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Talking about the people side of M&A

Corporate development, human resources, and communications leaders discuss how to better integrate and engage human capital on the heels of a deal

Talking about the people side of M&A

The M&A and Human Capital Roundtable, hosted by PwC, was attended by representatives from some of Silicon Valley's leading, most innovative companies. Organisations represented were:

- Adobe
- Atheros
- AutoDesk
- Cadence Design Systems
- Cisco Systems
- eBay
- Hewlett-Packard
- Informatica
- Intel
- Intuit
- LSI
- McAfee
- Microsoft
- NetApp
- Symantec
- Visa

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A note on the survey charts

PwC surveyed the participants on a variety of topics in advance of the actual event. We did that to better understand their experiences with human capital integration and to inform the roundtable conversation once the group came together. A few responses from that survey appear in this report. While the results cannot be considered representative of the technology industry as a whole, they do shed some light on people integration strategies and solutions within the industry.

The people aspects of merger integration cannot be handled in a silo, away from the rest of the effort. Human capital issues are critical to every work stream and must be managed with the same focus and discipline as issues of finance, operations, or information technology.

Getting it right

M&A can be a great source of growth in any economy, but particularly in one that's relatively stagnant and mired in deep uncertainty. These days there's much to be gained from so-called mergers of productivity and ones that strategically position organisations for future opportunities.

But doing deals right—and, in particular, integrating two or more operations postclose—can present a serious challenge, especially when it comes to the people side of the business and the operating units responsible for sustaining performance.

Since more of today's deals are about achieving operating synergies and less about financial machinations, the stakes are higher as more companies realise that the human side of deal making is critical to M&A value creation, strategic growth and sustainable business success.

Today's deal makers often place high value on both their current and acquired workforces, and when the people at either are overlooked, performance sags and retention suffers. What's more, there's a growing understanding that cultural conflict can completely derail deal success.

In the spirit of fostering such success, PwC invited corporate development, human resources, and communications leaders from companies across Silicon Valley to participate in a roundtable discussion about integrating and engaging human capital on the heels of a deal. The forum provided a unique opportunity for integration practitioners to share best practices and discuss the obstacles they encounter.

The conversation was lively—and eye-opening. Many of the participants offered unique, forward-looking perspectives, while others described solutions to challenges that any deal maker is likely to face, regardless of industry.

This report highlights the themes that emerged from the roundtable, summarising the leaders' comments and strategies as well as some of our own.

We extend our thanks to all of those who joined the conversation and generously shared their insights.

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Partner, People and Change
M&A Solutions Leader

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Principal, People and Change
Change Management
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Principal, Human Resource
Services

Managing the integration process

"My key [human resources] partner on a deal will be the business HR person from the acquiring business unit. Depending on their experience with acquisitions, they may be asked to take on a much bigger role."

HR must play a prominent role in any integration team

The integration of two organisations is often the real-world test of a successful merger or acquisition. For the newly combined company, it can mean the difference between ongoing financial success and eventual failure. But, as our roundtable participants admitted, it's never any easy task—and it should always include HR.

What attendees had to say…

The first step to achieving integration success is to build an effective integration team with plenty of HR representation. In fact, M&A

Integration is fast becoming a specialty discipline within the HR profession. The integration team forms the backbone of the entire effort, and great care must be taken to recruit the best players from all the right functions and business units.

Participants agreed that HR business partners for the units that will be home to the new acquisition should be members of the integration team. And, depending on their deal experience, some HR business partners might take on larger roles than those from other functions. Most also stressed the need for an HR integration lead from each of the business units affected.

Some raised a common constraint on effective integration: the inability to choose the best people due to legal constraints. "We constantly have that challenge about who I'm allowed to work with. There's the constant back and forth about who needs to know," one participant said. "And so the folks that really need to be engaged in that early due diligence, such as road trips and cultural audits and conversations with leaders, tend not to get nondisclosure agreements from legal until we're way down the road. And then it's really difficult to play catch-up." Others admitted that due to the economic downturn, integration core teams have gotten trimmed, resulting in a loss of critical knowledge and expertise as employees leave the discipline—or the company altogether.

