# M+A

M+A READINESS RESEARCH™ 2.0

## EXECUTIVE SUMMARY

# FLIGHT RISK IN M+A: THE ART AND SCIENCE OF RETAINING TALENT

DATA • INSIGHT • DIRECTION

MAKE TOMORROW, TODAY

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# CONTENTS

# FOREWORD: MAKING PEOPLE THE FOCUS

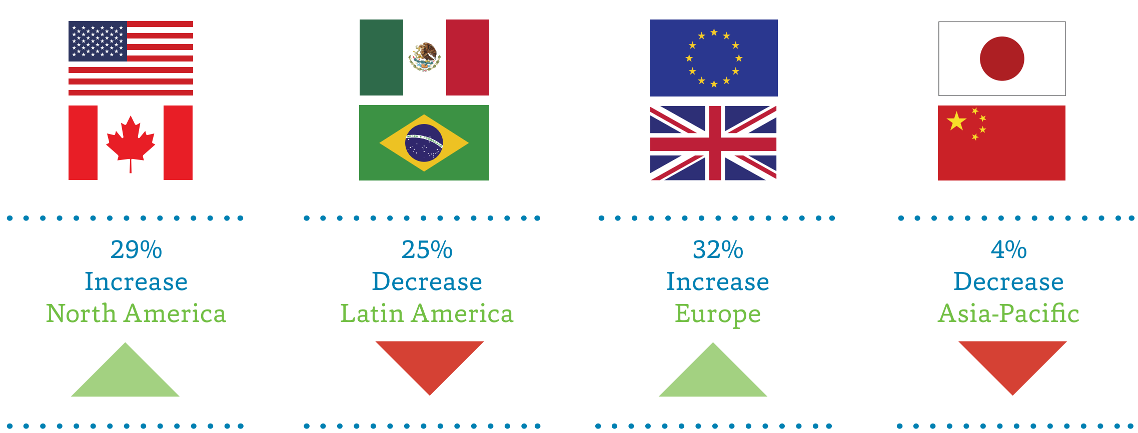
## In spite of the daily geopolitical chaos — be it North Korean military threats, Brexit, trade wars, Japan's corporate governance challenges, the Brazilian political crisis or daily turbulence in Washington —

# M&A is alive and well.

Recent results, however, point to noticeable shifts. To name a few,[1] global M&A volume is flat from 2017 to 2018, but deal value is up 6.6%; the value of China's outbound transactions has dropped by 5.3%; the value of cross-border deals increased by 32%; activists are now targeting and disrupting companies in North America, Europe and Japan; private equity fundraising has reached record highs; and the average EBITDA multiples (globally) upon exit are at record levels (15x).[2]

Consistent with our research findings last year ("People Risks in M&A Transactions": download at www.mercer.com/peoplerisk), buyers continue to take greater risks, operate with much less information, invest in new geographies and deploy unprecedented levels of capital in leveraging cheap debt and credit.

### GLOBAL DEAL VALUE[3]




**In taking a broad view of business and industry around the world, we see that one common denominator drives deal value: PEOPLE.**

In our experience advising on more than 1,200 deals annually, we see clear evidence that buyers who consistently drive exceptional operating results have a disciplined process for identifying, engaging and motivating key talent.

In this report, we dig into the issue at the top of every executive's mind: how to retain and engage key talent during and following a merger or acquisition.

