

Driving M&A value through HR integration

Get it right from the start

The evidence is overwhelming: Acquiring companies can neither focus too much nor too early on an M&A transaction's people implications. Chief Human Resources Officers (CHROs) as leaders and the Human Resources (HR) function as a whole play critical roles in determining whether a potential deal realizes its strategic, financial, and operational goals. As soon as an organization begins the M&A process, HR can share vital business information and expertise that may influence the identification of potential partners, the

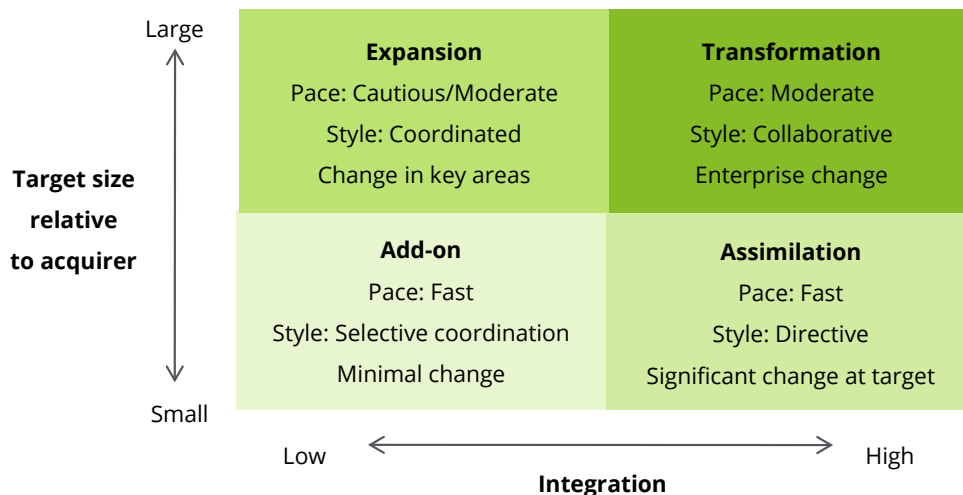
structure of the deal, effective timing for key decisions and milestones, and development of strategies to support a smooth integration. HR leadership also can lead the organization's efforts to identify potential business and human capital risks, and shape the strategy and integration plan. With HR playing a leadership role from the beginning of the M&A process, it is more likely that the organization will optimize a deal's financial and operational synergies.

Plan well: Understanding deal structure and HR's role

What should the "New Co" future state look like?

No two M&A deals are alike – each transaction's strategic and HR-related objectives may vary based on many factors. In general, most M&A transactions fall into one of four strategy classifications – transformation, expansion, assimilation, and add-on – according to deal objectives and the relative sizes of the acquiring company and its target (Figure 1).

Figure 1: M&A strategy classifications



Transformation: *Large target with high integration needs (i.e., merger of equals or “fish swallowing the whale”).*

In a transformative transaction, significant effort is made to consolidate HR systems, benefit plans, programs, and policies for the newly combined company (“New Co”). Typically, executives take the most effective processes and solutions from each organization or implement new, best-in-class solutions for the combined entity. When executing a large scale transaction, HR leaders may face significant challenges, such as meeting aggressive synergy targets for systems, benefit plans, and redundant resources; gaining leadership and organizational alignment; handling employee engagement and retention concerns; and addressing cultural differences.

Expansion: *Large target with low integration needs (i.e., large target that will maintain separate systems and/or programs with limited integration).*

In a typical expansion-focused transaction, the acquirer is widening its global footprint or adding a separate business that will not be fully integrated into its other business. Some effort may be required to meet synergy targets for systems, benefit plans, and redundant resources, including senior leadership; however, with limited integration, synergy opportunities also may be limited. For example, the existing HR organization may not possess the competencies to deal with the risks and needs of the new businesses and/or geographies. In addition, the expanded organization may need to rethink its leadership structure, operating model, and talent strategies, which adds complexity.

Assimilation: *Smaller target with high integration needs (e.g., target is assimilated into the acquirer’s strategic plans, systems, programs, and culture).*

Assimilation-focused M&A usually includes aggressive synergy goals for eliminating a certain portion of the target’s systems, benefit plans, and redundant resources (including senior leadership). Assimilation transactions tend to create significant change management and cultural issues for the target organization; however, the HR department should not underestimate the impact of the transaction on the acquiring organization.

