agreement. Securing noncompetition and nonsolicitation agreements as a negotiated part of the Purchase Agreement is the most efficient way to finalize agreements between target executives and the acquirer. Stand-alone employment agreements require both an acquirer and the target company's executives to divert their focus from the transaction. Severance practices should be guided by

a negotiated and agreed-upon severance plan that is adopted by the target company prior to closing. Outside of select employment offers and agreements, all continuing employment should be documented with an offer letter or confirmation letter. The practical benefit to a new and proper offer letter is the substitution of terms and conditions for any residual target company employment representations that might be overlooked in the transaction or Purchase Agreement.

Selection and criticality assessment of individuals and jobs. During due diligence, it is critical to have acquirer teams determine critical competencies and people to support the company for 18 to 24 months post close. The tangible end result of such assessment is a ranking of individuals currently working for the target company. The results are used to structure special incentives or other retention arrangements.

Retention consideration

- Philosophy
- Value
- Structure

Key steps

- Establish critical competencies
- Rank people
- Align incentives

Agreement to retention framework and concepts.

HR leads the development of an incentive structure that supports the probability of retaining key people and competencies for at least 18 months. This is a process by which the business unit and HR team positively respond to retention risks presented by the unique nature of the transaction. In every case, target company management has strong perspectives on how to incent and motivate its personnel effectively. M&A HR supports this by providing a set of tools that are tailored not only to maintain a focus on existing incentive schemes, but also to represent the unique requirements of each transaction. HR must educate management on retention philosophies and collectively establish acceptable parameters for value and structure. Upon due diligence, HR will facilitate a draft design of retention structures and value, as well as prompt target company management to rank people and competencies. The resulting ranking and first draft of the retention plan is a dialogue regarding preliminary business objectives and retention structure. Once the structure is fully committed to by both sides, a final dialogue will occur with specific focus on the top tier of the company. Usually this dialogue focuses on the top three to five people with disproportionate wealth and/or unique and critical skills. Where unique situations apply, management should explore unique incentives.

Process and agreement support

Almost simultaneous with the due diligence activity, drafting of the Purchase Agreement will be underway. This document is the definitive agreement between an acquirer and the target company. It is HR's responsibility to organize all of the employment-related concerns negotiated and established throughout the process into the Purchase Agreement.

Preliminary terms and conditions. The first agreement with a target company will be documented in a Letter of Intent or a Term Sheet. Both documents serve the same purpose with different tones. In the preliminary stages of discussions, HR should craft the boundaries for future discussion around employment arrangements, retention, migration of benefits and support for employees, transaction specific items (such as holdback arrangements, and noncompetition and nonsolicitation requirements), economic boundaries, and waivers of existing rights (such as acceleration or cash incentives and items such as severance or exits for individuals not needed posttransaction.

Once the structure is fully committed to by both sides, a final dialogue will occur with specific focus on the top tier of the company.

Purchase agreement. HR should confirm that the Purchase Agreement accurately reflects the acquirer's interests and the terms of the transaction. The core components of a Purchase Agreement are the purchase terms, exchange of consideration, representations and warranties of the target company, representations and warranties of the acquirer, conduct prior to closing, other covenants, and conditions of closing. HR should contribute transaction-specific advice and negotiation support to each of these areas. Table 1 reflects a list of common HR-related terms that may be included in a Purchase Agreement.

Selection and criticality assessment of individuals and jobs. During due diligence it is critical to have management determine the critical competencies and key people to support the business case for 18 to 24 months. The end result of such assessment is a ranking of individuals currently working for the target company. The results are used to structure special incentives or other retention arrangements.

Table 1. M&A HR contribution to the purchase agreement

Purchase agreement section	M&A HR responsibility
Purchase terms	Conversion or disposition of employee equity, including methodology and timing for documentation and delivery.
Representations and warranties (target)	<p>Boundaries for changes to employment-related concerns (i.e., compensation, recruitment, stock options, executive plans, change in control, and amendments to existing plan).</p> <p>Benefits savings and pension plans are fully represented and in compliance with all necessary legislative and regulatory requirements.</p> <p>Employment litigation and potential risks are fully disclosed.</p> <p>Labor matters are fully disclosed (i.e., collective bargaining, complaints, immigration, wage, claims, employment practices claims, receipt of notice by any governmental agency regarding practices or compliance, premiums and insurance are appropriately accounted for, and funds allocated for employees are appropriately accounted for).</p>
Representations and warranties (acquirer)	Validity and availability of underlying shares in the issuance of replacement stock options.
Conduct prior to closing	<p>Employment practices of the target company during the period between the signing of the purchase agreement and the closing of the transaction (i.e., hiring, terminating, altering employment relationships, compensation, other incentives, payment, vendors, and Board of Directors and Compensation Committee behaviors).</p> <p>Set in motion any Board resolutions necessary to finalize the transaction (i.e., tax issues related to executive compensation, severance plans, retention plans, preclose terminations, and termination of benefits plans).</p>
Convenants (acquirer)	<p>Eligibility of target company employees for acquirer incentives and benefits.</p> <p>Adoption of retention plan and related economic values. In most cases, this is a value of cash and a certain number of stock options that have been appropriately valued using an agreed-upon methodology during pre-due diligence and due diligence.</p>
Convenants (Target company)	<p>Take all necessary action to obtain waivers, cancel acceleration of stock options, or nullify any rights proposed under a change in control of the target company.</p> <p>Exclude noncompetition, noncompete, or other employment-related agreements that arise as a part of the transaction.</p> <p>Employment commitments of key people are fully satisfied (i.e., employment agreement or satisfactory noncompetition agreements and executed offer letters from acquirer).</p> <p>Repurchase agreement executed if applicable.</p> <p>Severance plan adopted if applicable.</p> <p>Satisfy any tax requirements related to executive compensation.</p> <p>Convenants are satisfied.</p>
Conditions to close	Identification of employees who must be active with the target company at closing. This is both specific to key individuals and to a specific level of employees (e.g., 90 percent of engineers).

Process and agreement support (cont.)

Stock repurchase agreement. In private company acquisitions, there is a group of people who will become disproportionately wealthy immediately upon close. More than likely these people are founders and key management staff hired by investors. In many circumstances, one or several individuals in this population will be critical to the results of the ongoing business. An acquirer can, and should, request that certain individuals defer a portion of their wealth created by the transaction to an escrow account managed by acquirer. These funds should represent a significant portion of their holdings and are subject to forfeiture if the employee voluntarily terminates before an agreed set of conditions is completed. An example of this arrangement is a USD \$80 million dollar transaction where the founder, who is fully vested in USD \$50 million in value, will be asked to submit USD \$20 million to an escrow fund. This fund will be released at a rate of 50 percent 6 months from close, 25 percent 12 months from close, and 25 percent 18 months from close. Stock repurchase agreements are useful only in the acquisition of a private entity. Publicly traded companies can liquidate with the investment market, whereas a private company can liquidate only if it has a buyer.

Stock option conversion. Employee stock options have been the primary vehicle for delivering value to target company employees in a transaction. In each transaction a negotiation occurs with the intent to dispose of employees' equity. Unless it is decided to pay cash to employees for any value embedded in the employee stock options, that value will be canceled or carried over to new stock options. A conventional method for conversion of stock options is to apply the same ratio (exchange ratio) that is used to convert shareholdings. For planning purposes, a quick estimate of the conversion exchange ratio is the quotient of an acquirer's per share price and the target company's per share price. Converted options are determined by multiplying the target company stock options by the exchange ratio and the converted options strike prices are determined by dividing the target company strike price by the exchange ratio.

Table 2 illustrates an example of an exchange rate calculation.

Exchange ratio calculation	
Target per share price	\$5.00
Acquirer per share price	\$20.00
Resulting exchange ratio	0.25

Preconversion data	
Preconversion example options	500
Preconversion example strike price	\$0.30
In the money value	\$2,350.00

Postconversion data applying exchange ratio	
Postconversion example options	125
Postconversion example strike price	\$1.20
In the money value	\$2,350.00

References to termination without cause

If employees forego change in control vesting or engage in a repurchase agreement, they should expect quid pro quo. A primary concern of these employees is the notion that without protection, an acquirer can terminate the employee for any reason, and as a consequence the employee will forfeit any deferred value resulting from the transaction. An acquirer may provide protection by installing language in the Repurchase Agreement or Employment Agreement addressing the definition of "cause" and the terms by which an employee can voluntarily terminate and have the same protections ("good reason"). Below are examples of negotiated language for both "cause" and "good reason."

Example: Definition of cause for employment termination purposes initiated by acquirer

"Cause" will mean a termination of the employment of the stockholder by acquirer for any of the following reasons: (i) the stockholder's continued failure (other than as a result of a physical or mental incapacity) to perform the material duties of his position after receipt of a written notice

from acquirer notifying the stockholder of such failure; (ii) the stockholder's engaging in gross misconduct which is demonstrably injurious to acquirer; (iii) the stockholder's conviction for an indictable offense by a court of competent jurisdiction; (iv) the commission of an act of fraud against, or the misappropriation of property belonging to, acquirer by the stockholder resulting in material adverse harm to acquirer; or (v) the material breach by the stockholder of any confidentiality, noncompete or proprietary information agreement between the stockholder and acquirer; provided, however, that if such "Cause" is curable, acquirer will not terminate the stockholder's employment unless it has first given the stockholder notice of its intention to terminate the stockholder's employment and the grounds of such termination and the stockholder has not, within fifteen (15) days following the receipt of such notice, cured such "Cause." The stockholder will not, solely for purposes of the definition of "Cause" above, be deemed to have violated a noncompete agreement with acquirer as a result of the stockholder maintaining an existing passive investment with no management, board of directors, consulting or supervisory role in any of the private companies listed on the attached Schedule C. Acquirer will provide written notice of the reason for termination in the case of any termination for "Cause." A termination for any reason other than those listed above will be a termination "Without Cause."

Example: Definition of Good Reason for voluntary employment termination purposes initiated by an employee

A resignation for "Good Reason" will occur if the stockholder resigns his employment with Acquirer after the occurrence of any of the following events: (1) any reduction in the stockholder's base salary; (2) a substantial reduction in the stockholder's job duties or a substantial adverse change in his job function; (3) a material adverse change in the stockholder's aggregate employment benefits other than reductions or changes caused by changes to acquirer's benefits plans affecting Company employees generally or (4) a material breach of any written employment agreement with the stockholder by acquirer. Good Reason for the stockholder's termination from his employment with acquirer will not exist if the stockholder's base salary has been reduced as contemplated in clause (1) above or the stockholder's duties or functions have been changed as contemplated in clause (2) above, and a majority of the acquirer employees who perform functions for acquirer that are similar to those the stockholder performed are also subject to such changes. A resignation by the stockholder in any other circumstances will be considered a resignation "Without Good Reason." Good Reason for the stockholder's termination from his employment with acquirer will not exist if the reduction in the stockholder's duties or function is due to substantial growth of the Company, expansion of the Company into additional lines of business or markets (including expansion into businesses of any acquirer affiliate), or the Company consolidations (or reorganizations) of operations, not specifically targeted at the stockholder, with the operations of any present or future parent, affiliate, or subsidiary, so long as the stockholder retains his leading technical role in the product development for the routing platform being developed by the Company. The stockholder shall not have the right to terminate this Agreement for Good Reason unless:

- The stockholder has provided the Company notice in writing of the acts giving rise to the claim of right to termination for Good Reason within (10) days after the occurrence of any such acts;
- And the stockholder provides the Company thirty (30) calendar days in which to cure the conduct giving rise to the claim of right to termination for Good Reason.



M&A HR job profile: responsibilities, minimum qualifications, and key qualities

Specific responsibilities

- Conduct pre-due diligence reconnaissance on target company and report results and initial recommendations to project management.
- Develop initial human resources strategies for key employee retention, executive compensation, equity disposal and allocation, and human resources processes integration.
- Conduct human resources due diligence on target company and report findings and recommendations to management, to include liabilities, risks, retention issues, and integration challenges.
- Develop retention bonus plans for retention of critical and key employees in target company.
- Develop strategies for disposition of existing equity and allocation of new equity (common stock, restricted stock, and stock options).
- Identify critical employees in target company; create and negotiate individual employment agreements with each.
- Develop transition strategies for key human resources processes, such as compensation and benefits, payroll, HRIS, training, and employee communications.
- Participate in planning new company employee communication tools.
- Lead human resources integration team through integration planning process and execution of initial phase of integration (8-12 weeks).
- Manage the transition and hand-off of new company to the mainstream human resources organization.
- Direct both internal and external human resources specialists throughout the acquisition process.

Minimum qualification criteria

- Eight years of progressively more responsible generalist human resources experience.
- A strong working knowledge of all major human resources areas, to include executive compensation, variable compensation, equity management, employee benefits, and human resources strategy and planning.