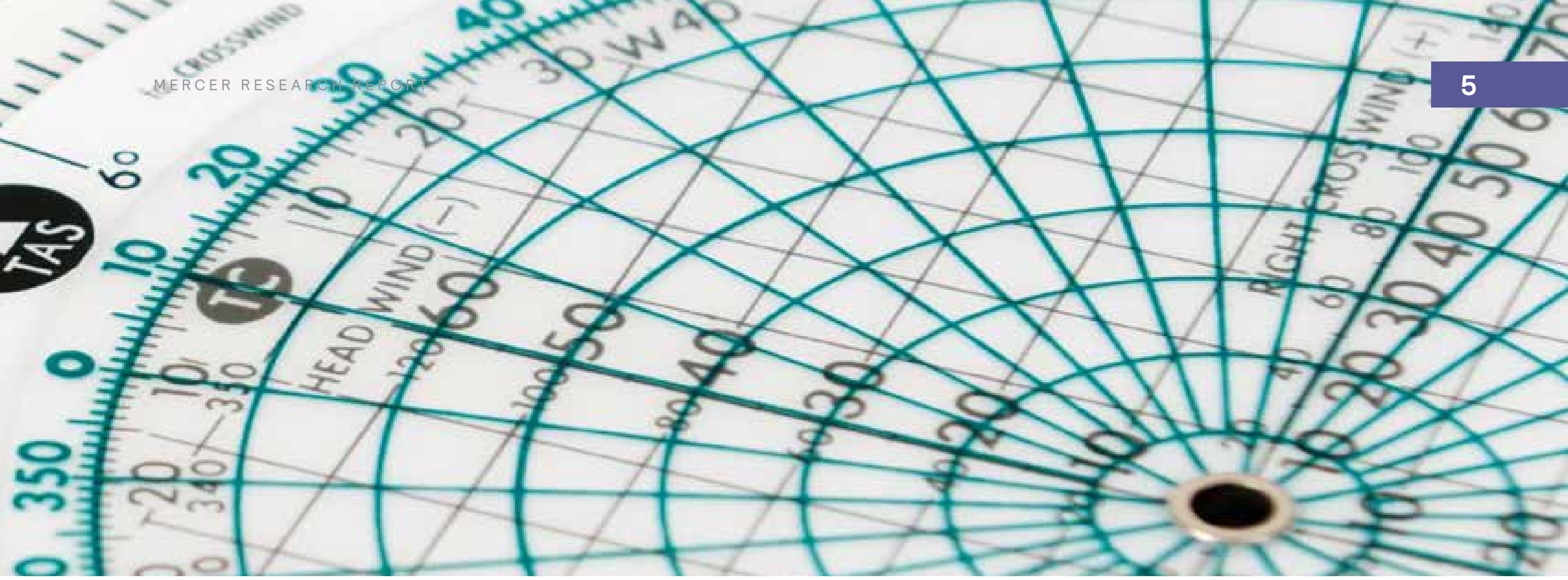
We researched the people aspects of mergers and acquisitions to help you sharpen your focus and learn about emerging trends through the lens of deal experts. We shared insights that highlighted people-related transaction risks and introduced practical strategies and solutions to help deliver economic value.

Still, both the buyers and the sellers we polled needed specific data and a process to help them identify and retain key talent during transactions.

**This report documents effective strategies and evolving trends in employee retention. We pinpoint specific actions that organizations can take to hedge flight risk, engage key talent and drive an affordable retention plan as part of an M&A transaction.**

## THE TOP FIVE PEOPLE ISSUES IDENTIFIED (IN RANK ORDER)

1. EMPLOYEE RETENTION
2. Cultural and organizational fit/integration
3. Leadership team (determining the quality of the management team/executives for the new company)
4. Compensation and benefit levels (market pay concerns)
5. Talent availability, as well as identifying, assessing and placing talent




Making the wrong investment decisions in talent can cripple a deal. Often, organizations operate in a silo, focusing on the necessary nuts and bolts of transactions, like operating margins and cash flow, while overlooking a critical aspect of the deal — people.

Too frequently, retention schemes focus only on those at the top. Our research shows that the "Rising Middle Stars" are essential to keep organizations operating smoothly during and after a merger or acquisition.

This report introduces effective strategies for employee retention, leveraging new data to significantly improve your chances of a successful transition.

I would like to thank all the participants who shared their experiences, perspectives and expertise in helping us prepare this valuable research. Equally deserving of thanks are the dedicated Mercer professionals who helped bring this report to life.