Add-on: *Small target with low integration needs (e.g., the target is bolted on to the acquirer with limited integration).*

In a typical add-on transaction, the acquirer is bolting on a new business that will not be fully-integrated into the acquirer’s other business. These transactions are generally very fast paced, with selective integration between the organizations. It is important to understand and plan for the long-term goals of these types of transactions to determine the right Human Capital strategy to support the deal.



HR's role in an M&A transaction

Regardless of deal structure, it is imperative that HR leaders be members of the leadership team that is identifying synergy opportunities, assessing potential financial and operational risks, and developing deal terms. By involving HR early in the transaction lifecycle, the function's executives can provide analysis and insight to help achieve the following deal objectives:

Pay the right price for the business being acquired

- Provide input on the purchase agreement
- Assist with performing due diligence and identifying and quantifying integration risks
- Help to mitigate identified risks
- Capture people-related integration costs

Achieve growth and cost-saving targets

- Retain key employee populations
- Maintain employee engagement and morale
- Stabilize and optimize the workforce
- Assist with quantifying one-time costs and ongoing savings
- Enable productivity improvements
- Help to restructure the business

In addition to providing input to the deal team, the acquirer's HR organization will need to immediately execute on the HR integration strategy – and this starts

with getting its own house in order. The acquirer should not only perform due diligence on the target, but also conduct a self-assessment to understand the issues and limitations of its own HR systems and processes: Has the acquirer closed past deals that have not been integrated? Does the current transaction provide the opportunity to fully integrate past deals or improve current processes? Can the acquirer's systems and processes (e.g., HRIS and Payroll) scale to integrate the target? These are just a few of the potential issues facing HR in any deal.

Using a side-by-side, global and country-by-country comparison of the acquirer's and target's similarities and differences (e.g., structure, demographics, compensation and benefit plans, and HR policies, systems and processes), the HR integration team can develop an effective integration strategy. This should include guiding principles, estimated complexity, timing, and costs, and potential synergies and dis-synergies.

Based on the transaction's size and scope, as well as the acquirer's current state, the deal team should also determine if this is an opportunity for HR transformation. Whether it's a change in culture, systems implementation, or a harmonization of HR policies, procedures or benefit plans, M&A transactions can provide the opportunity to upgrade or transform the way HR supports the overall business. This may include adopting the acquirer or target's HR practices; combining the best approaches from each organization; or fully

redesigning HR systems and services. A strategic HR implementation plan should take into account, among other things, the leading practices for the combined organization (including cost analysis) and an understanding of the supporting infrastructure (e.g., communication, culture, leadership, staffing, etc.).

In developing a strategic integration strategy, the HR team should address the following priorities:

- Redesign or harmonize HR policies and procedures
 - Inventory all existing compensation and benefit plans and programs for both the acquirer and target, including service providers/vendors used; identify key differences (compensation, health and welfare, retirement, paid time off [PTO], etc.).
 - Identify transitional incentive and retention needs, including:
 - » Broad-based compensation and employee job leveling
 - » Incentive compensation – short-term, long-term, equity, and other programs
 - » Executive compensation and employment agreements, as needed
 - » Retention and severance plans.
 - Define future-state global total rewards strategy and philosophy
 - Perform gap analysis against the inventory of existing benefits plans to determine plan design recommendations by country – including cost implications and vendor requirements.