Key qualities

- Flexibility
- Professionalism
- Credibility
- Judgment
- Teamwork and collaboration
- Influencing and consultative skills
- Communication skills
- Assertiveness
- Initiative
- Creativity and problem-solving
- Decision-making
- Ability and willingness to travel
- Ability to work with a variety of personalities, egos, and cultures
- Ability to work in an ambiguous and complex environment
- Ability to work under the pressures of time constraints and conflicting priorities and agendas

Making it all worthwhile

Following Day One, the integration team's job is to actualize the original vision set forth when the transaction was conceived, meeting the synergy targets, and capturing the value promised to the organization's stakeholders. When leadership has done its job well, the organization has an added bonus: a highly functioning integration team who understands and supports the end-state vision, with the collaborative work style, discipline, and broad perspective needed to achieve even better results from the next pressure cooking transaction.

Effective leadership transition

By Eileen Fernandes



"The employees have got to hear from me and my management team or they won't believe it. We've known these people for years and have always been straight with them. They're counting on us to give them the truth. They have always gotten important news from us."

— President of a newly acquired manufacturing company

"If the President wants to use his team to communicate with their workforce that's fine with us. We don't want to be seen as pushing them to the side. After all, they know these people better than we do."

— Leadership of the new owners

"I want to hear from the new owners."

— Experienced department head in the newly acquired company

Too often, the first signals that come from the leadership team of an organization taking over ownership, to the people of a newly acquired organization, send tremors of uncertainty and confusion through the organization. When clarity and trust are most needed, leadership seems more focused on itself than on taking care of its anxious people. Although many know that poor people management and communication drain financial value from many changeovers, few avoid the confusion and distortion that start from day one. Acquired employees cannot help noticing the disconnection between leadership's actions and words, and worrying: "Maybe my boss does not know what's going on." And things get more complicated — and costly — three, six, and twelve months later.

This damaging confusion does not spring from the new leaders' lack of intelligence, thoroughness in preparation, or hard work. These costly missteps usually begin on the interpersonal level, among both organizations' leaders. To prevent the costly turnover of valued employees and serious

morale and productivity problems that can result from poor communication, be aware of the myth of ownership change and consider the acquired company's needs.

The myth: Hardly anything will change

Many changes of ownership occur between healthy businesses amid the promise of "synergistic opportunities." According to management on both sides, this will happen without major change in the acquired business.

However, in the cold light of the new day of ownership change, three truths become self-evident to those involved:

1. A fundamental shift in power has occurred.
2. The acquired leaders' power has suddenly dwindled to an "opportunity to influence."
3. Decisions are made by the new boss.

The path to distortion, confusion, loss of key people, and reduced financial value becomes unavoidable when leadership embraces wishes and beliefs instead of dealing with hard facts. In many cases, both the new and the acquired leaders subtly and unintentionally collaborate in failing to deal quickly and decisively with transition issues.

Unspoken agreements

Sensitive to the needs of the leaders of the acquired organization, a new leader will often tacitly agree to help the acquired leader "save face" with his or her people. While these arrangements can work in everyone's interests, problems arise when this subtle arrangement replaces clarity and direction in too many vital transition-plan components.

Leadership transition planning is stressful and full of uncertainties. Instead of trying to delicately sidestep sensitive issues, recognize that these issues exist and incorporate them into the integration plan directly, clearly, and early.

There's a new boss in town. Is that good news or bad?

Crucial dignity

In addition to the real fears they share with their people about staying employed, acquired leaders have other concerns. One important but often overlooked concern is maintaining a perceived position of influence and personal dignity. And, understandably, acquired leaders do not want to be seen as selling out the employees to save their own skins.

The acquired leader's influence is like that of someone negotiating for a new job. He or she has more power before the deal closes. By enabling the acquired leader to exert some influence over transitional issues, you help him or her save face. One example of this would be agreeing to "freeze periods" with no layoffs or changes in the benefit programs for a set period.

After the honeymoon

Besides keeping the peace, helping people stay productive and focused on business, and reassuring and retaining key managers and employees, new leaders must project a positive image of respect for the valuable business and top-quality people that have joined their organization. Perhaps the most critical challenge is being liked and respected — or at least not rejected out of hand — by new employees and managers.

Being as clear as possible supports these leadership challenges. Be aware that as the "honeymoon" period wears off, so may your welcome. As the fundamental power shift becomes more obvious to all, acquired leaders, managers, and employees may feel that information is deliberately being withheld from them. This provokes a rapid drop-off in credibility, integration momentum, productivity, and financial value. The "benefits of doubt," which may have worked initially in the new leaders' favor, can quickly turn against them.

Guidelines for leadership transitions

Good communications can not solve all "change of ownership" problems; other crucial factors include the organizations' management styles, industry trends, integration goals, and the labor market, among others. No one solution fits every organization. However, here are a few generally helpful actions to include in leadership transition plans. Team up and create a unified public face early

As early as possible, have both the new and acquired leaders create an allied public face by appearing together frequently. Script topics and questions each individual will address. Make a flexible rule to always show people from both organizations side by side at meetings and events, and in photos.

Get the make-or-break audience on your side

Perhaps the most important moment in a leadership change is when an employee asks his or her direct supervisor: "So, is this deal good or bad?" That supervisor's response will engender cooperation or resistance that can profoundly influence productivity, financial value, and many other critical factors. Talk to line managers early and often. Take a "cascaded" approach to communications by prereleasing information to them, if only by a day or a few hours.

Don't hide the good news

Partly because of general nervousness around communications, new leaders sometimes miss out on publicizing the good news — often the first opportunity to build positive momentum in a transition. A change of ownership often creates significant opportunities for personal advancement for many acquired employees. Similarly, publicize early progress of any integration teams you have assembled.

Ask three questions — and listen to the answers

You can find much of the information you need to plan an effective leadership transition simply by asking the acquired employees what they think. Start with these questions:

- Who do you think knows what is really going on: your supervisor? division head? president? new leaders?
- How and from whom do you want to get information?
- Who will influence or affect your future over the next year or so?

Even if you do not like the answers, do not ignore them. If employees seem misinformed, communicate your thoughts. If you think they are right but do not like what you hear, start changing things for the better!

Don't be afraid to say that you just don't know yet

Give an estimate of when you expect to know an answer. Try not to miss that date.

The power of good news

In the earliest days following one acquisition, the first pilot project to manufacture a new product in an acquired facility had exceeded expectations. Pleased with the results, the new owner planned to send plenty of work to the plant, but did not publicize this intention. In the absence of good news, people's anxieties filled in the blanks. Many acquired employees "thought they had heard" the worst — that the plant could be shut down, and that they might be out of a job. In the then-tight labor market, the new owner faced an increased risk of losing good people right before the busy season, simply by not spreading the good news.

Cultural issues in mergers and acquisitions

By Frederick D. Miller and Eileen Fernandes



Companies today are combining in record numbers. Executives pursue mergers, acquisitions, and joint ventures as a means to create value by (1) acquiring technologies, products, and market access, (2) creating economies of scale, and (3) establishing global brand presence. There is an underlying belief that most markets can provide revenues to three large suppliers; when more than three exist the urge to merge is irresistible.

That said, the business world seems littered with integrated companies that have lost value for shareholders. The question that inevitably arises is: "What forces are powerful enough to counteract the value-creating energy of economies of scale or global market presence?" Culture has emerged as one of the dominant barriers to effective integrations. In one study, culture was found to be the cause of 30 percent of failed integrations.¹ Companies with different cultures find it difficult, if not often impossible, to make decisions quickly and correctly or to operate effectively.

The most insightful cultural observers often are outsiders, because cultural givens are not implicit to them.

What is "culture"?

Culture consists of the long-standing, largely implicit shared values, beliefs, and assumptions that influence behavior, attitudes, and meaning in a company (or society). This definition has several important implications:

Culture is implicit. People who share in a culture find their culture challenging to recognize. The most insightful cultural observers often are outsiders, because cultural givens are not implicit to them.

Culture influences how people behave and how people understand their own actions. As a result, culturally influenced beliefs and actions feel right to people, even while their implicit underpinnings make it difficult for those people to understand why they act the way they do or why other ways of acting might also be appropriate.

Culture is resilient. Its elements are long-standing, not a matter of fads. The resilience of culture is supported by culture being implicit. It is difficult for people to recognize their own culture and how it exerts an influence on them. The staying power of culture is that it feels right to people; new cultural values that are imposed on people seldom replace their underlying values and beliefs in the long run.

¹ Isaac Dixon, "Culture Management and Mergers and Acquisitions," Society for Human Resource Management case study, March 2005.

What does this mean for integrating two companies?

If people acted solely on the basis of rational calculations — the model of behavior preferred by economists — mergers would be effective — or not — based on the soundness of their economic underpinnings. But participants in mergers are human and driven both by their shared culture and individual personalities. Cultural influences have the potential to be broad and far reaching:

Culture affects	Resulting in
Decision-making style (for example: consensus contrasted with top-down)	<ul style="list-style-type: none">• Effective integration requires rapid decision-making.• Different decision-making styles can lead to slow decision-making, failure to make decisions, or failure to implement decisions.
Leadership style (for example: dictatorial or consultative, clear or diffuse)	<ul style="list-style-type: none">• A shift in leadership style can generate turnover among employees who object to the change. This is especially true for top talent, who are usually the most mobile employees.• Loss of top talent can quickly undermine value in an integration by draining intellectual capital and market contacts.
Ability to change (willingness to risk new things, compared with focus on maintaining current state and meeting current goals)	<ul style="list-style-type: none">• Unwillingness to implement new strategies.• Unwillingness to work through the inevitable difficulties in creating a new company.
How people work together (for example: based on formal structure and role definitions or based on informal relationships)	<ul style="list-style-type: none">• Merged companies will create interfaces between functions that come from each legacy company, or new functions that integrate people from both legacy companies. If the cultural assumptions of the legacy companies are inconsistent, then processes and handoffs may break down with each company's employees becoming frustrated by their colleagues' failure to understand or even recognize how work should be done.
Beliefs regarding personal "success" (for example: organizations that focus on individual "stars," or on teamwork, or where people rise through connections with senior practitioners)	<ul style="list-style-type: none">• Again, these differences can lead to breakdowns in getting work done. If people who believe they have to achieve goals as a team integrate with people whose notion of "success" emphasizes individual performance, the resulting situation is often characterized by personal dislike and lack of support for getting the job done.

How to harness culture to promote an effective integration

Culture usually is a soft concept; it is a set of implicit influences that people cannot account for completely or accurately. Premerger due diligence will ferret out things that are measurable, with an emphasis on financial data. Culture surveys and assessment tools can be used to measure culture, but these can be time consuming to complete, and the heat of deal-making usually precludes the luxury of an extended effort to assess soft variables. Even if a culture assessment is performed during due diligence, it is difficult to imagine a joint venture or merger being called off because due diligence revealed that the cultures of the two legacy companies were incompatible.

Given that culture will seldom stop a proposed transaction, it becomes the responsibility of the people managing the deal to stop culture from undermining their desired goals. The most widely used approach to managing the cultural issues is to define a set of desirable cultural attributes (a typical set being: customer-focused, innovative, entrepreneurial, decisive, team-oriented, respectful of others) and then to exhort employees to adopt these attributes in their daily behavior. Companies are replete with posters, screen savers, coffee mugs, and mouse pads that remind employees of desirable attributes. This method is not supported by many "success" stories. The attributes are usually generic and employees struggle to bridge the gap between broad principles that are easy to agree with and the specific, culture-driven ways that things get done in companies.

One of the inherent characteristics of postmerger integration is time pressure. Many tasks have to be completed quickly. Such an environment does not afford the time for a detailed cultural diagnosis or a long-term culture change project with dubious prospects of achieving desired goals. We suggest a more focused approach, based on identifying the high-risk points in the establishment of the integrated company and working with employees to reduce the ways in which culture magnifies these risks.

The major risks vary in every integration and need to be identified on a case-by-case basis, but a list of risks that will be encountered in most transactions can be provided as a starting point for specific analysis. These "standard integration risks" include:

- Establishing a shared approach to decision-making that achieves appropriate speed and decisiveness.
- Confirming that the most value-affecting interfaces (in the supply chain) between the two legacy companies work effectively.
- Establishing an internal brand — the value to the employee of being part of this newly integrated company expressed in a way that appeals to employees from both companies. This will vary strongly depending on whether the integration is a "merger of equals" or a joint venture on one hand, or the integration of one company into another. In an unequal situation, the acquirer's culture and brand should be expected to dominate and should be presented to acquired employees in a way they will value. This is especially true when the acquiring company in a hostile takeover wants to retain acquired employees. In a merger of equals, the most realistic approach is to look to the emergence of a new culture.
- Understanding the compensation programs in each legacy company and presenting any steps to integrate them in a way that employees see as beneficial to their interests.

Mixing the cultures: HP acquires Compaq

Two hallmarks of HP's absorption of Compaq were a strong focus on business issues and an equally strong focus on providing an interactive forum for employees using the Web. Interestingly, the extended proxy fight that delayed closing the deal may have helped integration by allowing time for product roadmaps to be completed before the integration began. Thus an end-state was clearly in view when large numbers of employees started to work toward it.