"All functional leads have their own playbook, and we look to them to update that playbook after every deal in order to include tips and tricks they learned."

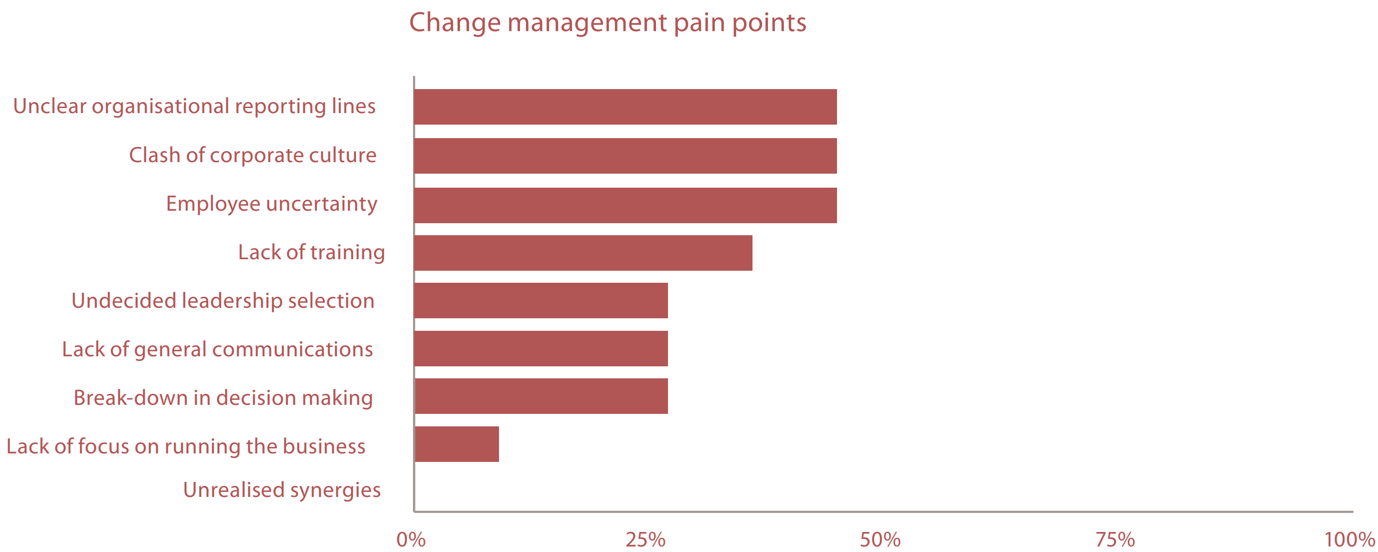

Figure 1

Most common change management pain points that must be overcome to achieve a successful merger integration.

As might be expected, many try to ensure a smooth transition from one deal to the next by using a playbook of standardised processes mined from past acquisitions. A playbook typically includes baseline templates for processes and information that get shared during integration management, often establishing protocols for leadership assessment, organisational structure, employee retention, culture assessment, communication initiatives, and future-state planning. Those templates become customised for each deal and represent living manuals for integrations. One firm reported taking the standard playbook a step further by creating process templates for each function within the global organisation.

"We acquired 1,200 people in China a couple of years ago, and we put a lot of time and effort into change management. But even though we used the words of change management within HR, when speaking with the business leaders we said, 'We are creating an opportunity. We are creating market space. We are creating new customers.' We made a point of using language they could connect with, because sometimes when we 'talk HR,' they just turn off."

Yet despite all of the planning and all of the use of tried-and-true templates, everyone agreed that each deal is always different from the last: "You can never get away with totally standardising execution," said one executive. "Merger integration is so difficult precisely because each one is unique and because much of the effort required is ad hoc."

PwC's point of view

In every M&A integration, effective programme management and change management are essential to aligning people with—and organising them around—business strategies. To accomplish that, it's critical to establish an integration management function that focuses exclusively on optimisation of human capital during the merger or acquisition. The integration management office will drive long-term integration, staffing and selection, employee retention, cultural alignment, and succession planning, among other elements.