- Develop strategy to harmonize HR policies and procedures, including performance management and training and development.
 - Develop communications strategy for changing compensation and benefit plans, policies, and procedures (e.g., Frequently Asked Questions [FAQs], Summary Plan Descriptions (SPDs), employee handbooks, intranet sites, etc.).
 - Manage talent
 - Develop detailed, future-state organizational structure in collaboration with business leaders.
 - Review the future-state organizational structure and staffing model based on deal objectives and adjust as necessary.
 - Review the current employee census against the future-state staffing model and organizational structure to determine where talent gaps or redundancies exist.
 - Define the talent assessment and selection criteria, considering existing quality, productivity, and responsiveness measures.
 - Assess the selection process, including title/band mapping process and relocation opportunities.
 - Identify global employment issues including unions, works councils, transfer of Undertakings (TUPE), acquired rights, notice requirements, and potential redundancy payments.
 - Identify potential reductions in force, including severance costs.
 - Define relocation strategy, policy, and costs, including expatriate responsibilities.
 - Identify HR interventions to support organizational design (e.g., talent management priorities: job design, performance management, leadership development, learning and training, career mapping, succession planning).
 - Harmonize and/or transform HR operations (payroll and HRIS systems, shared services, etc.)
 - Develop country-by-country inventory of current payroll operations, vendors, pay calendars, HR data management, and HRIS tools/systems, including time and attendance systems and shared services support structure.
 - Identify country-specific data privacy laws that impact payroll function and HR data management.
 - Coordinate with the legal department on legal entities and country-specific payroll registration process, and with the finance department on banking and general ledger requirements for the payroll function.
 - Develop high-level integration roadmap for HR operations, technology, and vendors.
 - Determine implementation timing and any required Transition Services Agreements (TSAs), including service delivery requirements and costing.
 - Develop and implement go-forward HRIS/HR operations approach (HR people, processes and technologies, and vendor RFPs), including interfaces with general ledger (GL) systems and other enterprise resource planners (ERPs).
 - Estimate HR synergy savings and any dis-synergies from migrating to consolidated HR operations, technology, and vendors (HRIS, payroll, time and attendance, learning management, recruiting, etc.)
- Obviously, there is a lot to consider from an HR perspective when developing an effective integration strategy. By taking a leadership role from the beginning of the transaction, HR will be able to influence and gain a thorough understanding of the deal's goals and objectives and develop an effective short- and long-term integration plan that aligns with and supports the organization's overall efforts.

HR value impacts: Integration and transformation

During an M&A transaction, HR professionals are often expected to work across the enterprise to drive significant synergies through headcount reductions. This traditional view of HR's role is often overstated and, in some cases, myopic. When two organizations are combining, operations are often complementary rather than redundant. Sometimes, these organizations also have optimized their administrative functions to the point where the additional scale of the combined organization does not provide much opportunity for synergy realization. That is not to say that HR cannot drive value in a transaction; however, HR should understand the value that can be realized through both traditional and non-traditional means. The key is to dig deep from the beginning of the transaction and follow through well beyond deal close.

Deeper diligence: HR-driven value in pre-close planning & preparation

Prior to an M&A transaction, both acquirer and seller routinely conduct thorough due diligence. This process is vital for the acquirer to fully realize the strategic expectations set forth in the initial deal valuation, and is critical for the seller to determine that the acquirer is viable and capable of executing the transaction. Given that many deals are executed to gain operational economies, market share, technology, or geographical scale, due diligence often centers on meeting regulatory requirements, financial statement implications, and basic business functionality. There are significant HR-related value drivers in this diligence phase, such as analyzing retirement funding (the lack of which could add significant costs at deal close), and proper valuation of health and welfare plans. Thorough due diligence

may reveal potential “deal killers” in these areas, as well as other factors that could significantly hamper the long-term success of the transaction. Some of these key discoveries include:

Executive leadership risk: An acquiring company's HR and executive leadership should partner to review the target's development and succession planning for the C-suite and other executives. This analysis can identify if there is significant risk or weakness in the governance of the business. Also, many executives have “change of control” clauses in their employment contracts that can drive large cash outlays upon deal close. In addition to risk and cost identification, C-suite analysis can help the acquirer's leadership team determine priorities for organizational changes at deal close.

HR operating model misalignment:

Does the target have multiple HRIS or payroll systems? Has it executed a number of acquisitions but not had the time or resources to do a full HR integration? Does the target have multiple HR business partner structures, or multiple shared service centers? How many benefits programs does it have? Bottom line, there are many reasons why misalignment may exist in an HR model, any of which could sidetrack successful deal execution. An acquirer should assess challenges and risks early to determine the potential cost of misalignment and proactively develop a strong integration roadmap. This assessment also might highlight potential delays in achieving some of the deal's strategic, operational, and financial targets, and influence the overall deal price accordingly.