The integration effort began with a two-day leadership kickoff. Expectations and rules of engagement were set firmly from the top down. Short deadlines were established to achieve clearly defined synergy targets. This forced collaboration in the interest of achieving desired goals.

An employee portal was used to drive extensive communication and interaction, including feedback. On Day One alone, that portal received 50,000 hits from employees.

Addressing culture when two companies integrate

A rigorous program with clearly stated objectives should be put in place to address cultural integration. Too often, culture is presented as a woolly and soft topic. When that happens, executives tend to slight the issue. This can generally be avoided by linking the cultural program to measurable business results. There are several steps to doing this:

1. Make culture a major component of the change management work stream.

Often the main change management task during integration is providing "communications." This focus may minimize the importance of change management, when communication becomes reporting the decisions of others, belatedly, rather than driving actual decisions. If culture is recognized as a major challenge that the change management team is responsible for, then this team assumes an essential role in achieving integration goals. The change team needs resources whose numbers and caliber are consistent with enacting a critical role.

2. Identify who "owns" corporate culture and have them report to senior management.

Choose owners from both companies to the integration to allow for representation of all views, even in a takeover. These "owners" typically will be senior Human Resources or Organizational Development practitioners. This is also an appropriate task for outside assistance, given the value of external insights in identifying culture. To drive home the importance of the issue, culture should be on the agenda of regularly scheduled (monthly/biweekly) Steering Committee meetings.

3. Insist that the cultural work focuses on the tangible and the measurable.

The Steering Committee should reject soft, vague, and poorly defined presentations of culture. Instead, culture owners should be required to discuss issues that are specific, well defined, and supported by specific examples that can be tied to business results. This is the difference between culture being addressed by general exhortations to enact "teamwork" and being addressed by analysis and interventions to increase measurable collaboration among the members of, for example, the new company's merged sales force. If the culture program focuses on whether members of the sales force are effective in selling the products of each other's companies and removing the barriers to doing so, that will be a more substantial contribution than a culture effort that creates communications to inform the sales force about the desirability of teamwork.

4. Consider the strengths of both existing cultures, not just the weaknesses.

When two companies merge, the assumption is often made that they should take the "best" of each company's culture and integrate them, much like creating a "Best Of" CD from a band's previous recordings. Would that mixing cultures were as simple as sequencing tracks on a mix CD! Corporate strengths are sometimes incompatible. Solid, more mature companies often acquire start-ups as a means of adding products to their portfolio. What they often find is that the structural controls and well defined processes that are a hallmark of predictable performance for the acquirer may be impossible to mix with the less structured ways of the start-up. A more varied integration than a simple addition of desired qualities is required.



One means to help achieve this is to retain separate core capabilities where possible. For example, in the HP-Compaq merger, the merged company kept HP's strong Printer Division with minimal change, but integrated its sales force along the Compaq model, which was judged to have been more effective. Each legacy company's culture was allowed to dominate on a by-function basis. Where the cultures are different, there should be an assessment of whether the elements can be integrated. When the integration is problematic, choices to act should focus on the relationship between cultural assumptions and business results. Only address those cultural issues that are critical to the business. Make an explicit connection between both business and personal achievements and any changes in (cultural) assumptions that people are asked to adopt.

5. Implement a decision-making process that is not hampered by cultural differences.

Decision-making style is often deeply ingrained in a company's culture. However, few things have a greater impact on integration results than the ability to make speedy decisions. Customer and employee loyalty can erode quickly if a company is perceived as unable to reach decisions. Leaders of integrating companies find themselves thrust into a situation where they have to make decisions quickly. While varying decision-making styles may hamper this, the differences among decision-making styles are often less important than the difference among these styles and the decision-making style required for an effective integration. This is an urgent matter.

The leaders of the integration project must address this with the support of the culture team by:

- Identifying decision-makers for each area of the integration.
- Understanding the decision-making style of each company both in terms of what the style is and the assumptions, processes, and structures that support that style. Use this as a basis for assisting decision-makers in moving beyond their assumptions to a point where they can act effectively.
- Communicating expectations to those decision-makers, including the deadlines when decisions are required. The demand for speed can be used to force changes in how decisions are made. Specific techniques can be used to support this, such as encouraging 80/20 decision-making rather than complete certainty before a choice is made.

The three steps outlined above are a starting point for culture change in the critical area of decision-making.

In the integration of HP and Compaq, leadership had to address the tendency of engineers to base decisions on careful analysis of large bodies of data and the cultural assumption that a request for more data is a legitimate reason to delay a decision. Integration teams were introduced to the concept of "adopt and go" — a method of limiting analysis to currently available data and options. "Adopt and go" emphasizes action, not analysis. The term was heard frequently during the integration, describing the new decision-making approach that the integration teams had embraced.

6. Build the employee brand with a view toward how it will be understood by employees.

If retaining the employees is a goal of integration, then an effort must be made to secure their loyalty, just as customers' loyalty must be reinforced. When one company is acquiring another, then the emphasis should be on making the acquiring company's brand attractive, in terms of the career opportunities, rewards, and the sense of identity that it offers to acquired employees. When equals are merging, it is important to find a common point that will not be so novel as to appear alien to all employees. It should neither install one company as dominant nor fail to recognize that employees from the merging companies have different expectations. In the merger of Daiichi and Sankyo, the goal of the merger that employees were presented with initially was to become a mid-size company in the U.S. pharmaceuticals market. Employee surveys showed that this was not an effective rallying cry. An employee brand was built around "adding to the balance

of life." That was reinforced by extensive communications, a campaign to identify and enroll key internal opinion leaders in the brand, and events that varied from providing "balanced" lunches to all employees on one day to massages at people's chairs on another day. This brand gained such momentum it was eventually featured in corporate advertisements.

7. Put people with culture change knowledge and experience on the teams that define the key interfaces in the new organizational model.

The organizational model defines how a merged entity will go to market and how it will integrate its back office functions. Where there are business-critical integration points (for example, sales force integration, hand-offs from R&D to manufacturing or from manufacturing to field support) and a short time available for integration, it is important to focus on the flow of work: how objects or information are passed from group to group or whether information is shared effectively. The interfaces should be designed, improved, or fixed so that they help create business value. If employees start to act in ways that lead to achieving desired goals, that can create trust and mutual respect among employees who have not worked together before. Underlying cultural beliefs should then tend to coalesce around effective and enjoyable shared behaviors. This reverses much typical thinking about culture change. Rather than trying to change the culture in the hope that behavior will follow, this approach advocates that one should change behavior and assume that culture will adjust accordingly.

One critical assumption underlying this approach is that new behaviors can help achieve employee and organizational goals and then over time "culture" will adjust to support desired, effective behaviors. If new behaviors that fail to achieve results are imposed on employees, those employees will likely cling to their old cultural beliefs all the more tenaciously.

In conclusion

Culture must be a focus in efforts to integrate companies, because when left to itself culture will often undermine value-creation. Efforts to address culture should be based on the recognition that culture is both powerful and implicit, that employees are unlikely to change their cultural beliefs in response to exhortations to adopt new cultural values, and that culture can be rigorously linked to behaviors that affect business value. The focus on business value, rather than on "soft stuff" is essential to positioning culture in a way that business leaders will agree to support it. By tying culture to value-creation and to identifying and changing specific behaviors when necessary, culture can become an effective tool for achieving postmerger integration objectives.

Beyond HR integration

Is a merger the right time to launch a transformation?

By David Parry, Carolyn Vavrek, Brian Borzone, Linda Jarnhamn and James Davies



Every merger integration involves major decisions and significant change. One new approach that we are seeing start to take hold is to think about transforming support functions, such as Human Resources (HR) during the integration process — instead of waiting until after the organization is stable. This approach is driven partly by immediate integration needs, and partly by the increasingly strategic role that HR is expected to play in business today.

For many organizations, we believe a merger may be the right moment for HR to boldly develop the services and capabilities it needs to support the company's future growth objectives — changes that go far beyond basic integration. Also, thinking about HR transformation as early as possible in the merger and acquisition (M&A) life cycle can help the integration team make short-term decisions that position HR for long-term success.

Of course, every situation is unique. Some companies may already be in the midst of an HR transformation when the merger begins. Others may still be in the thinking or planning stage. In all cases, it is important for a company to determine exactly how much HR transformation makes sense during the course of a particular integration. This article highlights key factors to consider when deciding whether to pursue an HR transformation as part of a merger — and how far to go.

HR under pressure

The moment the merger starting gun goes off, HR's responsibilities literally triple in number. First, HR must continue to provide the day-to-day services and transaction processing that keep the company running. This is normally HR's full-time job. Second, HR must support the critical people-related merger integration needs for the entire enterprise. Often, an issue-free Day One hinges on HR moving mountains to tackle challenges, such as leadership selection, organization design, staff consolidation, employment terms and conditions rationalization, communications, and of course, making sure HR data, benefits administration, and payroll processing are fully tested and operational upon deal close. HR's third role, like every other support function, is integrating and preparing its own operations, including consolidating policies, programs, systems, processes, and staff.

In addition to expanding responsibilities for HR, the operating environment for everyone changes — resources are scarce, employees (including HR staff) are uncertain about their future, and legal restrictions and organizational politics can supersede rational decisions. Our experience with over 700 deals shows that this situation can result in slow progress and suboptimal results that require corrective action later.

The starting shot for a merger can also be the starting shot for an HR transformation.

Reasons to consider HR transformation

Despite these challenges — and contrary to conventional wisdom — we believe the starting shot for a merger can also be the starting shot for an HR transformation. How so? Consider this: most significant mergers have a material impact on every aspect of HR — from customers served to ongoing operational strategy. Most companies are proficient at addressing each of these angles in isolation and through the lens of a single merger. However, we recommend taking the process one step further and considering these decisions holistically and as part of a larger vision for changing the way HR operates. We call this more complex, yet thoughtful approach an **M&A-led HR transformation**.

Thinking about transformation during the integration — rather than after — can help the HR integration team find the right answers to critical integration questions that have both an immediate and long-term impact, such as:

- What HR capabilities are required to support the merger's growth goals?
- What HR technologies are needed to efficiently handle increases in transaction volume and an expanded global footprint?
- What HR services are needed to acquire, develop, and retain new and critical talent?
- What skills and experiences will HR staff need in order to support the new strategy?
- What is the right price point for the services that HR needs to provide?

M&A led HR transformation can enable HR to develop services and capabilities that better address the combined entity's short- and long-term business needs.

One size does not fit all

The need for HR transformation varies from company to company, and is different for every merger as highlighted in the following three examples.

Widespread transformation

In a recent manufacturing industry merger, a company with nearly 10,000 employees did not have the HR capabilities, systems, and staff to support the addition of more than 5,000 employees. This led the company to develop a new HR service delivery model, including redesigned HR processes, a new ERP application, and a new employee service center. The HR transformation effort initially focused on the needs of the newly acquired employees, but was designed to be deployed across the entire company within two years.

Ongoing transformation

A major global consumer and industrial products company had embarked on a global HR transformation to streamline operations through increased use of shared services and greater leverage of its HR technology investments. However, in the middle of the transformation journey, two major global deals closed. The transformation team took a time-out to modify its existing plans and transformation roadmap in order to better integrate the newly acquired organizations into the company's global footprint. This helped the business address its immediate integration challenges without sacrificing the benefits of long-term HR transformation.

Focused transformation

When a high-tech company acquired its main competitor, large overlaps in products and services led to aggressive synergy targets that required a fast integration effort and major reductions in administrative overhead. The need for speed, combined with a lengthy review by the U.S. Securities and Exchange Commission, limited the time available for HR transformation. However, instead of simply integrating the two HR functions, the company took a long-term transformational view. Starting with its existing HR transformation blueprint, the company identified key integration areas that could also advance the long-term transformation goals (without slowing things down). Since systems integration and vendor consolidation were already on the integration agenda, the company decided to upgrade its HR systems for improved scalability, and to renegotiate key vendor contracts to capitalize on the new entity's increased buying power. In addition, HR used the merger as a catalyst to strengthen its role as a strategic business partner, offering new services and capabilities to support the company's global management team.



Keys to effective M&A led HR transformation

HR transformation is usually a significant event no matter when or why it starts. Here are some practical tips to consider that can help make an M&A led HR transformation more effective.

- **Determine the scale of transformation early on.** The framework presented can help decision-makers think through how far and how fast the transformation should go. Determining the scale of the transformation should quickly lead to finalizing the strategy, scope, timeline, and milestones — all of which should align with the overall integration plan.
- **Make the case for change as part of the deal.** A clear, detailed, and quantified rationale for immediate change will help build executive support and buy-in throughout the organization. The case for change should be made in terms of how an M&A led HR transformation will support the merger objectives while aligning HR with the company's longer-term strategic objectives.
- **Secure funding for transformation.** The financial model supporting a merger typically includes not only expected cost synergies, but also investments. The cost of HR transformation should be factored into the deal as part of achieving both the short-term and long-term integration objectives. In many cases, a merger can be the catalyst for funding a transformation that otherwise might face financial obstacles due to competing company priorities.
- **Make sure the basics are covered.** HR's long-term credibility is based on its ability to deliver the basic services well. In a merger, we recommend forming a dedicated team focused on achieving a flawless Day One. The Day One team should be connected to the HR transformation.