The integration management team will set the course for the integration by:

- Articulating the strategy of the combined company
- Determining the degree of integration and nonnegotiables
- Identifying and protecting core operations outside the scope of integration
- Customising the integration structure and approach
- Designating integration leaders at all levels
- Developing communication plans and executing early communications

The core deal team must implement the fundamentals of integration as early as possible in the deal process. A disciplined implementation should start during due diligence and extend through a 100-day postclose review of the deal strategy—and beyond.

Retaining pivotal talent

"We conduct employee polls and engagement surveys, and we often find that cash is not the primary incentive that retains people over the long term. It's really about the relationships that employees have with their managers. The polls and surveys ask, 'Do you feel a connection with your manager? Do you understand the company vision? Do you have growth opportunities?'"

While many are good at retaining target employees, retention plans are changing

The variations and complexities of retention planning are many. And while there's no one-size-fits-all approach, there are considerations that are common to all retention efforts.

What attendees had to say…

Perhaps surprisingly, our survey of attendees revealed that 82% of them reported satisfactory ability to retain desired talent for the first 12 months after a deal close. And many reported being able to retain 100% of the target's employees for the desired period.

How do they do it?

Well, their success hasn't come easy, and it's the result of years of trial-and-error. But one reason Valley companies achieve such results may just be because they focus on it.

Very often the smaller deals in the technology sector are heavily talent-driven — that is, one company buys another to secure a new innovative technology and the talent behind it. With so many resources focused on holding onto talent, it's little wonder, then, that the employees of the acquired company choose to remain with the acquirer, at least for the near term.

One company reported kicking off its retention effort by asking incoming employees one basic question: Do you see a future for yourself at this company? It's an effective and relevant question, especially when a large global firm is acquiring a small start-up. "There are a lot of inherent differences, particularly between a large company and a small, entrepreneurial firm. And there's a significant difference in mentality between someone who will sign up for a 15-person team versus a 20,000-person team," said one participant.

Some companies said they follow a regimented process in selecting

"We assign an HR business partner to follow which key talent stays and which goes, and we do a postacquisition survey within six months of close to assess issues and any retention risks."

employees and allocating retention-budget resources, taking into consideration each employee's salary as well as any equity allowances. Others factor in the historical cost of previous acquisitions to help predict the retention budget.

As you might expect, the sizes and types of retention bonuses vary by company. Some companies are starting to move away from retention awards for many types of employees—particularly the use of equity awards—while others offer a 30 to 50% bonus based on six months' salary for select groups of essential employees.

The question of cash versus equity is a struggle for many, and—again—the answers vary. When companies offer equity, it may be to all employees of the target, or only to key long-term players, or to those with skills essential to the success of the transition. Of those that offer equity awards, some offer them only to high-level managers and not to a broad cross section of staff.

One firm reported no longer granting equity bonuses at all. "Our retention analysis shows that deals where people have received equity actually have higher turnover rates in a shorter period of time than deals involving cash bonuses."

Some companies reported setting aside a portion of their retention budget for deferred retention payouts—helping ensure that retention bonuses are available for workers who weren't initially identified as critical to retain but later prove their importance.

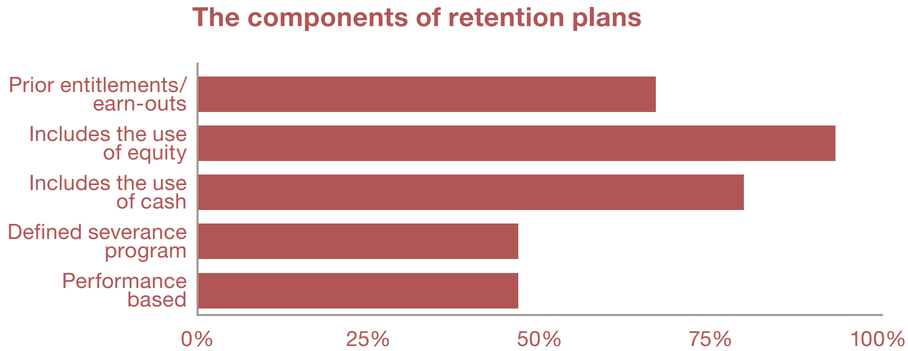

Figure 2

Equity and cash payments are the most common forms of retention awards.

