

People risks in post-pandemic transactions

Deal making will be back - What HR will need to do differently

The COVID-19 pandemic has changed the way we work and the implications will permeate far beyond the peak of the contagion. Companies are adjusting their business models and adapting their workforce needs. They have changed pay, benefits and HR policies to manage employees' wellbeing and the company's cost base without fully understanding long-term implications.

This new environment will have ramifications for the next wave of mergers and acquisitions (M&A). Business and HR leaders need to understand how the pandemic has changed the people risks and opportunities in deals. We explore how HR professionals should act as human capital advisor throughout all phases of their next transaction to make a strategic contribution to deal success.

When deal making comes back

Since the start of the pandemic, M&A activity has slowed down significantly because of business uncertainty, the need to prioritize attention to COVID-19 response, and the inability of buyers and sellers to meet face-to-face. However, deals are expected to rebound:

- **Resumed transactions.** Paused or abandoned deals will be revisited.
- **Distressed sales and opportunistic buys.** Consider divesting assets. Larger, financially healthy competitors will take advantage of lower valuations and financial distress to consolidate the market and acquire competitors.
- **Strategic acquisitions and alliances.** Sophisticated buyers will use acquisitions, strategic alliances or joint ventures to strengthen their business in areas where new opportunities have emerged in the wake of the crisis.

One of the challenges in upcoming deals is that buyers and targets are still in the midst of their own business 'return and reinvent' journey, which may involve a significant workforce transformation. Working on deals in this context means that HR will need to be 'changing the wheels of the car while driving'.

What HR will need to do differently

The role of Human Resources professionals in M&A is to advise the deal team on people implications throughout the deal and to plan and execute the human capital integration strategy. In the current environment, HR M&A professionals have an even broader strategic role to play and can only do so if they adapt their approach to the new business reality. Based on our conversations with deal leaders we recommend HR M&A leaders focus on the following during the readiness, due diligence and integration stages of their next deals.



1. Readiness: ensure business and people strategy alignment for deal success

In this volatile business environment, a thorough understanding of the business rationale and integration strategy is more critical than ever for HR to assess the people costs, risks and opportunities of a contemplated deal. Questions that need to be answered include: Does the deal thesis assume a quick or slow return to pre-COVID-19 revenue and cost levels, or does it assume that the business model is more or less permanently changed? If the latter applies, what type of talent and skills are required to deliver the future business model versus what the workforce looks like today?

Different industries and companies have been affected differently by the pandemic and subsequent economic changes. Many companies in particularly vulnerable industries, such as travel, energy and hospitality, already have introduced far-reaching workforce downsizing and cost restructuring initiatives, whereas others have only implemented temporary measures, such as reduced working hours. Other companies are rethinking where and how work needs to get done to be less vulnerable for future global crises. Across the board, we see an acceleration of digitization, system automation and new ways of working that will shape the workforce

requirements of the future. According to Mercer's 2020 Global Talent Trends research, only 45% of executives believe their current workforce can adapt to the new world of work.

HR will need to act as a human capital advisor to the deal team to determine the degree to which the current human capital model is a value driver or barrier to the deal's success and what changes will be needed to realize the deal value.

2. Due diligence: assess people risks and model current and future state workforce cost

How does all this change HR's traditional due diligence playbook to assess the people cost, risks and opportunities related to a deal?

First, HR due diligence relies heavily on formal policy and strategy documents, employee census information and reports shared with potential buyers in a data room. These documents provide a static view of the target's workforce at the time the document was created. It will not be possible to fully comprehend the unprecedented speed and scope of workforce and HR changes companies have made in the last months using this document review process alone. More than before, diligence will rely on additional management and HR expert dialogues to get an up-to-date view of the target's current state workforce and HR policies.