JEFF BLACK

Partner
Mercer's Global M&A Transaction Services Leader

> "The idea that an organization's workforce is an asset — rather than simply a business cost — is now broadly embraced by business leaders everywhere."
>
> — Haig R. Nalbantian
> Co-Leader, Mercer Workforce Sciences Institute

# ABOUT THE REPORT

# Our findings are based on 325 unique data points.

**243**
SURVEY PARTICIPANTS

**212**
UNIQUE TRANSACTIONS

**82**
INTERVIEWS

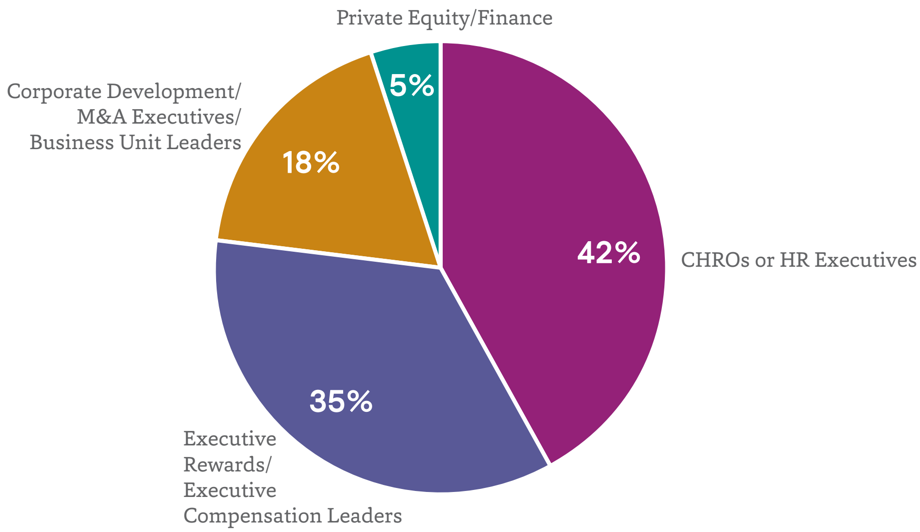
## FIRMS THAT PARTICIPATED IN THE RESEARCH

| NUMBER OF EMPLOYEES GLOBALLY (N=325) | |
|---|---|
| Fewer than 1,000 | 13% |
| 1,000 to fewer than 5,000 | 18% |
| 5,000 to fewer than 20,000 | 30% |
| 20,000 to fewer than 50,000 | 14% |
| 50,000 or more | 25% |

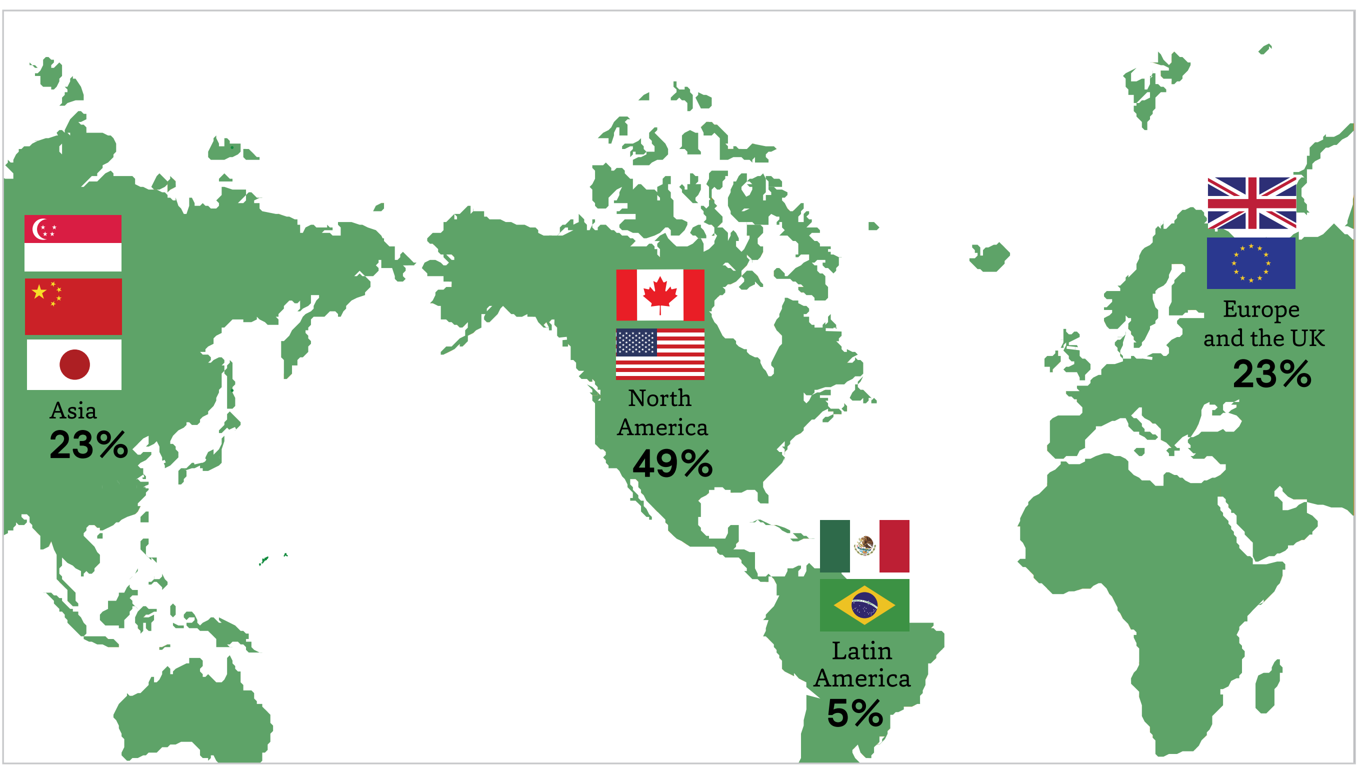
| ANNUAL REVENUE (N=321) | |
|---|---|
| Under US$100 million | 7% |
| US$100 million to less than US$500 million | 8% |
| US$500 million to less than US$1 billion | 8% |
| US$1 billion to less than US$5 billion | 34% |
| US$5 billion or more | 43% |