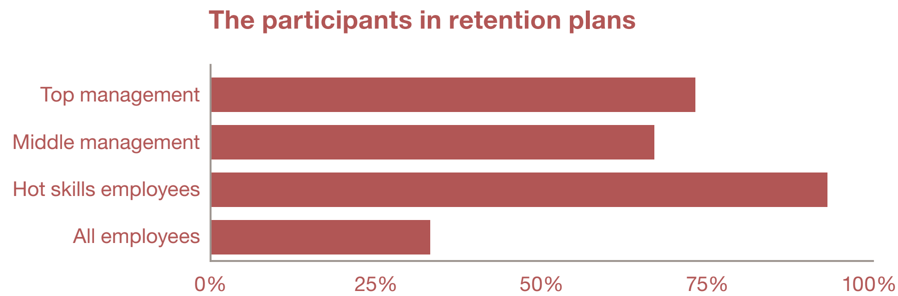

Figure 3

More than 90 percent of hot-skills employees are typically included in retention plans.

The retention pool must be determined early in the process, and attendees stressed the value of HR input to the design process. One attendee even stressed the importance of setting aside a travel budget for HR leaders to help evaluate targets and their talent.

Another noted the pitfalls of simply relying on the target's management to identify employees critical to retain. "We found they don't necessarily identify the knowledge transfer people we need. Instead, they pick the managers of the key people on their own staff, but those folks may or may not be key to the integration effort."

PwC's point of view

We believe that to effectively retain key talent, you must first understand the target and its employees and tailor an integration strategy to that understanding and reality.

The acquiring company must define each employee's relative importance to the business—both during the transition and beyond. In essence, the company must decide who is needed for short-term transition and who is needed for long-term value creation. Three levels of criticality may be used for defining those needs:

- ***Strategically critical.*** Those employees most essential to the ongoing operations of the newly combined organisation—typically, top executives and key business unit leaders
- ***Integration critical.*** Those employees essential to the integration effort itself
- ***Knowledge-transfer critical.*** Those employees with specialised knowledge essential to the transfer of ongoing information and know-how

One employee-type critical to ongoing value creation is a group we call 'pivotal talent'. Focusing the lion's share of your people investment on pivotal talent can be a source of major competitive advantage.

Pivotal talent is comprised of those game-changing employees whose performance can make-or-break the bottom line. They are those best positioned to add the greatest value and shape the future success of a company.

For every type of employee, the acquirer must consider award amount, award type (e.g., cash, equity, or both), and payout date (e.g., after as few as three months to after as many as 18 months). Keep in mind that payments for periods in excess of one to two years are typically not effective for retention. The acquiring firm should also consider noncompensatory factors that may be attractive to employees, such as flexible work arrangements and cell phones.

Companies usually reward short-term employees with cash (instead of equity) and enhanced severance packages. For long-term retention, companies must address engagement and career satisfaction as well as cash and equity grants. A regular evaluation of employees will help the organisation determine what drives engagement as well as help guide employees in career planning.

It is critical that organisations carefully (and factually) assess staffing for senior positions, because inattention to that issue can put the wrong people into the wrong jobs—often for years. To ensure a good fit, the acquirer must clarify and articulate the core competencies and skills required for key jobs.

Level of engagement is also critical for senior employees. The acquirer sets the engagement agenda, which is typically managed at the local level. We believe engagement efforts should focus on the pivotal roles and behaviors that disproportionately drive business value.

Understanding and aligning separate cultures

"We're starting to look at culture as part of diligence—and actually having a culture diligence track—and then we're trying to define culture in certain describable dimensions like values, beliefs, and practices that will help us start defining the similarities and differences."