HR operations-related risks: This is a bit of a catch-all topic, but it can still be significant. It is critical that an acquirer ask the target about the number of open Equal Employment Opportunity Commission (EEOC) claims, active employment litigation, current Office of Federal Contract Compliance Programs (OFCCP) audits, and current Department of Labor investigations. A preponderance of these issues can provide significant clues as to the target company's HR's governance, its position on risk avoidance, and its corporate culture. This area tends to be “feast or famine”: In most cases, there are no significant issues, which would seem to indicate a properly managed HR risk position. When trouble is uncovered early, however, the acquirer may be better-positioned to mitigate or avoid associated risks and costs.

NOTE: *It is very important to involve internal or external employment legal counsel during these activities to ensure that the analysis is accurate and follows all legal guidelines.*

Finally, M&A team members should acknowledge that human capital opportunities and risks exist in every deal, regardless of scope. Giving HR an active voice early and often during a transaction may lead to significant cost savings and a reduction in employee-related risks.

Keeping the lights on throughout integration: HR's value as a business steward

As explained in this paper, strategic HR leadership can provide significant value during the M&A lifecycle. However, a number of tactical HR actions, when proactively implemented, can also add business value by “keeping the lights on,” particularly during integration.

HR Day 1 focus areas

While Day 1 is a significant milestone in a new company's life, it typically requires few, if any, noteworthy HR operational changes, such as benefits integration or payroll adjustments. That said, employees who are joining the new organization are likely to have questions and concerns that HR can help to address. Important HR Day 1 focus areas include:

1. Clarifying leadership structure:

Facilitating organizational design changes that become effective Day 1 means going beyond the typical announcement of who is in what leadership position. Using meetings and select strategic materials, HR should aid employee understanding of what the new leadership roles might mean down and across the organization, therefore alleviating some anxiety.

2. Managing and communicating change:

HR should work with Communications, Marketing, and other functions at both the acquirer and target companies to develop and communicate a change management strategy and implementation plan for Day 1 and beyond. The plan should address reporting structure changes, process redesign, technology changes, corporate branding, and more.

3. Striving for zero “breakage”:

HR, IT, and other departments should strive to make sure that any Day 1-related changes do not “break” existing systems. Even limited organizational changes

may cause disruptions in downstream HRIS and payroll systems. It may sound obvious, but ensuring that everyone in the new organization receives an error-free, first post-close paycheck goes a long way in helping employees at all levels settle in to the new organization.

Headcount synergies

As stated earlier, a well-known HR responsibility during M&A is facilitating the realization of headcount synergies. Often this is seen as identifying and eliminating organizational redundancies. For many companies this is where the exercise begins and ends. However, strong HR leadership can transform the pursuit of headcount synergies from a pure cost play to true organizational alignment. There are a number of ways that HR can add business value during this process:

Understand retention. Well-planned retention strategies can have significant impact and make every dollar paid count. HR staff should understand who the key employees are, why they should be retained, and what it will take to make retention meaningful.

Match the organization structure to the business model. HR should work with C-suite executives and department heads to match the expanded organization structure to the combined company's operational needs. The degree of alignment between operations and organization structure directly drives optimal cost reduction and operational efficiency.

Select talent wisely. Talent selection is fertile ground for inconsistent decision-making among hiring managers and senior executives. HR can help to drive logical, business-based employee selection by optimizing the process design, extracting the right data, and providing consistency throughout the hiring process.

Separate cleanly. Creating and executing a consistent and concise severance process can drive significant value during integration. HR can strengthen employee trust and protect the company's reputation by implementing a separation process that meets local legal and regulatory requirements and is guided by firm milestones, clear communication, and strict rigor.

HR integration

Combining two HR functions is not easy; sometimes, it may be the most prolonged portion of post-deal integration. While the overall concept is not necessarily complex, it requires flawless execution. HR Integration value is driven in a few straightforward ways:

Identify the value. What are the goals of the integration? What value is realized by combining vendors and systems? What are the risks? All of these questions will help shape the HR integration's strategy and purpose, and help the new organization achieve its expected value.

Do it once, do it right. Just because an organization can integrate one part of the HR function quickly doesn't always mean that it should. Minimizing the number of times a "change" occurs and having clear milestone dates when multiple changes will take place may help the HR team avoid integration burnout and employee confusion.