**A total of 325 corporate and private equity professionals participated in our retention research.**

## RESEARCH PARTICIPANTS: JOB RESPONSIBILITIES/TITLES




## RESEARCH PARTICIPANTS BY REGION



## RESEARCH PARTICIPANTS BY INDUSTRY

| | |
|---|---|
| 22% | Technology |
| 19% | Manufacturing/Industrials |
| 15% | Other |
| 11% | Health/Life Sciences |
| 10% | Financial Services/ Insurance |
| 10% | Energy, Mining and Metals |
| 7% | Services (Nonfinancial) |
| 6% | Consumer Goods |

## COMBINED EXPERIENCE OF RESEARCH PARTICIPANTS

**1,500**

DEALS CLOSED OVER PAST 5 YEARS

> "We have experienced very different retention requirements and people issues in regions around the world. Select European statutory mandates and work council rules have forced us to pay a lot more in severance and retention than anywhere else in the world."
>
> — CHRO, global financial services firm, ¥340 billion in revenue


# EXECUTIVE SUMMARY

## LITTLE ROOM FOR ERROR

We are experiencing another year of a brutally competitive, full-on seller's market around the world. As such, buyers are paying record multiples and taking on unprecedented risk in order to complete transactions. In today's environment, where capital is abundant and cheap, the opposite is true for talent. Top performers are expensive to replace. And buyers are vulnerable to the flight risk of key talent in most transactions. The organizational change involved in most deals puts people on edge, and they opt out or disengage without an added incentive to stay focused.

*"The common denominator consistently driving economic value is having the right people on board to execute post-close. At no time globally have we seen it so critical for buyers and sellers both, who want to drive shareholder value, lock down talent at the top and including those 'Rising Middle Stars' critical for execution,"* said Konrad Deiters, Mercer's International M&A Transaction Services Leader.

Successful acquirers around the world routinely manage their people assets with the same rigor and discipline with which they manage balance sheet risk. They concentrate on three primary people practices to drive value:

## RETENTION BONUS PREVALENCE*

| | |
|---|---|
| 89% | Japan |
| 76% | United States |
| 68% | Europe (Excluding UK) |
| 64% | United Kingdom |
| 63% | Canada |
| 58% | Latin America |
| 58% | Asia (Excluding Japan) |

* Buyers regardless of target location

## 1

### ENGAGE THE WORKFORCE

The first step is to commit to an investment in change management communications. This starts with defining a culture that is tangible, assigning decision-making rights, risk management, accountability and governance.