Understanding cultural differences is a critical first step

Gaining an understanding of a target's culture—the way the target's people think and act daily as they go about their work—should be a critical step in the due diligence for any deal. Cultural hurdles can spring up from work-style differences and from geographic and ethnic differences between the two firms. And when it comes to integration, both of those differences must be addressed.

What attendees had to say…

Many said cultural assessment is among the most important parts of any integration because there are often potentially value-destroying cultural differences between acquirer and target—especially when large companies acquire much smaller ones. And the need for culture insight becomes even more acute when the target and the acquirer are based in different countries.

Corporate culture is that set of entrenched behaviors that characterise how a company gets things done. Cultural differences between companies — in operating style, in the handling of customer relations, in methods of decision making, collaboration, and communication, etc. — can become major obstacles to achieving the strategic and operational goals of a merger or acquisition.

The goal of any such assessment is to define the culture of each company across dimensions like values, beliefs, and work practices and then compare them with each other to better understand how they're similar and how they're different. Often, workplace factors of a qualitative nature get measured, like whether executives have parking spaces and which employees sit in cubicles versus which sit in enclosed offices.

"If HR is in on the scouting trips and communicating closely with leadership, we usually get a pretty good feel for the culture. Sometimes we can get a lot of information by going on-site to look at the facilities. Somebody might come back and say, 'Hey, did you know that every-body was wearing business formal there?'"

Many participants said they apply an assessment tool—often a combination of employee survey and leadership interviews—to gauge the target's cultural environment and to predict

Aligning cultural drivers

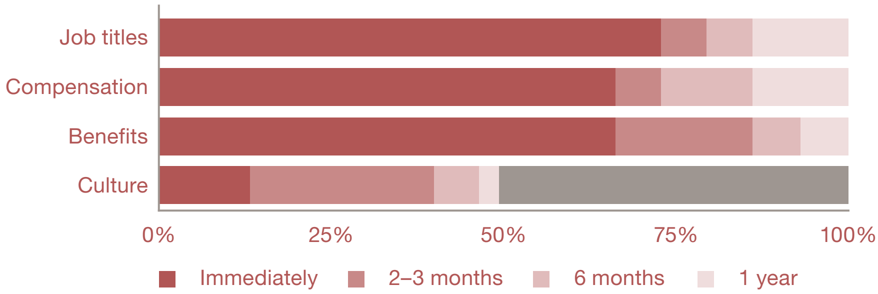

Figure 4

Almost half of the respondents said cultural alignment takes a full calendar year or more from close to achieve.

integration needs. But, they stressed, surveys alone don't provide the necessary window into culture: True understanding can come only from spending time with the target's employees in their normal work environments. Such scouting trips result in cultural insights, demonstrate commitment, and—very often—build relationships. And understanding is the first step toward cultural alignment.

While "it's not always necessary to change the differences, there's great value in simply understanding what the differences are and in being able to describe them," said one participant. Just by taking purposeful looks, "we're starting to get more awareness about culture overall, and we're developing a more structured way of evaluating and managing through the transition."

However, integration-related travel is not always one-way. Another attendee said that, often, key employees of the targets his firm has acquired were invited to the acquirer's headquarters for periodic visits. "We bring out staff into their location, but we also make sure that some of their key people are coming to our headquarters so they can get a sense that it's actually filled with people just like them."

Others noted that targets operating in a society and culture very different from those of the acquirer may not be filled with "people just like them." Those circumstances require a much deeper level of understanding. And in some cases, it may be beneficial to provide the integration team with cultural training.

"We typically don't attempt to take on a target's culture, but we may incorporate elements of it—their 'secret sauce,' so to speak. But there's no way we're going to preserve their culture over the long term. So the assessment is really about raising awareness of what the challenges are going to be for both sides."

PwC's point of view

Corporate culture consists of that set of entrenched behaviors that characterise how a company gets things done. Cultural differences between companies—for instance, in operating style, in the handling of customer relations, and in methods of decision making, collaboration, and communication—can become major obstacles to achieving the strategic and operational goals of a merger or acquisition.