Sweat the small stuff. Effective HR integration, specifically HRIS, payroll, and benefits cutovers, requires paying great attention to the smallest details. Payroll deductions, payroll tax registrations, garnishments, reporting relationships, transition of deductibles and out-of-pocket (OOP) maximums, and payback of 401(k) loans are just a few examples of incredibly detailed items that – when not properly managed – can produce significant disruptions and costs. When it comes to HR integration, no detail is too small.

Communicate clearly and often. HR integration often brings a significant amount of change for employees and their dependents. The biggest stumbling block in this scenario is lack of information. Rumors, innuendo, frustration, and even anger can quickly fill the vacuum created by no information. Even if there is little of significance to share at a particular point in the integration process, telling people when they can expect an update may be all it takes to assuage fear and reduce misinformation. Bottom line: have a plan, communicate the plan, and execute the plan.

Test, test, and test again. Testing is a critical yet frequently overlooked step in HR integration. By creating a robust testing plan for HRIS, payroll, benefits, and other processes, HR leaders can help to deliver an issue-free integration.

The value of boredom

When is employee boredom a good thing? When it happens during HR integration. By providing consistent processes, clear communication, and goal alignment, HR can make sure that employees know what to expect and when, so they can focus their attention on their daily responsibilities. Boredom means that employees who are transitioning out of the organization are treated with respect and transparency. Boredom means that no one misses a paycheck or a payroll deduction. Boredom means the day after benefits integration an employee walks into a pharmacy and obtains their child's medication without issue. Boredom means all people-related

synergies and HR integration synergies arrive on time and in the expected amounts. In other words, HR developed and implemented its plan so smoothly that the integration was a non-issue and the expected value was created or exceeded.

M&A as a catalyst for HR transformation

The amount of upheaval involved with M&A-generated HR integration can be substantial. For many organizations, navigating this level of change can seem overwhelming, but within that transition, momentum for longer-lasting change can be created. Take, for example, a CHRO who has been seeking opportunities to reduce HR costs by moving transactional HR activities into a shared services environment. During project planning, the CHRO's company acquires another business of substantial size. The initial priority would appear to be completing the transaction prior to the HR shared services transition. From a strategic perspective, however, using the transaction as a change agent to merge both organizations into an HR shared services environment could create more value for the deal and the new company. Additional value an organization can realize by transforming HR during an M&A transaction includes:

- Accelerating and increasing cost synergy value realization
- Reducing the “us” versus “them” cultural dynamic as both organizations move into a new model together
- Leveraging deal budgets to accelerate optimization of the new HR model
- Avoiding perpetuation of outdated or inefficient policies, processes, or technology.

There are many levers that executives may pull to help turn M&A HR integration into HR transformation. Understanding the current state of each HR function is critical in selecting the areas of greatest potential impact for the function and the organization as a whole. For instance, perhaps the HR operating model is optimized but the talent

pipeline (acquisition, development, and succession) is fractured and does not have a clear line of sight through the employee lifecycle. An acquisition could add scale and momentum to jump-start a program to optimize the talent pipeline. Integration versus transformation is a sliding scale of possibilities. Executives should select the area(s) where the most value may be realized, create a compelling business case for their decision, and move forward with purpose.

Arrive early, work the room

If HR is not involved from the beginning of the M&A process, information vital to the transaction and subsequent integration may be omitted or underutilized. By understanding and assessing the value of specific deal drivers, HR can help to identify and prioritize people-related strategies, risks, and opportunities, and express potential options to the leadership team in relation to deal terms and objectives. Arriving early and working the room during an M&A transaction can elevate HR's role to one that will create value for the organization well beyond Day 1.



Contacts

Mike Fuchs

Principal
Deloitte Consulting LLP
mfuchs@deloitte.com

Tom Joseph

Principal
Deloitte Consulting LLP
tjoseph@deloitte.com

Cliff Mansfield

Senior Manager
Deloitte Consulting LLP
clmansfield@deloitte.com

Tom Seliga

Senior Manager
Deloitte Consulting LLP
tseliga@deloitte.com

Matt Usdin

Principal
Deloitte Consulting LLP
musdin@deloitte.com

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