Drivers of Deal Success in Global M&A

Navigating Human Capital Risks Across Borders

By Duncan Smithson, Chuck Moritt and Jeff Cox

Duncan Smithson
Mercer

Chuck Moritt
Mercer

Jeff Cox
Mercer

Mercer

As the economic recovery builds momentum in 2014, global M&A activity is expected to trend upward: Overall deal volume is forecasted to rise 17 percent, pushing global volume to its highest level since 2008.* However, realizing the full value of these deals will require immense coordination, and depth and breadth of experience — particularly for global transactions, which are far more complicated, costly, and time- and resource-intensive than their domestic counterparts.

Indeed, managing the risks of people integration alone is a highly specialized niche, subject to myriad cross-border nuances and complexities. Companies that understand these unique challenges, and develop clear strategies to address them, will be poised to capitalize on resurging global M&A opportunities and drive deal success. This applies not only during due diligence, which is the first step in identifying all of the issues a buyer/operator will confront post-deal, but also during the post-signing and post-closing integration, which is when most deals are won or lost.

General Due Diligence Objectives

Whether deals are domestic or global, and involve one or two countries or dozens, a few key objectives are critical to the due diligence process and to reaching a final purchase agreement.

Identify deal-breakers. These early red flags prevent a deal from getting signed and are typically issues discovered to have such a large financial impact that future profits would no longer provide the ROI presented in the target company's financials. An HR deal-breaker might be the discovery of a material under-funded pension liability, or executive change-in-control payments that not only may be detrimental to the valuation of the company (to the extent these will be financed by the target instead of the seller), but

* Thomson Reuters 2014 Outlook for Investment Banking Services.

also may result in the departure of key leadership talent believed to be integral to the company's financial success.

Identify value-changers. While not all-out financial deal-breakers, these operational issues impact profits, cash flow, and the balance sheet, and must be addressed to ensure an accurate valuation model and fair purchase price. HR-related value-changers might be associated with the deployment of talent, compensation and benefit programs, or HR operations.

Mitigate material risks. Once the financial analysis is complete, the buyer needs to identify specific strategies the seller must implement before closing (usually structured as part of the purchase agreement). This ensures that issues uncovered in due diligence are accurately captured and the precise remedies are defined. Perhaps the seller needs to restructure the workforce (and pay severance) before transfer of ownership, or agree not to set up a generous new sales incentive plan before selling the company.

Identify deal-makers. Realistically, these activities can only be performed once the buyer owns the business, but they are critical to ensuring the company runs as smoothly and efficiently as possible and realizes the financial synergies from new ownership. These post-signing and post-closing activities include identifying priorities, establishing timetables, managing dependencies, and ushering resources to successfully carve out and stand up, transition, and/or integrate the target company.

Unique HR Challenges of Cross-Border Deals

Most companies are very familiar with the technical aspects of managing people in their own country and have reliable processes for dealing with a relatively finite set of issues. Those companies face a steep learning curve in addressing the same issues elsewhere in the world, and the complexities grow exponentially when dealing with multiple issues across multiple countries.

Workforce and labor issues

Unlike US employers, companies in most other countries are legally required to provide workers at all levels with contracts that define the specific terms and conditions of their employment. Often these conditions are guaranteed and must transfer to the buyer. However, if the buyer is unwilling to take on the terms of a contract, protracted negotiations or possibly firings may result, in turn necessitating the management of numerous details around severance and restructuring.

Organized representation of workers varies widely around the world as well. Every Brazilian employee — white-and blue-collar alike — belongs to a union; in Italy, every worker is subject to a collective bargaining agreement; and certain European countries have works councils — local- or site-specific negotiating bodies that represent employees' interests and are quite powerful. In fact, a German company needs only five employees to form a works council, and management cannot make far-reaching decisions about structure or operations without the agreement of this body.

Most foreign companies are required to provide mandatory minimum severance and also must consult or negotiate with employees around the extent and scale of any restructuring. French companies are required to negotiate with works councils regarding how much will be spent on re-training and re-deploying terminated employees; Germany has no mandatory minimum severance, but for a works council or local labor union to agree to the termination of workers, companies must provide employees with re-training, job-placement assistance, and very generous payments — both cash and in-kind.

Headcount can be a very poor indicator of deal complexity, particularly when the workforce is distributed unevenly across countries. While seemingly counter-intuitive, depending on the location and the specifics of the transaction, operations with relatively small numbers of workers can cost more time, money, and effort than other countries with much larger headcounts.

Benefits issues

Social security, tax systems, and labor laws look vastly different from one country to another and drive very individualized benefits practices. In the Netherlands, while social security benefits are quite meager, there exists a thriving employer pension-fund industry with great sophistication around funding, financing, and investing. Conversely, France's social security system, which includes a mandatory employer component, is very generous and picks up the slack from a dearth of supplemental retirement plans.

The mandatory or discretionary nature of ben-

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efits continues to evolve and morph around the world, and acquiring companies need to stay abreast of current policies. For example, a company making an acquisition into the US would need to understand that under healthcare reform, most employers now need to provide minimum affordable medical coverage to a majority of full-time employees. In addition, many countries have mandatory retirement arrangements, such as termination indemnities, creating defined benefit balance sheet liabilities that can negatively impact a deal.

Culture issues

Culture greatly affects how information is gathered, how comprehensive it is, and how what is said and done is received and interpreted. With multinational transactions, these issues multiply exponentially, making the deal much more challenging and potentially problematic. Ironically, many companies are so focused on the financial aspects of the deal that culture is never really addressed. Headlines in the past decade about such failed high-profile deals as Alcatel/Lucent or Hewlett-Packard/Palm, bear out culture's importance. If there is no validation of how companies do business, how they make decisions, and how they are influenced by cultural differences, a seemingly good deal can turn disastrous.

Drivers of Global Deal Success

Many well-intentioned companies set their sights on a global acquisition but have no idea what they want to achieve by doing so. First and foremost, the buyer must have a clearly defined global strategy that provides a sound rationale for the deal. If the company is trying to make HR determinations about which programs to keep or what kinds of headcount changes to make, and lacks a guiding strategy to inform those decisions, clearly the effort is doomed to fail.

To be successful, companies need HR knowledge and expertise both at a strategic level to guide the buyer through the transaction, and at a boots-on-the-ground level to navigate the challenges and pitfalls of global transactions. In addition, they must be willing to invest in dedicated project management — a value-added skill that takes time, money, and resources, and is essential to the high degree of coordination required for complex multinational deals.

Beyond a mastery of the technical aspects, companies must have resources that can cope with different languages and times zones. And, they need experts who understand that a deal timeline that expects a US-centric level of data and responsiveness at all times will invariably get de-railed.

As the environment for cross-border deals continues to improve, companies that have deep knowledge of countries' unique operations and cultures, a clearly defined global strategy, and proven expertise in executing complex multinational transactions will be well-positioned to capitalize on worldwide M&A growth opportunities.

About the authors: Duncan Smithson leads Mercer's Private Equity and Mergers & Acquisitions group for the west and central US based in Chicago. He may be reached at duncan.smithson@mercer.com.

Chuck Moritt is a Mercer senior partner and Chair, Mercer's Global M&A Leadership Group based in Washington. He may be reached at chuck.moritt@mercer.com.

Jeff Cox is a Mercer senior partner and the North American Leader of the Private Equity M&A team based in Chicago. He may be reached at jeff.cox@mercer.com.

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