Evaluating the need for transformation

M&A led HR transformation can be a powerful tool; however, many factors come into play when deciding whether to transform HR as part of a merger. The following framework includes a wide range of decision factors grouped into five broad categories: external factors, merger scope, stakeholder support, time limitations, and HR specific factors. This decision framework can help understand the "when" and "why" of an M&A led HR transformation.

Figure 1



External factors

The need for HR transformation is often driven by external factors that go far beyond the Day One merger requirements. Companies that expect to pursue a fundamentally different strategy after the merger are likely to need fundamentally different HR services and capabilities — particularly in strategic areas, such as talent management, succession planning, rewards management, and recruiting. The same is true for companies facing aggressive growth and synergy targets, or significant increases in competitive pressure.

To help the business tackle these challenges, HR will need to shift its focus and transform the way it operates. Generally speaking, the greater the changes to the overall business as a result of the merger, the greater the need to start transforming HR now.

Merger scope

If the merger will involve fundamental changes to the business — e.g., new operating model, larger global footprint, increased workforce size, and complexity — HR must adapt itself accordingly. For example, an expanded geographic footprint requires HR to address a wide range of new challenges, including local hiring and staffing, local HR operations, and local workforce regulations. Similarly, a larger and more complex workforce requires HR to serve a much broader range of stakeholders with new and different needs.

A significant merger is likely to drive changes in all aspects of the HR function, including HR's organization structure, staffing, technology platforms, services, delivery models, and more. Executing these discrete changes as part of a broader transformation vision for HR will help HR grow and adapt effectively over time.

Figure 2

	◀ Less immediate need for HR transformation	More immediate need for HR transformation ▶
Competitive environment	Stable competitive environment. The competitive environment is stable and the combined entity will have a strong position against competitors.	Changing competitive environment. The combined entity will operate in a new, highly competitive, and/or changing environment.
Strategy	Stable strategy. The strategy of the combined entity is similar to each legacy company's strategy.	New strategy. The strategy of the combined entity is fundamentally new and different.
Merger goals	Simple growth. Growth and synergy targets can largely be achieved simply by combining the businesses and capitalizing on economies of scale.	Aggressive growth and synergy targets. The company is expected to deliver significant revenue growth and cost savings over and above what can be achieved simply by combining the businesses.

Figure 3

	◀ Less immediate need for HR transformation	More immediate need for HR transformation ▶
Extent of integration	Autonomous units. The two organizations will remain largely unchanged and will operate independently of each other after the merger.	Complete integration. The two companies will be completely integrated and will operate as a single business soon after the close.
Size of deal	Small scale. The deal is relatively small and does not involve a significant increase in revenue, profitability, or the size of the workforce.	Large scale. The deal is relatively large and involves a significant increase in revenue, profitability, and the size of the workforce.
Geographic footprint	Minor geographic impact. The merger will not significantly change the acquiring company's geographic footprint.	Major geographic impact. The merger will significantly expand the acquiring company's geographic footprint.
HR customers	Largely unchanged. HR will continue to serve the same types of customers as before.	Different customers with different needs. HR will serve new types of customers with fundamentally different needs.

Stakeholder support

Any fundamental shift in operations is a long-term undertaking that will have both ups and downs, as well as fundamental leaps forward. To achieve or exceed expected objectives, a transformation needs strong support from senior management. The most effective approach we have found is to paint a realistic picture and then engage the CEO and other top executives in the new vision. At the same time, it is important to gain the trust of middle management, since they are the stakeholders most responsible for making the daily changes that will lead to the transformation.

The pitch for HR transformation as part of a merger should be as natural as the assumption that a deal will require a new IT strategy. Armed with the right message and a strong business case, proposing an M&A led HR transformation can actually enhance HR's image as a strategic, forward-thinking business partner.

Time limitations

Time is the enemy of every deal. Operational transformations are complex endeavors that often take a year to plan and two to five years to execute. That said, a merger is one of the few events where functions are often forced to work outside of their silos, cross their natural boundaries, and step up to a new level of enterprise-wide thinking. Capitalizing on this energy can accelerate the planning process and reduce the time needed to transform HR overall.

The decision to transform HR as part of a merger is not just a function of time. Other factors play a critical role in determining if HR transformation is viable — or even essential — for effectively executing the integration. If time turns out to be the most limiting element, it is still worth making an effort to consider the new vision for HR after the deal closes. Even a high level picture of the future

(if well articulated and communicated to key decision makers) can enable short-term integration decisions that support HR's long-term strategic direction.

HR-specific factors

At the highest level, HR organizations worldwide provide the same types of basic services, track the same types of data using the same types of systems, and are organized to operate in similar ways. On the ground floor of any organization, the HR function can vary significantly, even

within the same company. Over time HR organizations evolve into different shapes and sizes based on the unique needs of the businesses they support. In a merger situation, these differences need to be identified, analyzed, and then rationalized.

The case for HR transformation is strongest if one or both HR functions are already at an inflection point. In these situations, an M&A led HR transformation can be a welcome springboard for change.

Figure 4

	◀ Less immediate need for HR transformation	More immediate need for HR transformation ▶
Appetite for HR transformation	Little appetite for HR transformation. Senior decision makers are sceptical – or even hostile – about the idea of transforming HR during a merger.	Strong interest in HR transformation. Senior decision makers believe HR can make significant improvements and they support the idea of transforming HR during the merger.
Depth and strength of HR leadership	Inexperienced HR leadership. HR leaders are not ready for a large-scale change that could disrupt HR's daily tasks.	Strong, change-oriented HR leadership. Current HR leaders see a great opportunity for improvement and have the strength and depth of HR talent to execute on it.
Level of business support	Business leaders want HR "business as usual." Business leadership does not see the need for HR to change, and in fact, might be willing to pay more for HR to stay the same.	Business leaders pushing for new HR services and support. Business leaders can readily articulate what changes they need from HR and how these changes will help drive their business forward.

Figure 5

	◀ Less immediate need for HR transformation	More immediate need for HR transformation ▶
Real-world time constraints	Significant time pressure. The integration needs to happen very quickly with no time to consider anything, but the "must haves."	Less time pressure. The anticipated merger close and integration schedule allows enough time, or can be stretched to allow enough time, to plan for an M&A led HR transformation.

Figure 6

	◀ Less immediate need for HR transformation	More immediate need for HR transformation ▶
HR service delivery model	Similar models. The two HR organizations have similar models for delivering services, and their staffing models are closely aligned in terms of organizational roles, performance objectives, and compensation.	Very different models. The two HR organizations have fundamentally different models for service delivery and staffing. They may include disparate organizational models, as well as a complex mix of insourcing, outsourcing, and offshoring.
HR efficiency and effectiveness	Solid HR operations. Both companies are satisfied with their HR operations and the value that HR provides.	Needs improvement. One or both companies believe HR could significantly improve its efficiency and value.
HR roles	Similar roles and strong business alignment. The two HR organizations play similar roles in the business and their competencies align well with the company's future strategy.	Dissimilar roles or the wrong focus. The two HR organizations play different roles in the business, and/or their competencies do not align well with the company's future strategy.
HR technology	Similar or easily integrated. The two companies have HR systems and technology strategies that are similar and/or relatively easy to integrate.	Different and difficult to integrate. The two companies have HR systems and technology strategies that are significantly different and integration is expected to be a major challenge.

Case Study: M&A led HR transformation at Thomson Reuters

The Thomson Reuters integration is a good example of how a well planned HR transformation can form a natural part of the integration journey. On May 8, 2007, the Canadian information publisher Thomson Reuters made a preliminary bid to acquire British-based Reuters Group Plc for \$18 billion. The company's goal was to become "the number one provider of electronic information services, trading systems, and news for professionals in knowledge-based industries"—a goal that had significant implications for how the HR function would be organized as the workforce expanded from 30,000 to over 52,000 employees.

According to Stephen Dando, the company's Chief Human Resources Officer, *"Our decision to transform HR early on in the integration process was driven by a strong corporate purpose. The key levers for change were particularly the new corporate strategy, a challenging synergy target, and a significantly changing footprint; less US/UK focused and much more global. We also had two very different HR operating models and were using different systems. Despite one of the companies having just transformed their HR function, business leaders also felt that HR needed to become better aligned with the business, provide a more consistent employee experience, and become more cost effective whilst at the same time provide a better service."*

Given the challenges highlighted by Dando, it is easy to see why Thomson Reuters decided to transform HR as part of the integration. Some of the Thomson Reuters responses to these challenges have been highlighted below:

- **External and business factors: *strategy and synergy target***

They restructured specialist functions, realigned business HR teams, and developed a detailed plan for delivering HR synergy targets.

- **Merger scope and impact: *footprint and scale***

The team initiated a review of their overall service delivery model and developed a plan to better match the company's new global footprint.

- **HR-specific factors: *systems and service delivery model***

In addition to restructuring, the integration team also had an early focus on obtaining funding to develop and merge HR systems for Day One.

- **Stakeholder support: *little initial support***

HR developed a rationale for the transformation, and clearly defined the expected scope, timing, and benefits.

- **Time pressure**

A change in timeline due to a waiting period for regulatory approval gave the company more time to plan and prepare for the changes across HR.

Although the journey is still in progress — with the final synergy targets expected to be realized by 2011 — there is little doubt that the decision to start early was the right one.

Dando continues: *"Key to success of the transformation was a single integrated project team with members from both companies and external support working collaboratively on the transformation early on. This, combined with the team members being freed up from their day-to-day jobs, a clear steer from the business of what they wanted from HR in the future, clear accountabilities and secured funding for systems integration, helped the function to start operating as one much earlier than had we not had a strong cross company focus and longer term plan in mind."*

Transformation starts today

A merger can place the HR function under tremendous pressure; however, it can also provide an unmatched opportunity for HR to shine.

During a merger, HR is at the center of important conversations about leadership, culture, and talent management. We believe that by spending a little time thinking about M&A led HR transformation early in the planning process — and by consciously looking for opportunities to improve (not just combine) its capabilities throughout the merger life cycle — HR can pave its own path to success.

The art and science of executive selection

Selecting leaders to capture the value of the deal

By Kevin Knowles, Sarah Hindley, Kimberly Storin and Daniel Schimmelpfenig



Selecting the new leadership team is one of the most important decisions you will face when combining two organizations after the completion of a merger or acquisition. It is a decision with lasting implications that are often underestimated. The leaders you choose will define the new organization's capabilities and culture. Stakeholders — employees, investors, and board members — will watch closely because your decision sets the tone for the integration, as well as the newly combined organization.

As the CEO of the new organization, your ultimate goal is to select leaders who will create and drive value, whether they come from the legacy company, the acquired organization, or from the outside. Regardless of their past experiences, the new leaders must demonstrate leadership competencies and behaviors that are aligned with the strategy, operating model, and desired culture of the future organization.

The selection process will test your own leadership skills. You must be able to deal with potentially volatile egos and remain objective as you keep the long-term good of the organization at the forefront. You will need to distinguish the people who will lead effectively from those who want to lead, and those who should stay from those who want to stay.

Executive employment agreements and severance protections add an additional layer of complexity to executive selection. A knowledgeable Human Resources (HR) professional, whether your organization's HR leader or outside professional, can provide guidance and support needed to navigate the nuances of these agreements and develop an objective selection process.

We have found that the best selections are often made by balancing the "science" of following a structured, rigorous, and objective decision process with the "art" of leveraging tools and tactics to gain insight to leadership abilities and behaviors, as well as cultural fit. This article outlines five key steps to consider as you select the leadership team that will champion and lead transformational change.

Five-step leadership selection process and considerations

Step 1: Define the future vision of the new organization.

Before you can select new leaders, the functional operating model, structure, and strategy of the new organization should be defined. Consider conducting cultural assessments that can help identify the culture you want to instill in the future organization, which may be different from the legacy and acquired organizations' cultures. Be confident that the leaders you select can — and will — execute this strategy.

Artful considerations: Executives with political clout may pressure you to create roles within the organization's structure for themselves or particular individuals, perhaps out of a sense of loyalty or because of the individual's long tenure with one of the legacy organizations. Resist this pressure and reinforce the importance of creating leadership roles around what needs to be done, not around the abilities or relationships of people who have done the job in the past.

Step 2:

Define the job requirements and leadership attributes.

Clarify your expectations for the new organization's leaders by defining the specific, relevant job requirements, and desired leadership attributes that will be needed to execute the new vision, strategy, and operating model. You should incorporate the competencies, behaviors, and technical knowledge that the new leaders will need to fulfill their responsibilities.