## 2

### EVENT MANAGEMENT AROUND RETAINING TOP TALENT

Retention programs are viewed as insurance policies to hedge against flight risk in transactions. By applying Mercer's framework, buyers and sellers can effectively lock down critical talent and drive operational excellence post-close.

## 3

### ALIGN REWARDS WITH BEHAVIORS

Aligning total rewards (compensation, long-term incentives, benefits, etc.) is foundational to driving behaviors within the organization to unlock true value.

## FOCUS ON RETAINING TOP TALENT, NOT JUST TOP EXECUTIVES

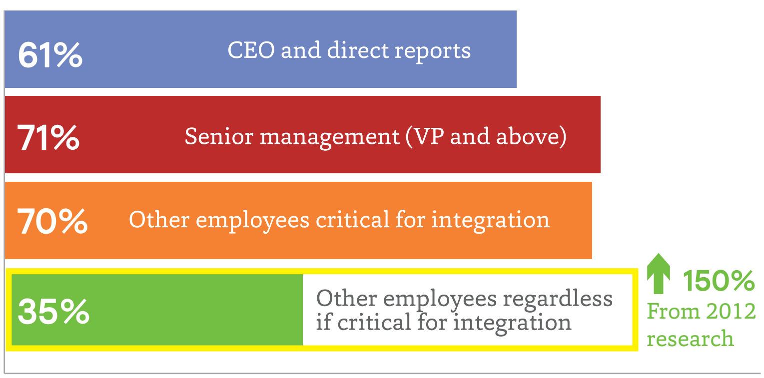
We uncovered some key insights that are important to call out because they were quite different from the last time we looked at retention in M&A back in 2012.

One significant finding is that successful acquirers are taking a people-first, bottom-up approach when designing retention programs. They're not first budgeting for retention and distributing to employees ("top down" approach); they're focusing on talent first, making sure retention is designed with a focus on key employees.

This bottom-up approach also revealed another significant trend — retention programs are expanding outside of the C-suite. Buyers and sellers are definitely getting more nuanced about whom they offer retention to and how deeply and broadly to go into the acquired organization.

> "We reached deeper down into the organization [with retention] just to make sure that nothing critical was going to break after close."
>
> – M&A deal professional, health care company, 2,100 employees, €1.06 billion in revenue

### ELIGIBILITY FOR RETENTION BONUSES GLOBALLY

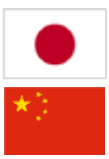



This research was triggered by last year's "People Risks in M&A Transactions" *(www.mercer.com/peoplerisk)* report, which found that **employee retention was (and continues to be) the number one perceived people risk for global deal makers**. We based these findings on comprehensive survey responses from 243 global business professionals reporting on 212 discrete closed transactions. We also conducted 82 in-depth interviews with a combination of investment bankers, lawyers, private equity deal leads and corporate buyers/sellers. Collectively, the participants have been engaged in over 1,500 closed transactions in the past five years. Most companies (69%) represented by respondents had 5,000 or more employees, and 77% had annual global revenue exceeding US$1 billion.

Consistent with our experiences working on over 1,200 transactions annually, **smart buyers are more frequently leveraging enhanced severance programs to drive affordable short-term retention. Of course, all have access to market pay data for budgeting to ensure they do not overspend.**

## RETENTION BONUS AS A PERCENTAGE OF BASE PAY

| | 25th percentile | Median | 75th percentile |
|---|---|---|---|
| CEOs | 51% | 100% | 200% |
| Executives (CEO's direct reports) | 39% | 75% | 150% |
| Senior management | 25% | 50% | 100% |
| Other critical employees | 15% | 25% | 50% |



Asia Outbound

50%

All Levels on Average

Technology Industry

49%

All Levels on Average

## OUR RESEARCH ANALYZED THE MOST COMMON PRACTICES OF RETENTION PLAN DESIGN, INCLUDING:

Vehicle for payments cash vs. equity

Conditions for payment time vs. performance

Number of payments one, two or more

Timing of payments pre-close, post-close, etc.