It's a huge leap, though, to claim that those differences alone are the primary reasons for the less-than-optimal performance of a newly combined company. Our research suggests that many times, the culprit isn't solely cultural conflict. Rather, lack of focus on value-driving actions and failure to generate early momentum can significantly hinder the capture of deal value.

Culture alignment is a deliberate and planned management activity that plays a critical role in nearly all M&A integration environments. Managers face certain challenges in their efforts to align two company cultures. Sometimes those challenges lie not in the cultures themselves but in the managers' inability to perceive a culture. That is, managers may not understand how the culture functions across the two organisations and how to manage the culture so that it drives economic value.

Day One and on-boarding

"In the past, acquired employees have said that we just slammed them with a lot of information within the first week or so. So now we try to bring the leaders out to the location along with the HR specialist to go over what is absolutely necessary on the first day. But then there are other things that we'll want those acquired employees to pick up later via, say, Webinars and e-mails."

A successful Day One is about providing enough information—but not too much

The first phase of deal execution—culminating in the close and the on-boarding of target employees—can be fraught with potential mishaps. For instance, no matter how good a company's due diligence, culture assessments, and retention planning have been, ineffective Day One execution and inept employee on-boarding can create negative impressions that are nearly impossible to erase.

What attendees had to say…

Preparing a target's employees to start work at the acquirer requires that the integrators understand what those employees want to know and need to know for a successful start and then that they ensure the employees are given the information.

So, what might a successful Day One look like? Of course, it will vary by deal, but several attendees talked about the importance of offer letters and the benefits of providing immediate access to the acquirer's network. "The number one things [acquired employees] think about are job security and title and role," one participant said.

Immediate access to the corporate intranet or even a Web site dedicated to the acquisition is an effective way to begin to engage acquired employees. "We give them the dates for all of their upcoming training and the deadline for their benefit enrolment. They'll have links to all of our systems, plus they'll have access to online training for each of those systems."
Some attendees acknowledged that providing immediate network access was not a popular idea in all parts of their companies. "I got a lot of pushback from our [information technology] department saying the department couldn't get them access on Day One," one participant said. "But we pushed ahead and reset the standard that you don't have to wait three weeks to get folks onto the network."

When it comes to dealing with rumors: "We have a meeting and speak to what people have heard, because that's basically the key to dealing with the anxiety and shutting it down. We find the source of anxiety, and we show that the rumor's not true. Everybody leaves the meeting and gets right back to work."

Several said they had learned to limit the amount of information presented on Day One. “We try to convey information over time and let them know what to expect. That way they get the information when they need it.” And as a result, “you end up communicating over an extended period, and a greater sense of transparency results. On-boarding is not just a single event where everything happens all at once.”

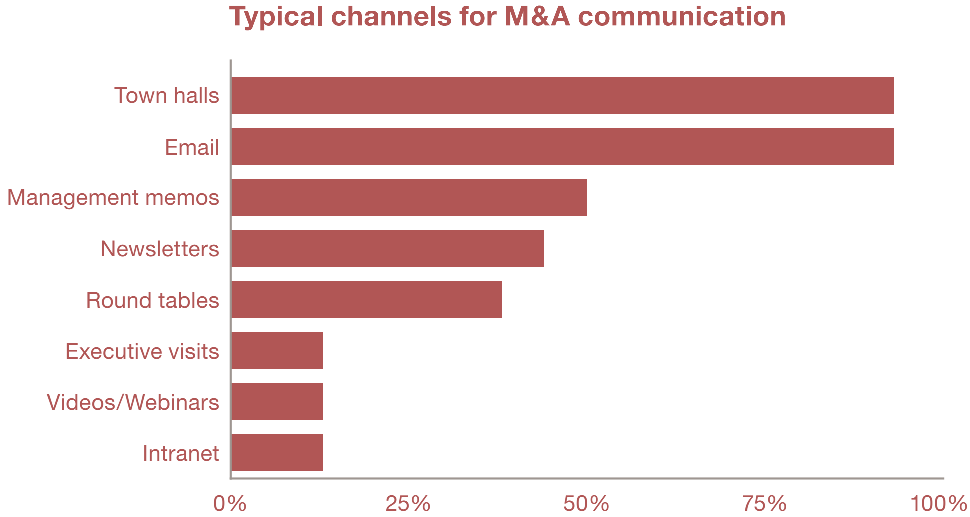

Figure 5

Integration communication efforts often rely heavily on town hall meetings and e-mail messages.