Compare new positions' job requirements and leadership attributes with current leadership positions in both organizations to provide a baseline for evaluating whether or not leaders within either the legacy or the acquired company possess the ideal skill sets. If not, you may need to add outside candidates to the selection pool.

When setting compensation for the new leadership positions, consider salary ranges and benefits for comparable positions at both organizations, including specific executive incentive compensation programs. Adjustments may be required to balance inequities in salary ranges across the organizations and manage expectations.

Artful considerations: By determining the desired competencies, attitudes, and behaviors required for success in the combined organization, you can focus on what is needed for the future, rather than tailoring the new leadership roles to fit existing leaders. This allows you to assess candidates objectively based on the organization's future needs, rather than the current organizational structure or the candidates' past performances or roles.

Some of these attributes may be difficult to define, but they will provide a clear benchmark to measure candidates against. While specific job requirements will vary based on the organization's strategy and culture, you should look for individuals who have demonstrated an effective leadership style while driving growth in a transformational environment. Your future organization will need leaders who are able to motivate and empower employees while maintaining focus and delivering results.

Use the job requirements and leadership attributes during the interview process to communicate your expectations to candidates. This can help prepare them for the challenges ahead and position them to be successful in the new organization, if selected.

Step 3:

Objectively evaluate candidates and select the new leadership team.

It is important to have an objective approach to evaluating candidates from both organizations, as well as any outside candidates. Historical performance data for the candidates, including past performance reports and 360-degree feedback, if available, should be collected and reviewed to provide insight into past performance and behavior.

Selection tools, such as leadership competency tests and behavioral interview guides, may help to objectively assess candidates. Personality assessments conducted by outside vendors can provide additional information about the candidates' management styles and behaviors, helping you identify candidates who possess not only the required technical skills and competencies to lead, but also fit the desired culture of the new organization.

Conduct interviews that include behavioral questions that uncover whether or not candidates possess the interpersonal skills that fit with the culture of the new organization. During the interview phase, work with legal counsel or HR to monitor the interview process for consistency in the selection process for all candidates and for favoritism to reduce the chances for litigation or other legal repercussions that could create negative publicity, internal turmoil, and legal costs.

Artful considerations: Use a holistic approach in evaluating candidates. Rather than analyzing a candidate's past performance reviews, interview data, and personality assessments separately, examine them as a whole, looking for patterns and discrepancies. This process may uncover subtle competency and behavior gaps, which may not stand out on their own, but that could affect the person's ability to lead in the new organization.

It's important to have an objective approach to evaluating candidates from both organizations, as well as any outside candidates.

Step 4:**Develop leadership announcement plans.**

Even before the new leaders have been selected, develop a detailed change readiness and communications plan for announcing the decisions to the candidates and other stakeholders. A prompt announcement and introduction of the new organization's leadership team to employees will help influence and engage them in the change and retain them in the organization. Plan to incorporate multiple communication methods, such as town halls, leadership meetings, corporate newsletters, and e-mails, to help employees understand the new leadership structure and the new leader announcement plans. When possible, create employee events so that they can meet the new leaders. Also, develop a detailed communications plan to announce the new leaders to external stakeholders, such as the investment community, board members, customers, and suppliers.

Artful considerations: Timing and tone are important when communicating leadership changes. If possible, plan to select the new leadership team just prior to the transaction close. Also consider incorporating media and communications coaching in the plan to prepare the new leadership team for effectively communicating with employees and other stakeholders when the public announcement is made. For executives who will not be continuing with the future organization, plan a clear — and preferably swift — exit strategy. Incentives in their severance package will encourage them to support a smooth leadership transition.

Step 5:**Communicate decision to all stakeholders.**

Once the decisions are made, the selected candidates should be informed through one-on-one conversations that include pre-close offer letters that detail compensation and benefits, as well as explicit confidentiality guidelines. As soon as the selected candidates accept their leadership positions, notify the other candidates quickly and discretely — also with explicit confidentiality guidelines tied to severance packages. Once that is done, roll out the communication plan for other stakeholders as quickly as possible to help avoid unofficial leaks and to reduce employee uncertainty, an unfortunate event that could affect job performance.

Artful considerations: Publically showing strong support and confidence in the new leadership team will help alleviate some of the uncertainty employees may feel about the future of the new organization. Treat the candidates who are not selected to lead the new organization with dignity and respect. This will show stakeholders that the organization is committed to integrity and sets the precedence for how future decisions will be handled.

The leadership journey begins

Selecting your leadership team marks the beginning of the postmerger leadership journey. Balancing the science of a rigorous process with the art of managing interpersonal dynamics can help optimize your ability to choose a capable leadership team that shares your vision for value capture and growth — it is a unique opportunity to set the future trajectory of the new organization.

Real life results in the energy industry

Two regional energy companies came together in a "merger of equals," creating a significant U.S. energy producer. Two cornerstone objectives of the merger were to minimize business disruption and capture the best of both organizations.

In order to meet these objectives, it was critical for them to balance the art and science of leadership selection:

- **Science:** Develop a methodical process to select the leadership team quickly and efficiently in order to alleviate uncertainty, allowing employees to remain focused on day-to-day operations.
- **Art:** Choose the "right" leaders from both organizations, factoring in desired culture, as well as experience, capability, and behavior.

Step 1:

Define the future vision

Science: The new CEO, who was quickly appointed by the Board of Directors, worked with the deal team to define what the organization should look like going forward.

Art: Facing political pull from both organizations, the CEO focused on remaining neutral, as well as on defining the business drivers, key positions, and span of control required to support the combined business.

Step 2:

Define the job requirements and leadership attributes

Science: A leadership competency model was developed to serve as a decision making tool, outlining the requirements for the second tier jobs going forward.

Art: In conjunction with the organizational design and selection process, the leadership team defined an interim mission, vision, and values to guide the combined organization through the transition. Candidates were assessed for cultural fit using the mission, vision, and values as a benchmark.

Step 3:

Objectively evaluate candidates and select the new leadership team

Science: The CEO put two specific processes in place to select the first level Senior Vice Presidents and the second level of executives, using a balanced scorecard and consensus meetings to achieve equitable consideration.

Art: In addition to gathering past performance data, interviews were conducted to gauge interest and cultural fit with the new organization.

Step 4:

Develop leadership announcement plans

Science: The CEO partnered with the Communications Team to develop a comprehensive leadership announcement plan for both selected/nonselected leaders, as well as the broad employee population.

Art: Employees at both organizations were concerned about the future organization structure and how their function would be impacted. In anticipation that a prolonged period of uncertainty would lead to a decline in productivity and engagement, the selection process was expedited in order to make leadership announcements prior to close.

Step 5:

Communicate decision to all stakeholders

Science: The CEO employed a structured cascade approach to leadership announcements. Human Resources first notified the candidates of the decisions. Once all candidates were notified, information was cascaded throughout the organization to provide clarity on the new roles and leadership, as well as to provide an opportunity for associates to ask questions.

Art: Communications did not end after the initial leadership announcement. Employees received regular updates on the continued organization design and selection process, including organization structure, functional responsibilities, and reporting relationships.

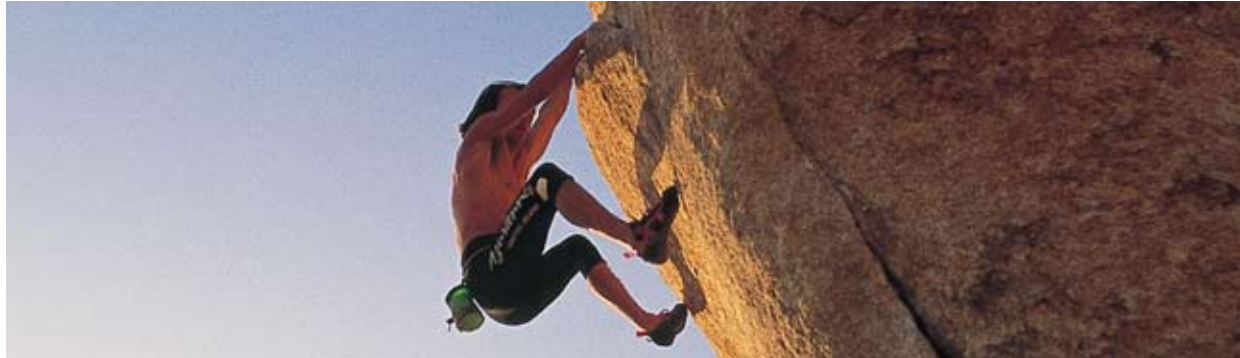
Results:

- Expedited process led to Level 1 and 2 leadership selected and announced prior to close
- Reduction in employee uncertainty influenced a continued focus on day-to-day operations, which helped minimize customer disruption
- Employees remained productive and engaged from deal announcement to close, typically a period of high anxiety

The leadership journey

Preparing your leadership team to navigate the transition to a new organization

By Eileen Fernandes and Kevin Knowles

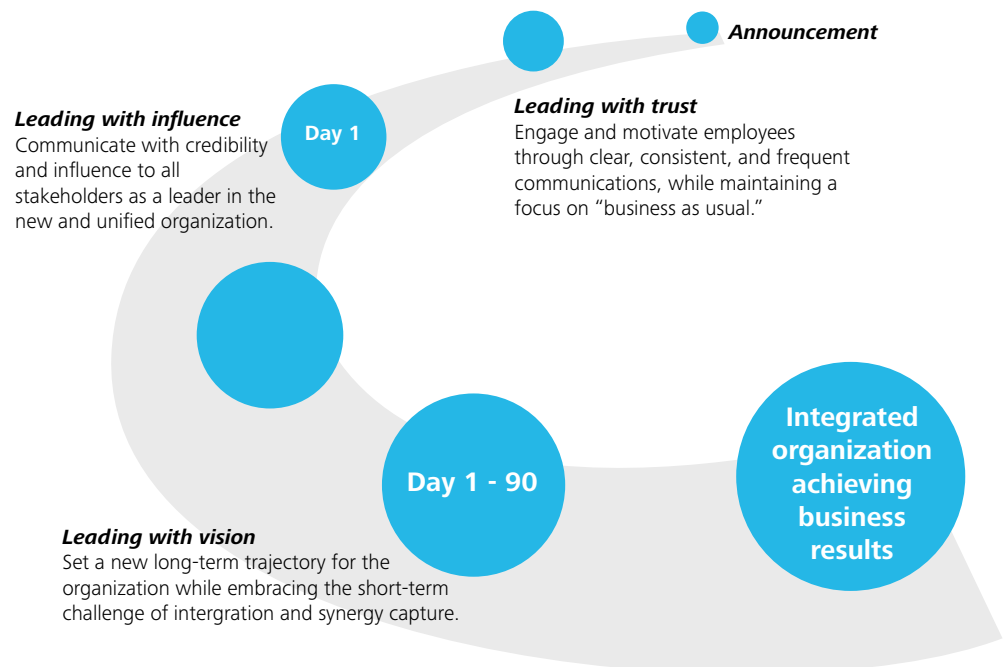


Most executive leaders know that a successful merger and acquisition (M&A) transaction and integration hinges on a smooth transition for employees and customers. Appropriately, they make significant investments in planning and executing positive employee and customer experiences for Day One¹ and beyond.

But too often, the same rigor and intense focus is not dedicated to preparing the functional leadership team to navigate their organizations through the transition.

As the CEO, your leadership team can be the strongest link in your company's M&A transition — or the weakest. Investing in building a cohesive and aligned team increases the odds that they will successfully navigate the leadership journey that begins when a transaction is announced. This article describes some of the ways to support and cultivate these capabilities in your go-forward leadership team:

- Leading with trust after the announcement
- Leading with influence as Day One approaches
- Leading with vision on Day One and beyond



¹ Day One is the day the two companies or organizations become one, usually the day the transaction is closed.

Leading with trust

Before a transaction is announced, your leadership team should have a clear idea of how their organizations support the company's overarching vision and have communicated this mission to their people, and engaged them in crafting and executing strategies and tactics. They also should have built a legacy of trust based on a foundation of clear communication, constructive feedback, and appropriate rewards.

Then, their world changes. A planned merger or acquisition signals that the company is accelerating in a new direction with a shift in vision and operating model. It is not clear what roles these leaders, or their organizations, will play in this new vision. While struggling with their own uncertainty, they must continue to engage and motivate their people, maintaining "business as usual."

To manage through flux, your leaders must call upon the trust they have instilled in their people. Without the support of a clearly defined vision or role, they must lead by engaging their people with communications that are even more clear, consistent, and frequent than in the past. They must become champions of change, even though they don't have all the answers themselves.

Core challenge: Aligning your leadership team

Aligning people — especially leaders — is never easy, but it is even more difficult during a merger or acquisition since both organizations must remain separate and independent until the deal closes. As much as regulatory requirements allow, the leadership teams of the two organizations should collaborate, sharing ideas and perspectives while building credibility and trust.