Individual retention bonus as a percentage of base pay

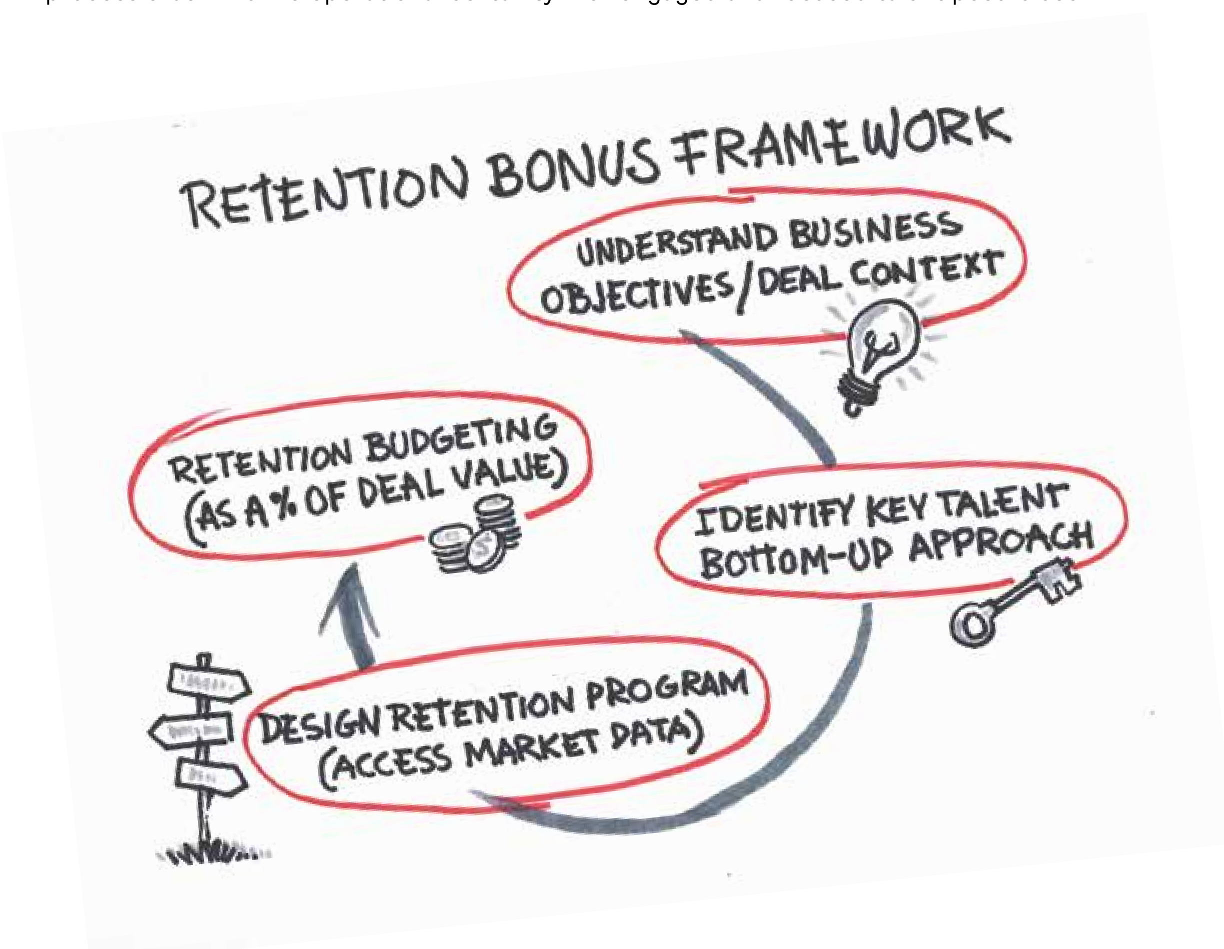
> "When you're in the professional services industry, your greatest asset walks out the door at 5 pm ... balancing the art and science of retaining talent is critical to driving deal value."
>
> – Corporate development leader, professional services firm, 60,000 employees, US$12 billion in revenue

## FRAMEWORK FOR SUCCESS

The research was conclusive. Well-designed and implemented retention programs are viewed as "insurance policies." They keep the right people focused and engaged through integration. There is, however, no one silver bullet for buyers trying to solve deal-specific talent retention needs. While analysis of the global data uncovered regional and industry differences crucial to understand, everyone must first start in the same place in the process — with a clear understanding of the deal thesis.