Exhibit 1: Top 10 M&A Human Capital risk due to pandemic response

Human capital value driver	Potential COVID-19 measures / impact	Human Capital Risks
1. Business strategy and organization design	<ul style="list-style-type: none"> Change in business model and processes Business restructuring in response to change in customer demand 	<ul style="list-style-type: none"> Additional restructuring and severance cost Reduced productivity Talent/skill misalignment
2. Leadership	<ul style="list-style-type: none"> Change in roles and responsibilities due to business restructuring 	<ul style="list-style-type: none"> Unproven leadership and misaligned decision rights Outdated succession plan
3. Executive compensation	<ul style="list-style-type: none"> Temporary reduction of executive pay Use of discretion to assess 2020 performance 	<ul style="list-style-type: none"> Incorrect cost projections Reputation Retention
4. Talent management and workforce planning	<ul style="list-style-type: none"> Employees placed on furlough, voluntary sabbaticals, temporary talent sharing or severed; hiring freeze Revised definition of critical roles / essential workers Shift to a more flexible workforce model 	<ul style="list-style-type: none"> Incorrect workforce (cost) projections Reputation, ability to hire (back) talent Imbalance between current workforce and revenue
5. Compensation	<ul style="list-style-type: none"> Increase/decrease of pay (all/specific employees) Reliance on government subsidies Delay, rescind or reduce merit increase Use of discretion to assess 2020 performance 	<ul style="list-style-type: none"> Incorrect cost projections Retention and attraction
6. Health & welfare benefits	<ul style="list-style-type: none"> More impactful changes to benefit plans (e.g. eligibility, plan design, employee cost share) 	<ul style="list-style-type: none"> Incorrect cost projections (volatile 2020 claim cost and impact on 2021 renewal cost)
7. Retirement benefits	<ul style="list-style-type: none"> Defined benefit pension funding status decrease Change or delay in company contribution/match 	<ul style="list-style-type: none"> Increased balance sheet liabilities for DB plans Higher cash funding requirements for DB plans Impact on employee retirement expectations and their financial wellness
8. Employment policies and practices	<ul style="list-style-type: none"> Changes to policies and practices, such as work from home, flex work, leave/PTO, emergency leave 	<ul style="list-style-type: none"> Increased vacation accruals Regulatory compliance and outdated documentation
9. Culture	<ul style="list-style-type: none"> Accelerated workplace (digital) transformation Change in leadership style Empathy and collaboration over individualism 	<ul style="list-style-type: none"> Reduced productivity Misaligned employee value proposition Retention and attraction
10. Employee engagement	<ul style="list-style-type: none"> Impact on physical, mental, financial, and collective well-being of employees 	<ul style="list-style-type: none"> Reduced productivity and increased disability Retention and attraction

Second, projecting workforce costs will require a deep understanding of the future state workforce requirements, both quantitatively and qualitatively. Pre-pandemic workforce and HR (cost) assumptions built into the valuation model will need to be reviewed in light of the more radical people strategy changes required.

Third, HR professionals will need to provide their expert opinion on the risks, costs and liabilities associated with recently announced and implemented HR policy and workforce changes. They will also need to consider additional risks if a target company has failed to protect key elements of their workforce. **Exhibit 1** shows the Top 10 Human Capital Risks as a result of the measures initiated during the pandemic identified through Mercer's global pulse surveys.

Many of the measures in Exhibit 1 were announced while companies were in crisis-response mode, without having a fully developed view of the long-term implications. In addition, government aid and relief programs were introduced to support companies and their workers which significantly –but temporary– changes their cost base. The application, scope and potential end dates of these changes and programs are often not completely clear. The HR due diligence process will need to review and highlight the people risk, cost and liabilities associated with these measures and identify potential mitigation actions. HR leaders should assure that they have the capacity and capabilities lined up to provide the rigorous HR due diligence support required in an urgent deal environment.

3. Integration: assume the role as strategic human capital advisor

As buyer and target each are involved in the 'return and reinvent' of their respective businesses and workforces, the integration management office oversees the planning and execution of the integration of the businesses. With so much people change ongoing, HR integration leaders will need to act as strategic human capital advisor to the executive team to ensure the integration strategy balances employee wellbeing and productivity. A focus on employee health and safety, wellness and organizational purpose and sustainability will be critical to develop, retain and attract the workforce of the future. HR integration leaders should coach their fellow leaders to understand and take into account the people and culture implications of their decisions.

Conclusion

The pandemic has reminded the world of just how critical people are to so many businesses. The post-pandemic deal environment will challenge HR M&A professionals to take a strategic and critical view to new deals to identify and mitigate people risk and opportunities. Traditional methods, models and assumptions will need to be challenged against changing business models. In addition, companies will need sound human capital strategies to create the workforce of the future. In this context, HR M&A professionals will have the opportunity to play a paramount role to contribute to deal success.

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