Specific recommendation: Facilitate separate, parallel, and coordinated communications

- **Commit to your leaders.** Commit to leaders from both organizations that they will be integral to the success of the business. Reinforce their role in planning and goal setting for the integration. Ask them to effectively collaborate, aggressively communicate with their people, and continue to execute the business at hand.
- **Engage leaders early.** Vision, strategy, and operating model are the highest priorities for leaders in transition and organizations in flux. While honoring confidentiality requirements, be as transparent as possible with your leaders. Engage the leadership team early in the process of creating the new vision, strategy, and operating model for the combined company. This will help increase understanding and support, forming the foundation for communicating with their people.

- **Rapidly define messages.** While specific details will continue to evolve, clearly define the overall vision for the combined company and encourage leaders to share this message with their people. An effective and trusted leadership team must be able to describe the opportunity, rationale, and challenges while being accountable for yet-to-be-determined priorities.
- **Strongly encourage high visibility.** Appoint leaders from both organizations to the steering committee that guides the core integration team. Encourage them to keep their finger on the pulse of their respective organization by increasing face-to-face time with employees at all levels.
- **Keep it simple.** As with any day-to-day communication, keep the messages to employees clear and concise. Provide up-to-date information to leaders regularly and encourage them to share these messages with their people aggressively and consistently, using any means that make sense.

They [leaders] must become champions of change, even though they don't have all the answers themselves.

Leading with influence

As the company approaches Day One, a shift occurs when the top tiers of the go-forward leadership team are selected and the remaining leaders assume transitional roles. This is a shift in power, accountability, roles, and ultimately leadership.

Up to this point, the leadership team has been deeply involved in overseeing the integration planning, so they have a clear understanding of what needs to be done to merge the two organizations. The new role of the go-forward leaders will be to engage employees and lead with influence across both organizations.

Core challenge: Executing a smooth transition of authority

Your goal is to present a unified leadership team on Day One. They must represent the new company and communicate with credibility and influence to all stakeholders, including employees they have not met or led before.

Specific recommendation: Confer authority and confidence in the new leadership team

- **Convene an executive leadership summit.** Bring together your new team of direct reports to share your aspirations for the business and convey responsibility to them for delivering on commitments to shareholders, customers, and employees. Lead the collaborative

process of identifying challenges and strategies for actualizing the company's new mission, vision, values and culture, and ultimately gain their commitment to succeeding in spite of obstacles.

- **Rollout the leadership announcement plan.** An effective leadership transition requires careful planning, even before final decisions are made. Plan to announce the go-forward leadership team to the integration team just prior to the transaction close, ideally a week or so in advance. Put plans in place to roll out the news to other employees through multiple communication channels. When possible, create employee events to provide opportunities to meet the new leaders.

Set the right tone. When announcing the new leadership team, personally express your strong support and confidence in the new leaders. Also acknowledge the contribution of the exiting leaders; treating them with respect and dignity will help set the tone for the culture of the new organization and set precedence for how future employee transitions will be handled. Consider participating in media and presentation coaching to prepare yourself and the leadership team to effectively communicate with all stakeholders and address their concerns.

- **Facilitate a smooth, but rapid, transition of authority.** There are no hard and fast rules for handing off leadership roles, so be prepared to deal with a wide range of emotions and behaviors. Ideally, the exiting and incoming leaders work together to transition the organization's work and people. In some cases, the previous leader may be assigned a new role within the organization or may become an outside consultant to the new leader. However, in most cases, it is best to transfer complete authority as rapidly as possible, ending the prior leader's influence and visibility within the organization.

Leading with vision

Immediately following Day One, the new leaders have the authority and influence needed to build a new vision for their organizations that supports the overall company vision. While embracing the short-term challenge of integrating their organization and meeting synergy targets, they have a unique opportunity to set a new long-term trajectory for their organization.

Core challenge: Supporting leaders in creating their new organization

Your guidance will be needed to help the leadership team work together, rather than solely focus on their functional areas. Establish a process that will keep their organizations in sync, while encouraging a continuous flow of communications at all levels of the company.

Specific recommendation: Encourage engaging all employees in the new vision

- **Synchronize organizational planning.** Establish a common approach and timeline for your leaders to collectively set their organizations' goals and objectives. Encourage a collaborative environment by creating a planning process that is transparent and incorporates all of the integration priorities and functional interdependencies.
- **Encourage leaders to get smart.** Getting smart means learning as much as possible about their new organizations as quickly as possible. Starting Day One, the new leaders should be out talking with their people at all levels, encouraging ideas and candor. The goal is to gain intimate knowledge of the day-to-day operations of their organizations.
- **Support alignment of functional management teams.** Within 90 days of Day One, each functional leader should hold a strategic planning session with their management team to identify the strengths, weakness, opportunities, and threats facing their organization. This information will become the foundation for designing the organization's new vision, strategy, and operating model, forming the foundation for the new "business as usual."
- **Encourage leaders to cascade their vision down and channel feedback up.** The new leaders must communicate how their people can be successful in their jobs and help achieve the company's vision and goals. Leaders should pay attention to reports that indicate what is really happening on the people side of the business, such as attrition reports, performance review reports, and customer satisfaction surveys. They should also consider subjective feedback systems, such as anonymous 360° employee surveys. Finally, they should close the feedback loop by providing employees with summaries of the feedback and the actions the management team will take to address their concerns.

The journey begins

As an executive leader, a merger or acquisition offers you the opportunity to build a cohesive leadership team that will support your priorities to capture value, create growth, and bring two organizations together as one company with a common vision and shared goals. Your leadership team will need a guiding hand to effectively complete their journey from announcement to Day One and beyond. By supporting your leadership team on their journey toward leading with vision, you are in a unique position to set a positive trajectory for the new organization.

Section 4: Post Merger Integration

Address the new set of people challenges that emerge with the birth of a newly combined company.

Merger Aftershocks

Surviving the people challenges of a postmerger integration

By Carolyn Vavrek, Eileen Fernandes, John Fiore, Fred Miller, Kevin Knowles and Michelle Angier



The announcement of a merger or acquisition typically sends shockwaves of anxiety rippling through an organization. Employees worry about losing their jobs. Managers struggle to maintain control in an environment where everything is shifting. Leaders agonize over the tough decisions that need to be made. And, people at every level may even lie awake at night wondering about their role in the new organization.

This initial shock is often followed by a series of aftershocks. Unexpected defections of key talent. Bouts of organizational panic caused by rumors and innuendo. Sharp declines in productivity and morale. And in some cases, the loss of customers and poor market performance.

Organizations that are unprepared to tackle these challenges quickly and decisively are likely to find themselves watching helplessly as their merger benefits — and chances for achieving desired results — rapidly slip away.

Here are six critical actions to consider that can help you stabilize your organization after a merger announcement.

Leadership alignment

Effective merger integration begins at the top

An aligned leadership team sets the tone for the rest of the organization. When key leaders from both sides of the merger are actively engaged in the integration effort — and behave in a positive and consistent manner — employees are more likely to engage and follow suit. The foundation for leadership alignment is set with a common vision, purpose, and strategy. These shared elements can give leaders a personal reason to pull in the same direction. A clear integration strategy is particularly important. By identifying potential barriers to change — and mitigating

their impact — an effective integration strategy, can accelerate the integration process. It can also help facilitate a smooth transition during the first 90 days.

Keys to achieving results:

- *Get leaders involved.* Create meaningful opportunities for involvement and ownership by engaging key leaders and stakeholders in development of the integration strategy as well as the post-merger operating strategy.
- *Make it personal.* Align personal goals and working styles with the overall goals of the organization. Create a compelling vision to excite and energize leaders.
- *Follow a structured approach.* Use time-tested approaches and tools to foster alignment and to implement shared objectives, goals, and plans. Hold a formal "summit" meeting to get leaders aligned and on board.

Organizational design

More than lines and boxes

An effective merger hinges on deploying the organization's diverse and critical talent to meet changing business needs. Good organizational design can help address this challenge by creating a clear reporting relationship structure and well defined roles. It can also help address the merger-related questions that often keep employees awake at night. How will the merger affect me? Will I have a job? Where will I work? Who will I work for? What about my friends?

Effective organizational design is more than simply drawing some boxes and lines on a page. It requires a comprehensive approach that encompasses all functions, cross-functional areas, and geographic regions. It also requires clear objectives and a robust implementation plan that minimizes disruption to the business.

Keys to achieving results:

- *Take inventory.* Identify the capabilities required to support the new organization's objectives. Conduct a thorough evaluation of employee skills, competency, and performance. Identify top talent and design the organization to harness their full potential.
- *Seek input.* Interview key stakeholders from both sides of the deal. Talk to people at every level — and from each major function.
- *Explain "how" and "why."* Clearly communicate the new organizational structure, explaining exactly how it will work, why it was designed the way it was, and how roles will be staffed.

Talent retention

Holding on to your most effective people

Although a merger might be a great opportunity for the organization, employees generally view it as a threat. Even your most effective people — the ones who should have the least to worry about — are likely to start making contingency plans. And in this period of uncertainty, it is all too easy for other organizations to swoop in and steal them away.

Organizations need an explicit strategy for retaining talent during a merger. This is especially true for deals where people and talent — rather than products, financial assets, or market position — are at the heart of the merger strategy and benefits.

An effective talent retention strategy can help you hold on to the people, knowledge, and focus you most want to keep. This can help enhance business continuity and lay the groundwork for a high performance culture in the new organization.

Keys to achieving results:

- *Act quickly.* Talented people are decisive, action-oriented, and highly marketable. Be sure they understand they are valued and have nothing to worry about. Do not give them a chance to even think about leaving.
- *Build commitment.* Take specific steps to involve, engage, and empower employees at every level. Help them understand where the organization is headed — and how they fit in.
- *Work with Human Resources (HR).* Collaborate with HR to establish retention strategies that help keep people, transfer knowledge, and maintain focus.

Communications

Fighting rumors with facts

A merger — or even the possibility of a merger — is sure to get people talking. And when they are not talking, they are probably worrying in silence. Either way, the negative impact to productivity and morale is undeniable. Even worse, the damage can easily spread beyond your workforce, poisoning customer relationships, and undermining the organization's reputation and brand.

A 360° communications program can help reduce these risks by replacing rumors and half-truths with facts and information. A comprehensive and strategic program should target all of an organization's key stakeholders — including managers, employees, customers, suppliers, shareholders, board members, and the media — with messages and communication tailored to their specific needs and concerns. Such an approach requires a significant investment and deliberate effort, but the investment generally pays for itself many times over during the integration process and beyond.

Keys to achieving results:

- *Don't wait too long.* Executives are often reluctant to share information about a merger until all of the integration details have been nailed down. But unless the organization's leaders communicate with the workforce, there is nothing to keep the rumor mill in check. And in most cases, the resulting rumors and imaginary fears are much worse than reality.



- *Provide frequent updates.* Merger communication is an ongoing process, not a one-time event. Communicate early and often, providing information updates as the integration unfolds. Strive for consistent messaging over time — and across stakeholder groups — but don't feel as if you need to be perfect. Mergers can be challenging, and people understand that.
- *Establish a two-way dialogue.* Give individuals a chance to voice their concerns and to provide input. People are more likely to get on board when they feel as if they are involved in the process.

Culture

Culture clash is often the most significant obstacle to an effective merger

Corporate culture might be difficult to quantify, but its impact on a merger is very real. Some organizations make the mistake of ignoring culture-related issues. Others carefully design an "ideal" culture and assume that employee behavior will automatically fall in line. In our experience, neither of these approaches are effective.

Corporate culture can be incredibly tenacious, resisting any and all attempts to modify its underlying values — and associated behaviors — even when such modifications would clearly improve things.

Accept the fact that culture and employee behaviors are difficult to change and plan your strategy accordingly.

Accept the fact that culture and employee behaviors are difficult to change and plan your strategy accordingly.

Keys to achieving results:

- *Pick your battles.* Focus on areas where cultural differences are likely to have the most significant impact on postmerger results, such as the critical business interfaces between the two organizations. Do not try to change culture overnight; it cannot — and would not — happen.
- *Work with culture, not against it.* Encourage new behaviors that are a natural extension of the current cultures, and then help employees understand how to apply the new behaviors to their day-to-day activities. Build a new cultural "brand" that supports your strategies and that people can identify with.

- *Link cultural issues to business value.* Business leaders often have trouble understanding the value and impact of culture. Get their attention by showing a clear link between cultural issues and critical aspects of business performance.

Day One

The end of the beginning

The first day of combined operations — often referred to as "Day One" — is a critical merger milestone that should be acknowledged and celebrated. It is a chance to help employees understand what is expected of them and to show them how they fit in. Even more important, it provides an opportunity for the organization's leaders to shift attention to the future, to talk about the challenges that lie ahead, and to build excitement about the organization's strategic goals.

Given the importance and visibility of Day One, it is essential that it goes smoothly. That means setting the appropriate objectives, and then designing and delivering a Day One experience that brings the two organizations together — boosting morale, engaging the workforce, and creating positive momentum for the future.