*"Successful buyers have elevated their retention strategies from an art to a repeatable science. The results are tangible and clear — increased productivity, engagement, owner-like behaviors and accountability,"* said Jeff Black, Mercer's Global M&A Transaction Services Leader.

This report introduces a best-in-class retention framework (Mercer's Retention Playbook™) for structuring financial incentives that are time sensitive, market competitive and aligned with business objectives. Adopting this framework will arm you with a comprehensive, repeatable process that will drive operational certainty with engaged and focused talent post-close.



# CONCLUSION

The only way to drive sustainable transaction value — regardless of deal size, geography and industry — is to get employees at all levels to understand their role in any impending CHANGE. Leaders willing to invest in frequent and transparent communication typically drive better workforce engagement and operating results.

Our research reinforces that successful buyers have a disciplined approach and roadmap to managing people assets in transactions. That roadmap has three clear strategies that capture economic value.

## 1 ENGAGE THE WORKFORCE

- Leverage frequent and transparent communication.
- Define and socialize new cultural norms around decision-making rights, accountability, performance expectations and tolerance for failure.
- Clearly articulate the new business strategy, including specific performance objectives for the new company and the need for changing behaviors at all levels to align with the new business objectives.
- Continuously communicate and measure business results against financial and other targets throughout the entire company.
- Document and socialize enterprisewide risk governance policies/procedures/boundaries.
- Embrace change and continuous improvement.

## 2 RETAIN CRITICAL TALENT THROUGH THE EVENT

- Understand first and foremost your business objectives and deal rationale.
- Identify mission-critical key talent, beyond the executives, for running your business.
- Design a deal-specific retention plan that provides the necessary “insurance” to engage key talent.
- Understand the market data and reasonableness of your retention budget.

## 3 ALIGN REWARDS SYSTEM WITH BEHAVIORS

- Drive a total rewards system that is “affordable” and aligned with the new business strategy and desired outcomes.

MERCER'S M&A TALENT RETENTION PLAYBOOK™ PROVIDES A COMPREHENSIVE, REPEATABLE PROCESS FRAMEWORK TO HELP RETAIN YOUR MOST VALUABLE ASSET — YOUR PEOPLE. AS DISCUSSED IN THE "KEY FINDINGS" SECTION, IT'S IMPORTANT TO FIRST UNDERSTAND THE DEAL OBJECTIVES AND THEN SEGMENT THE WORKFORCE NEEDED TO DELIVER ON THOSE OBJECTIVES. FROM THERE, YOU HAVE OPTIONS.

## BUYERS AND SELLERS EACH VIEW RETENTION THROUGH A UNIQUE LENS

Buyers want to make sure they develop the right talent retention strategy to protect their investment and deliver long-term value. Sellers work to avoid all potential disruption during the sale process. This means making sure key talent remains and, when they are involved in the process, ensuring strong engagement through aligned interests to successfully complete the transaction — whether it is the sale of the full company or part of the business.

### BUYERS

Identify critical talent (short term, midterm and longer term) to ensure an orderly transition.

Design retention programs that take into account deal objectives, market pay data, individual cash flow, etc.

View retention as an insurance policy to mitigate deal risk and ensure an orderly transition of running the business from one group to another.

### SELLERS

Identify and retain key talent necessary to stabilize the business and financial results through close.

Preempt flight risk with a presale review of transaction bonuses/severance policies. Undoubtedly, the secret of your sale will get out before the deal is done, causing uncertainty in the broader workforce. Recognize that people are going to be doing two jobs — continuing their day jobs and helping with the sale of the business.