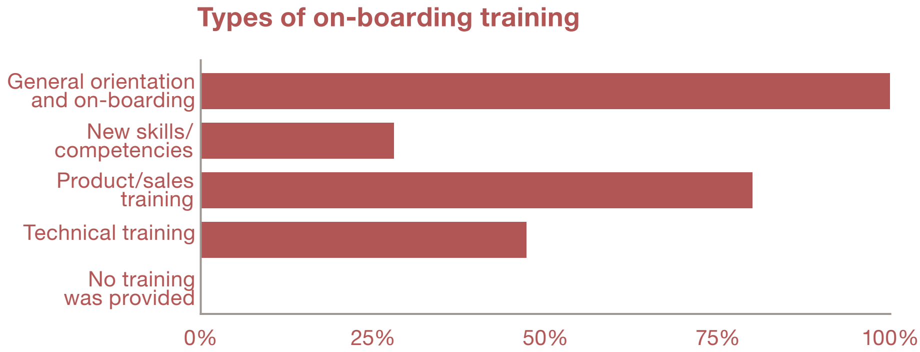

Figure 6

Eighty percent of respondents include product/sales training in their on-boarding training programmes as a way of helping ensure that acquired employees understand—and could cross-sell—all that the combined company has to offer.

PwC's point of view

Day One is about continuity. And that's never truer than with people matters because there are the demands of customers to be served, payrolls to be met, employee benefit coverages to be extended, and workplace infrastructure to be maintained—in the form of assets, systems, and processes that enable people to do their jobs day to day.

Critical Day One tasks need to be identified early—before longer-term, more-detailed planning commences. Early identification of those immediate tasks allows for prompt identification of long-lead-time items—well before they can turn into closing-day surprises. A detailed plan should then be created that includes all of the actions that will be put in place on Day One. Planning for Day One should begin in conjunction with the due diligence process.

Finally, while everyone needs to know to whom they report and have a clear understanding of who the leaders are within the combined company, knowing reporting relationships — alone — does not ensure alignment, productivity, timely decision-making, and high performance.

People want to know what is expected of them, what they're accountable for, and what decisions they own. Ultimately, you cannot expect effective execution until you can publish the accountability and decision-making authority for each position, and explain how the combined organisation's strategy, leadership and structure will create sustained economic value.

Long story short—key takeaways and insights

The people aspects of integration cannot be handled in a silo, away from the rest of the effort. Human capital issues are critical to every workstream.

Human resources departments must be ready to proactively lead and manage the people side of a merger or acquisition integration. A company that foresees future acquisitions needs to start building a knowledge base of integration best practices and to consider whom it will want on the integration team.

So, what's a proactive leader to do?

Perhaps the best chances for success lie in:

- Bringing the combined organisation together around a single company culture
- Finding the right incentives for retaining the people needed for both the transition and the longer term
- Adding some quick clarity to the organisational structure
- Adopting an approach to selection and staffing that is perceived as both fair and transparent
- Executing on a strong and clear communications strategy—certainly for all stakeholders but especially for employees
- Regularly measuring lessons learned and taking the steps required for continuous improvement

How a company addresses those and other people issues—and when—will prove critical to beating the odds stacked against deal success.

But don't get too impatient. Reaching that success is something that comes with time and experience. Capturing deal value is a learned skill, but not one that's learned overnight.

About PwC's Human Resource Services

PwC's Human Resource Services practice, with around 6,000 practitioners across 100 countries, works with corporate and public-sector clients that strive to make their people a sustainable source of competitive advantage.

Together with PwC Saratoga, PwC's Human Resource Services practice can help you address all your human capital needs, including HR strategies and operations, workforce planning, talent management and engagement, benefits, compensation, employee communication, international assignment, culture and diversity, and HR-related regulation.

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