Keys to achieving results:

- *Celebrate.* Day One is worth celebrating, both as a major achievement and as the start of even better things to come.
- *Set the tone for the future.* Use Day One to reiterate the organization's vision, aspirations, and strategy — and to generate excitement.
- *Do not let up.* Day One is merely the end of the beginning. The most significant challenges — and accomplishments — are still ahead.

Putting the pieces together

These six actions might seem straightforward, but in the frenzy of activity that usually follows a merger announcement, even simple things can be difficult to remember and execute. Moreover, each of these people-related actions must be closely coordinated with other merger integration initiatives that touch every part of the organization — from business strategy and operations to administrative functions, information systems, and all of the above.

Given these immense challenges, it is no wonder that most mergers end up destroying more value than they create. To overcome the odds, you need a simple, practical, and time-tested approach for tackling the organizational aftershocks associated with post-merger integration. Addressing these issues quickly and decisively can help you capture all of the merger benefits your shareholders expect.

Merger Aftershocks II

Shaping the newly combined company

By Suzanne Skipper and Diane Sinti



A merger announcement usually sends shock waves throughout an organization — shock waves that can undermine the potential value of a deal even before you reach Day One, when the two companies become one. The first *Merger Aftershocks** article addressed the people issues you will likely face in the months between the merger announcement and the quarter following the close of the merger deal. This article picks up where that one left off — looking at a new set of people challenges that emerge with the birth of a newly combined company.

The morning after an issue-free Day One, you will feel a sense of relief. It is no small feat to successfully combine two companies' physical operations into one: employees get their paychecks, customers place orders online, and senior management receives financial reports.

But your real work has just begun. Now you must capture the value of the deal by hitting long-term integration goals and synergy targets. At the same time, you face a new set of people issues — getting employees to work together as one company with a common vision and shared goals for the future. Consider focusing on these six key action areas as you address the people issues for a smooth post-Day One transition.

Six action areas that can help shape the newly combined company

1. Culture: Talk the talk, and walk the walk

A company's culture is not the plaque over the reception desk — it is how people interact with each other, their clients, and their community for personal success and achievement of the company's goals. If you have a question, do you send an e-mail or do you walk down the hall so you can ask a coworker in person? Are managers expected to stay late or is it acceptable to leave at 5 p.m. sharp? Is it okay for employees to express a concern to the Senior Vice President directly, or should they talk to their immediate manager? The answers are not right or wrong; they vary depending on the company's culture. When two companies merge, cultural conflicts are inevitable.

Keys to achieving results

Create a vision for the new way of doing business. Early on, decide what type of culture you want to cultivate. You must set the example and decide how to communicate cultural change throughout the new organization. You must establish the structure for making decisions and how work gets done. These actions set the stage for the new company's "business as usual."

*To obtain a copy of the first *Merger Aftershocks* article, visit www.deloitte.com or click on the hyperlink above.

Cascade the vision down. Let people know the new rules — how they can be successful in their job and help achieve the company's vision and goals. This goes far beyond what is documented in a job description; it is how people communicate, how they treat each other, and how they perform their jobs, regardless of their position in the company.

Channel feedback up. Check to ensure key messages are reaching targeted audiences. Pay close attention to reports that indicate what is really happening on the people side of the business — attrition reports, performance review reports, and customer satisfaction surveys. Supplement statistics with subjective feedback systems, such as anonymous 360° employee surveys. In addition, close the feedback loop by providing employees with summaries of the feedback and the actions management will take to address their concerns.

Use multiple communication methods. Some companies rely on e-mail to communicate changes while others use voicemail, newsletters, or staff meetings. When communicating merger-related information, consider how employees are accustomed to receiving messages in their prior organizations. Also, recognize that not everyone absorbs information in the same way. Incorporate various communication methods into the plan to ensure you are reaching all audiences. As backup, also designate a central location, such as an intranet, where all corporate messages are housed for future reference. Do not underestimate just how much information must be communicated, absorbed, and remembered.

3. Project management: Work smart and keep the momentum alive

Of course, you must stay focused on achieving the synergy goals that shareholders and financial markets expect. That means all the program management systems and tools that were created for Day One are still needed. But if you are not careful, project management can turn into mile-long lists of never-ending tasks. People can start believing that checking off items on their integration task list is more important than looking for ways to better serve customers or achieve operational efficiency. Do not forget that many integration task lists were created well before the companies were combined. Since then, new problems and opportunities have probably surfaced, so priorities and approaches must be revisited.

Keys to achieving results

Capture lessons learned. Give the project management team a well-deserved break after Day One. But afterwards, bring them back together while the first integration phase is fresh on their minds. Ask them to discuss and document what happened, including what worked well and what could have been done better.

Record history. If you are audited three years from now, will you be able to explain exactly what happened during the integration? Now is the time for each work group to collect and organize their project plans and paperwork so that, if needed, someone new can reconstruct what transpired. These records will also provide a head start if another merger is announced in the future.

An effective integration project plan is constantly changing.

2. Communications: Complete the circle to make one company a reality

When you bring two companies together, communications must encompass more than merger-related facts, such as new benefits, e-mail addresses, and closing dates. You are also communicating the new culture — how employees and the new company can be successful. An effective corporate communications plan engages and enables employees by delivering the right messages to the right audiences, at the right time, and using the right vehicles. No small feat.

Keys to achieving results

Develop a strategic communications plan. Key messages must be developed for internal and external stakeholders (customers, employees, management, and shareholders). Then timelines must be developed and the vehicles for distributing the messages determined.

Identify a communications champion. Assign a communications champion the responsibility of overseeing the development and execution of the plan. That person should head up a centralized team that manages communications to avoid the risk of misinformation, missed deadlines, and overlooked audiences.

Refocus and reprioritize. It often takes two or three years for a newly combined company to become fully integrated. A lot can change during this time. You should continually review the plan and update it as new problems, risks, and opportunities emerge. An effective integration project plan is constantly changing.

Leverage project management skills and tools to manage ongoing change. For many companies, a merger is the first time the organization has worked together towards a major goal: Department leaders meet regularly, detailed performance reports are going to senior management, and communications are coordinated and planned. Leverage this investment you have made in the merger project management infrastructure. With minor changes, these systems can be adapted to manage other types of change: Entering a new business line, moving operations offshore, or expanding markets.

4. Organization design: Clarify roles and responsibilities

For the Day One close, you do not have to reorganize your whole organization. You do, however, need to have people in place to merge the most critical entities — usually the holding company and top-level infrastructure. For many reasons, whether it is regulatory compliance, limited resources, tight timeframes, or high costs, companies usually implement organization changes gradually in the months following the close. As you move beyond Day One, you should be formulating the next levels of the organization structure that will support the synergy targets and end-state vision for the combined company.

Keys to achieving results

Make the tough decisions early, and act on them as soon as possible. If meeting the synergy targets requires major changes, like downsizing the workforce, implement as much as you can before the close. Whenever possible, give advance notice to people who will be released so they will have time to make life-changing decisions and plans.

Communicate as you go. Many times, you do not know at the early stages of a merger exactly what changes will be needed. It is important to communicate all along the way, probably well before you have the answers yourself. It is ok to communicate that all decisions have not been made, but assure employees that you will let them know as soon as you know. People need to feel they are being kept informed as decisions are made so they do not have to search for information on their own from less reliable resources.

Create the new organization with an open mind.

Remember that the prior organizations do not exist. The new organization should be planned with the future in mind, including establishing the most efficient framework to support the new business as usual. Design positions around what needs to be done, not around the abilities of the person who has done the job in the past.

Refocus and refresh workforce planning. Look for ways to use normal attrition to ease downsizing. When an employee leaves, consider if you can avoid filling the position. You will save the headache of letting another person go later, and you will gain immediate cost savings, putting you closer to reaching synergy targets.

5. Leadership team: Maintain focus and influence

You must have the right leaders to successfully merge two organizations. It is important to look objectively across both legacy companies and recognize that people who were good leaders in a steady state may not be good leaders through change. You need forward-thinkers who can garner support from different areas. Who can bring two organizations together to work side-by-side? Who will focus on achieving the end-state vision? These people may, or may not, have been leaders of the legacy organizations.



Keys to achieving results

Pick the right leaders and provide training and support. Be open-minded and look for people with leadership qualities, regardless of their previous roles. The person with the right qualities may need training and support to develop their project- and change-management skills. Be ready to provide mentoring, coaching, leadership training — whatever is needed to give them the skills they need to be successful.

Support the combined work teams. Good leaders understand and provide guidance through integration, as well as ongoing "business as usual" concerns. They address potential team fatigue and burnout. They also avoid the "blame game" and keep an eye toward future effectiveness, rather than highlighting flaws in a legacy organization's way of doing business.

Set incentives to achieve goals. Set individual incentives for leaders that reward them based on their team's performance and employee retention.

6. Talent management: Engage people and encourage growth

Talent management is not only about high-potential employees. It is about managing the entire talent pool. Focus on retaining critical talent and carefully manage the transition of people who will be leaving. At the same time, hold people accountable for their jobs and reward them accordingly.

Keys to achieving results

Hold management accountable for staff performance. Set performance goals for managers based on the retention and performance of their staff. Even with heavy integration workloads, encourage managers to support employee time-off for vacation and sick leave. An exhausted staff is not productive over the long run. Support managers in transitioning employees who are not in the right roles. This is the time to form high-performing teams by selecting the best talent from both legacy organizations.

Foster career coaching and development. During change, it is important to continue career coaching and professional development opportunities so that employees know you are interested in their future success. If employees feel that there is no room for advancement and growth, they will leave when you need them most.

Transfer knowledge. Establish an environment where people are encouraged to learn new skills and assume new roles. Document processes and develop contingency plans so performance is not jeopardized if someone leaves.

When the ripples subside: People working together to create value

Effectively managing the people issues that result from a merger takes discipline and focus, but the rewards are lasting. People working together as one company with a common vision and shared goals is how shareholder value is created. By focusing on fulfilling these six actions, you will be in a better position to capture the full value of the merger deal.

Retention after a merger

Keeping your employees from “jumping ship” and your intellectual capital and client relationships “on board”

By Eileen Fernandes, Kevin Knowles and Robin Adair Erickson



Introduction

Despite the fact that mergers and acquisitions look attractive in theory to management and investors, the reality of their execution is that organizations are composed of employees who generally view such organizational changes as a threat. Accordingly, many merger and acquisition (M&A) deals have inherent retention issues resulting from negative attitudes often felt by employees, including, but not limited to:

- Uncertainty about the future organizational direction
- Feelings of loss of previous organizational culture
- Uncertainty about personal job security
- Perceptions of lack of leadership credibility
- Feelings of confusion due to a lack of communication
- Survivor guilt due to downsizing of other employees
- Perceptions of increased job stress and workload

In essence, employees often lose trust in their organizations and feel betrayed by leadership. Consequently, in an attempt to regain control over individual job situations, many employees begin to contemplate “jumping ship” as the merger or acquisition is implemented. However, during a merger or acquisition, it is essential to keep employee turnover low for two significant reasons:

1. Business continuity is key to realizing the benefits of a merger or acquisition
2. There can be large financial implications from the cost of hiring new employees, the loss of knowledge/intellectual capital, and the loss of client relationships

Therefore, organizations must proactively work to maintain or regain employee trust to keep them and the intellectual capital they represent “on board.” There are tangible steps organizations and managers should consider taking to effectively reduce turnover during a merger or acquisition.

Financial remuneration

Financial remuneration in the form of retention incentives has long been considered an antidote for potential employee attrition during a merger or acquisition. Most M&A financial models include a retention plan line item, and the amount of money that is added for employee retention is often considered part of the “cost of the deal.” Companies want to believe that providing retention incentives to stay with the combined organization is sufficient to cause employees to stay. However, the retention incentives can only begin to build a bridge to restoring employee trust by buying time.

Financial remuneration alone will not rebuild long-term employee trust. The company must regain employee trust. Otherwise, once the retention incentives are paid, employees may be more likely to consider other employment opportunities. Subsequently, the amount of money paid to them as retention incentives, if not extended or renewed, might have only created a temporary stability.

So what else should organizations consider to rebuild employee trust? A secondary analysis of data from a 2004 employee survey conducted at an international professional services organization sheds some light on ways organizations can increase their employees’ commitment and trust.¹ The sample of approximately 2,750 employees had experienced numerous organizational changes through multiple downsizings on the heels of being acquired, and the study found that increased organizational support and increased managerial support improved employees’ organizational commitment.

Organizational support

The perceived organizational support perspective is guided by the principle that most employees need to feel that their organization respects and supports them in order to remain committed and loyal, satisfied with their jobs, and willing to work hard. Accordingly, employees develop global beliefs concerning the extent to which their organizations value their contributions and care about their well-being.²

The analysis of the 2004 employee survey results found that organizations can provide additional support to employees during organizational changes by taking the following steps:³

- Reducing uncertainty through credible leadership
- Providing sufficient access to information about organizational changes
- Continuing ongoing learning and professional development

Credible leadership

After a significant organizational change, employees want leaders who are credible and tell the truth. If employees perceive their leaders to be credible, some of their uncertainty about the merger or acquisition can be reduced. Credibility can be conveyed through messages sent by management, especially messages that communicate ongoing organization support. In addition, management should be visible and set expectations regarding corporate performance goals and employee roles.