## THE RESEARCH WAS CONCLUSIVE

In order to optimize the value of the transaction, buyers and sellers must identify the key people needed to secure an orderly transition and lock in commitment. In addition, adopting a long-term, enterprisewide rewards strategy aligned with the new business objectives will ensure the necessary behavior modification to drive long-term business outcomes. People execute on what they are rewarded to deliver.

> "As the dust settles on our acquisition activities, we need to sort through who we have on the bench and determine if we have the right talent and a sustainable workforce strategy to deliver on our long-term objectives."
>
> — CEO, Fortune 100 technology company, 102,000 employees globally

# ABOUT MERCER'S M&A TRANSACTION SERVICES

Our network of global advisors develops customized solutions that leverage the deep expertise we have gained working on over 1,200 deals per year, 60% of which are cross-border, as well as calling on our global insights and world-class capabilities across health, wealth and career.

## Mercer's M&A Transaction Services is the pre-eminent global advisor on people issues.

Mercer delivers advice and technology-driven solutions that help organizations meet the health, wealth and career needs of a changing workforce. Mercer's more than 25,000 employees are based in 44 countries and the firm operates in over 130 countries. Mercer is business of Marsh & McLennan Companies (NYSE:MMC), the world's leading professional services firm in the areas of risk, strategy and people, with 76,000 colleagues and annual revenue over $17 billion. Through its market-leading businesses including Marsh, Guy Carpenter and Oliver Wyman, Marsh & McLennan helps clients navigate an increasingly dynamic and complex environment. For more information, visit www.mercer.com. Follow Mercer on Twitter @Mercer.

## Reports Available from Mercer's M&A Readiness Research™ Series

***Mitigating Culture Risk to Drive Deal Value*** joins ***Flight Risk in M&A*** and ***People Risks in M&A Transactions*** as the third in a series of M&A Readiness Research™ reports from Mercer that analyze and recommend best practices in people-related deal issues. To learn more, please visit ***www.mercer.com/ma***.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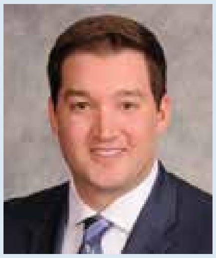
# About the Authors

## Jeff Black

Jeff Black is Mercer's Global M&A Transaction Services Leader. He has nearly 25 years of experience as a trusted advisor to business leaders. Jeff provides strategic deal advice to organizations on people-related aspects of transactions including start-ups, IPOs, acquisitions, mergers, partnerships, and divestitures. This advice is provided across all deal phases (sourcing, diligence, pre-close and post-merger integration). Jeff is a Phi Beta Kappa and graduated summa cum laude from the University of Illinois at Urbana-Champaign.



## Dan McGuire

Dan McGuire is Mercer's Director of M&A Retention Research. He was selected in 2016 to participate in Mercer's prestigious Global Rotation Program. Over his 12-year career with the firm, he has worked on the ground in the US, India, Europe and Hong Kong. He has particular expertise consulting with global clients.

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Ursula Weiszflog
Kenneth Yung

# NOTES

1. Mergermarket, Merrill Corp. 2017

2. Refinitiv. Mergers & Acquisitions Review (Full Year 2018)

3. Refinitiv. Mergers & Acquisitions Review (Full Year 2018)

4.1) US$6 trillion cash on corporate balance sheets
Citation: JP Morgan 2016 M&A Outlook
*(https://www.jpmorgan.com/country/AR/ES/insights/maglobaloutlook)*

4.2) US$1.6 trillion dry powder with private equity
Citation: Forbes March 2017

4.3) US$2.6 trillion US corporate cash held overseas
Citation: CNBC April 2017: Companies are holding a US$2.6 trillion pile of cash overseas that's still growing *(http://www.cnbc.com/2017/04/28/companies-are-holding-trillions-in-cash-overseas.html)*

4.4) US$100 billion-US$200 billion (5% of Saudi Aramco)
*(http://www.cnbc.com/2017/03/23/saudi-aramco-ipo-new-york-listing-may-be-tough-sell.html)*

4.5) US$142 billion cash with activist investors intent on inciting change
Citation: Why activist investor surge means more tech M&A
*(http://www.cnbc.com/2016/01/21/activism-.html)*

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