Sufficient access to information

Organizations should proactively create communication strategies that utilize effective organizational communication practices. For example, management should explain why the merger or acquisition was advantageous; repeat messages through multiple communication channels; recognize that employees prefer face-to-face communications; check to make sure that the messages sent were the messages received; and realize that not communicating has negative instead of neutral effects.

Ongoing learning & professional development

During the build-up to a merger or acquisition, organizations might discontinue training and development opportunities to cut costs and improve their financial bottom-lines. Management should rethink this practice since the costs of attrition can far outweigh continuing to give employees some level of discretionary resources. In addition, training that is clearly linked to job performance can be another example that reinforces the message that the organization values their employees and wants to help them improve their job-related skills.

Managerial support

Just as employees develop global beliefs concerning the extent to which the personified organization values their contributions and cares about their well-being through organizational support, employees develop impressions about how much their manager (or supervisor) values their contributions and cares about their well-being through perceived supervisor support.⁴ Managers play a critical role when employees are deciding whether or not to stay in an organization through carefully assessing employee potential, clearly articulating organizational goals, encouraging employee development, and helping attain necessary information, resources, and technology. Consequently, organizations should hold managers accountable for the retention of subordinates. They should also evaluate managers' people management skills, as these skills are often either not evaluated or are undervalued when compared to business performance results.

The analysis of the 2004 employee survey data found that managers can provide support by taking the following steps:

- Monitoring employee workloads
- Meeting regularly with employees to communicate both organizational and managerial support
- Providing employee performance management feedback on a regular basis⁵

¹ Erickson, R. A. & Roloff, M. E. (2007). Reducing attrition after downsizing: Analyzing the effects of organizational support, supervisor support, and gender on organizational commitment. *International Journal of Organizational Analysis*, Vol. 15 No. 1, pp. 35-55.

² Eisenberger, R., Huntington, R., Hutchison, S., & Sowa, D. (1986). Perceived organizational support. *Journal of Applied Psychology*, Vol. 71 No. 3, pp. 500-507.

³ Erickson, R. A. & Roloff, M. E. (2007). Reducing attrition after downsizing: Analyzing the effects of organizational support, supervisor support, and gender on organizational commitment. *International Journal of Organizational Analysis*, Vol. 15 No. 1, pp. 35-55.

⁴ Eisenberger, R., Stinglhamer, F., Vandenberghe, C., Sucharski, I. L., & Rhoades, L. (2002). Perceived supervisor support: Contributions to perceived organizational support and employee retention. *Journal of Applied Psychology*, Vol. 87 No. 3, pp. 565-573.

⁵ Erickson, R. A. & Roloff, M. E. (2007). Reducing attrition after downsizing: Analyzing the effects of organizational support, supervisor support, and gender on organizational commitment. *International Journal of Organizational Analysis*, Vol. 15 No. 1, pp. 35-55.

Monitoring workloads

One unfortunate consequence of mergers and acquisitions is that employees are often required to take on additional workloads. Accordingly, organizations should require managers to have conversations with employees about their potential new roles subsequent to the merger or acquisition and support them, as much as possible, in developing/acquiring/learning the knowledge, skills, and tools necessary to be effective in that new role.

Meeting with employees

A simple way managers can communicate organizational and managerial support to employees is by holding regular one-on-one meetings to discuss how the employees are coping with their new roles and often increased workloads. Through these one-on-one meetings, managers should also communicate care and concern about the well-being of the employees as individuals.

Providing performance management

Organizations should evaluate their performance management processes to determine whether they provide a rigorous identification of talent, effectively evaluate behavioral and professional competency development, and appropriately recognize achievements. In addition, organizations should require managers to provide individualized, formal feedback to employees. Managers should be encouraged to view the performance management process as a priority, investing time and energy in mentoring and developmental feedback discussions.

Conclusion

Retention incentives are an important part of any merger or acquisition. Employers need to retain their employees because they need to retain their intellectual capital, the client relationships that have been fostered, and the business focus that allows the organization to continue to operate effectively.

Financial remuneration during the time of a merger or acquisition can be important and is usually expected. In some cases, it can make the cost for a competitor to "buy out" the employee prohibitive. Similar to a sign-on bonus for a new employee — which helps convince an employee to jump ship and take a new job — a retention incentive needs to be a counterbalance. The retention incentive should be designed to convince the employee that a new job in a new organization may not be the better option and to give their current organization's merger or acquisition a chance to show its value.

Managers play a critical role when employees are deciding whether or not to stay in an organization

However, it is critical that the organization understand the limitations of financial remuneration in an M&A situation. The additional dollars will not buy hard work or long-term loyalty. Instead, they should help open the door for the organization to begin demonstrating it will "do the right things" for its employees. Those things may include providing managerial support and direction, clear communications about the business, learning opportunities, and strong leadership. The new organization also has to do a good job at communicating its vision for the new combined entity and how the combination is actually beneficial to the employees through growth and/or sustained viability.

In order to decrease post-M&A attrition, over the long term, organizations and managers must take tangible steps to improve employee commitment and employee retention by providing additional support. These types of effort can help keep your critical talent, intellectual capital, and client relationships on board.

Deloitte has service offerings and tools to help you in your efforts to keep employee turnover low and rebuild employee trust at each of these points in the M&A life cycle:

- Due diligence
 - Developing the preferred employment model
 - Identifying high-performing employees and critical roles
 - Developing a retention strategy and designing a retention program
 - Obtaining program and budget approvals
- Integration advisory
 - Developing a communication strategy
 - Developing performance management programs
 - Creating training programs
 - Providing leadership coaching
 - Facilitating employee focus groups or round tables
 - Developing employee engagement surveys and assessments
- Program management
 - Completing management transition
 - Improving communication across entities
 - Facilitating complex integration activities.

Section 5: Divestiture

Manage ownership transitions by setting business goals and address the existing HR-related and people management challenges.

The transition from big to smaller

A change of ownership

By Eileen Fernandes



Hardly a day goes by without news of a company's spinning off its ancillary businesses and noncore divisions to concentrate on its core competencies. Instead of trying to manage unwieldy, diverse holdings that often relate only marginally to each other, companies are rethinking their charters, consolidating their businesses through restructuring, and refocusing on core capabilities. Indeed, in today's focused, divested, and consumer-driven business environment, many are seeing the competitive advantages of running a leaner, more tightly focused ship.

If your department is shifting from being a division of a multibusiness company to becoming the primary business of a new enterprise, you undoubtedly find yourself facing many new issues and challenges. Although some "transition pains" are implicit in any change of ownership, there are certain guidelines you can follow to minimize the disruption of operations — and of employees — during this time.

Unique benefits

There are specific approaches that are most effective when the business transition moves "from big to smaller." Typically, the most effective ways to manage these ownership transitions are by setting business goals that take advantage of the unique opportunities afforded by your situation, and by directly addressing the existing Human Resources (HR) related and people management challenges.

Before you can do this, it is important to understand the advantages behind this type of change of ownership. To some extent, these represent much of the reasoning behind your company's decision to make this strategic move in the first place.

Sharper business focus and priority

A smaller, more sharply focused company has several advantages over its competitors. The most important advantage is the smaller company's undiluted focus on its marketplace and customers. Whereas various divisions of a large, diverse company often compete with each other, a company focused on one segment of a market will not compete with unrelated businesses for investments and executive attention from the parent company. Instead, all eyes, from senior management through frontline employees, will focus on the company and its customers' needs.

This sharper business concentration allows HR leadership to focus more directly on competitive compensation, benefits, employee programs, recruitment, and development strategies that are directly appropriate to the core business. This can free the company from efforts to force-fit HR management into a larger multibusiness corporate structure.

Quicker decision-making

In smaller companies, decisions are typically made more quickly and implemented much faster. This gives you a heightened ability to respond to opportunities in the marketplace. As a result, you have an improved ability to more aggressively compete and pursue growth — as a smaller, more flexible company.

Meeting the challenges of becoming the core business unit.

Greater personal influence

A hallmark of more tightly focused companies is their ability to act more quickly upon the insights and suggestions of the people closest to the marketplace — there are fewer layers of management to separate the customer from company leadership. As a smaller, more entrepreneurial company, you can act now and see the immediate effect on your customers.

For example, if your market researchers strongly recommend that you develop a hot new product, you do not have to submit your request to the slow-moving corporate machine. Your priority is meeting customer demand, and your HR model provides the vehicle to meet this demand, whether that involves hiring new software developers and information technology (IT) support people, or offering employees flex-time and work-at-home options.

Job growth

Year after year, focused entrepreneurial companies have consistently fueled job growth. As your new company grows and adds new offices, you will almost certainly need to add positions to meet market needs. From the HR perspective, this is an ideal time to review and adjust recruiting, selection, and development processes to increase productivity, cost-effectiveness, profitability, and customer service.

Clone and go: A quick-start strategy

If the structure of your company is shifting from a big organization into a smaller one, you might take a "clone and go" initiative. Basically, this involves taking some of the aspects of the former company's HR policies and procedures, including compensation, benefits, retirement policies, and employee programs.

A useful start-up approach, the "clone and go" strategy has some notable advantages:

The company is building on the plans, programs, and administrative arrangements that already work well — a good example of the "if it ain't broke, don't fix it" philosophy.

Maintaining consistency between the old and new companies helps minimize disruption to employees. This is often a critical objective in business ownership transitions, especially in potentially high turnover businesses in tight labor markets. Besides avoiding undue confusion to employees, you help to raise their comfort level by maintaining continuity with the current, familiar environment.

If you do not need to focus extensive amounts of time and attention on revamping your HR strategies and practices, you can concentrate on other critical business demands associated with this change of ownership, including leadership change and incentive development, strategy formulation, and implementation of information technology and financial system. This, again, minimizes disruption to the company and employees.

As soon as possible, you'll need to build an HR function precisely tailored to your new environment.

What to watch for

The "clone and go" approach has its limitations, the most obvious being scale. In other words, the strategies, processes, and scale of the old HR function were designed for a larger, more mature, and diverse multibusiness corporation. In many "clone and go" cases, the cloned HR strategies were developed incrementally over a long period of time in a corporate environment primarily focused on an industry different from yours. The HR strategies of a mature multibusiness corporation would not likely match the most effective strategies for a new, tightly focused niche player in a competitive, high-growth market.

Also, remember that you can float on the "clone and go" life raft for only so long. As soon as possible, you'll need to build an HR function precisely tailored to your new environment. Otherwise, you could end up with strategies mismatched to your business plan and excessively high costs.

By knowing the specific limitations of the "clone and go" approach, you can be aware of common, costly pitfalls typical of many companies. Instead of passively relying on your former company's HR strategies, be watchful of the following aspects of changeover, which can not only drain your financial resources, but also yield a drastically mismatched infrastructure for your company.

Bad fit. Cost structure and scale of the carryover HR infrastructure will probably be poorly matched to the smaller company environment. Smaller, more focused companies can develop HR programs and processes without the complexity and infrastructure required of the larger, predecessor company.

Distracted, overpriced providers. The vendors used by your former company might not be the right fit for the new company. Like many companies, HR vendors often deliver less responsive service at a higher price to customers outside their target market.

Fortunately, however, some vendors will provide "bridge" or interim service to a valued customer's business unit spinoff, or Initial Public Offering (IPO). Keep in mind, however, that the smaller "new customer" is sometimes served at a much lower level of priority and higher cost when its start-up support needs are greatest. For cost-effectiveness and quality of employee service, confirm that appropriate and motivated vendors serve your new company. Evaluate your needs, and look for vendors whose top priority is serving clients like you.

Mismatched goals. By relying too heavily on the former company's HR policies, you could miss opportunities to initiate HR strategies directly tailored to the new company's vision. Your new company should focus its HR strategies on initiatives that directly support its business objective. A more targeted HR delivery model can be a primary tool in your growth strategy — differentiating your company from others by providing uniquely attractive incentives to attract and retain key employees, for example. Becoming a smaller company is the perfect time to break out of the pack with more creative elements in your employment experience.

Although tailoring your HR strategies to your leaner, meaner company presents challenges, the process affords you unique opportunities to turn the situation to your advantage. In so doing, you can help your company to improve customer service, redefine the organizational structure to eliminate bottlenecks and address deficiencies, and increase the likelihood that your employees stay happy during the transition — and after.

Related reading:

Counting on Finance: A CFO's Guide to Doing Deals

Wired for Winning? Managing IT Effectively in M&A

These are the second and third compendium of articles in Deloitte's *Making the Deal Work* series. For a broader look at M&A issues, please visit *Making the Deal Work – Perspectives on Driving Merger and Acquisition Value*.

Find all our Making the Deal Work related content at: www.deloitte.com/us/makingthedealwork.

Talk to us. We look forward to hearing from you and discussing what you think of the ideas presented in this compendium.

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