

VIEWPOINT

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HR ISSUES CAN SINK M&A DEALS IF NOT ADDRESSED IN ADVANCE

By Elliot Williams

"It's the people, stupid." That is rapidly becoming the mantra for both buyers and sellers in the M&A arena. Having mostly taken a backseat to financial considerations when companies changed hands in the past, human resource issues are increasingly recognized as critical to deal success.

Tackling thorny HR issues sooner rather than later helps avoid last minute snafus that can capsize a deal. It also increases the odds of a smooth post-transaction integration and a positive long-term outcome for the newly united organization.

WHY THIS MATTERS:

- Your ability to close a deal for your company may hinge on resolving human resources issues to the buyer's satisfaction.
- In service companies, the personnel are the chief assets. Making sure these assets stay in place is critical to maintaining your company's value.
- Most HR issues cost little to do right up front, but left unfixed, can cause significant headaches after an M&A deal closes.

Three converging trends help explain why people-related issues have become ever-more important when companies are being bought and sold:

- Service companies increasingly dominate the largest global economies. That means the chief assets are not factories and equipment, but people—including executives who develop client relationships and leverage a certain expertise. Consequently, more mergers involve assets that can walk out the door if they're not happy.
- The sharp increase in cross-border deals between global firms with operations in many different countries has raised the odds that mergers will involve blending both national and corporate cultures.
- Deal rationales have become more complex. Many companies engage in M&A not just to squeeze out value or increase their size but also to transform their business or industry. It is often the expertise of the people in the company being acquired that is critical to achieving this goal.

MISTAKES SELLERS MAKE

Where do sellers commonly err when it comes to dealing with people-related issues? Some treat employees the same as other assets that are being transferred to a buyer, neglecting to consider that, unlike buildings or machinery, employees can walk out the door.

Taking a cavalier attitude toward employee concerns about a company's future can produce a multitude of mistakes. For example, senior executives may assume that if they are happy about selling their small, fun, entrepreneurial company to an industry giant,

everyone else will be as well. In reality, some people do not want to work for a Fortune 500 company.

Other sellers suffer from the “damned if you do/damned if you don’t” challenge regarding which employees to tell about a deal and when to tell them. On the one hand, the loyalty and performance of people who are told about the potential sale may suffer, causing the value of a company to drop. Those who are left out of the loop, however, may feel betrayed when they do learn the news and immediately start to circulate their resumes.

Predicting how people will react to news of a deal is tricky. “People react differently,” says Steven Wasserman, Vice President and CFO of Constant Contact in Waltham, MA. Wasserman should know. He has been with three companies that have been acquired. Most recently he helped steer ON Technology through its acquisition by Symantec.

“People’s reactions are a function of experience, not necessarily age or job level. At ON Technology, we had some senior people who had never been through an acquisition and junior people who had been through it twice already. People who have been through an acquisition tend to say, ‘Okay, I understand.’ People who are going through it for the first time react with a bit more uncertainty.”

Why should a seller care if employees are happy about the deal or not? Because a buyer who observes a sudden exodus of disaffected personnel, especially key people, can start to have second thoughts about a company’s value. As Wasserman notes, “If the assets walk out the door, nobody is happy.”

AVOIDING PEOPLE PROBLEMS

Now more than ever, it’s important to start with the premise that the workforce is an important—if not *the* most important—asset a company has. The effort put forth to assure that people are on board with the deal should match the effort you’ve already expended on hiring, training and retaining the right people to begin with.

“During the period between when a transaction is announced and the deal is closed, the whole management team needs to work with everybody to make sure they understand the process,” says Wasserman. “Each time I go through this process, I learn a little bit more, and my main advice is prepare, prepare, prepare. You need to have talking points ready. Acknowledge the uncertainty that arises during this period. Talk about the acquirer and how they typically run a business.”

It is important to understand that it’s often the little things that people get upset about, according to Arden Port, Vice President, Human Resources at TechTarget

in Needham, MA. Having observed a number of acquisitions from the buyer side, she knows first hand how seemingly small issues can become big points of contention.

“Little things that you wouldn’t think would be a big deal become a big deal because people are used to their routines,” Port says. For this reason, she likes to see a thorough benefits audit from the seller that includes not just a rundown of expected items like health insurance and 401k plans, but also includes information on little benefits that employees are accustomed to receiving, such as free bagels once a week or paying only 25 cents for vending machine items.

“I’d like to have that information well in advance of the closing so we can do a comparison to what the new benefits will be and see where we have to make adjustments or know where people might be going to feel that they’re losing something,” says Port.

With such information in hand, the buyer’s HR people can prepare messages for employees that play up any benefits being gained and acknowledge any trade offs they might be making. For example, they may have been used to having health insurance covered 100%, whereas the new organization will expect them to make a contribution toward this cost but offers better or additional coverage. Or perhaps the increase in health insurance cost will be offset by a 401K contribution that the company being sold did not offer. Being prepared to address all of these issues from day one is extremely helpful.

The other people-related information that Port would like sellers to be forthcoming about is corporate culture. “In our latest acquisition, we thought the cultures were much more similar than they actually were,” she says. “We thought we were similar because both companies were about the same age and both were growing rapidly and had high energy cultures. But it turns out that what was fast-paced to them was nothing compared to our fast pace.

“Also, we are very e-mail driven,” Port adds. “The company we acquired, however, was very IM driven and they rarely used regular e-mails. During the transition, we’d send an e-mail and we’d expect a quick response but wouldn’t get one! They now have adapted to the e-mail, because it’s the acquiring company’s culture that is going to prevail. But over the fast pace issue, some people could not adjust and either left on their own or were let go.”

Such cultural problems can be anticipated by having a thorough and open discussion about culture during the sale process. If possible, allowing the acquirer’s HR people to spend time in your office observing how things are done might also help give them insights into cultural differences that they’ll need to address during the transition.

PUT IT IN WRITING

Another HR-related area where difficulties often arise when a company is being acquired is that verbal promises made to employees by management have not been put in writing. This may include stock options that haven’t been legally

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documented or verbal commitments for bonuses employees would receive for staying during the transition period or raises they would receive after the deal closes.

The first of these is extremely common; in roughly two-thirds of the companies Mirus works with, we run into the issue of undocumented stock options. Not knowing who owns what portion of the company can become a real problem.

With regard to verbal promises about retention bonuses or post-transaction raises, a buyer often tells a seller, "That's your problem, not mine." A buyer may reduce the offering price if a seller suddenly reveals that operating costs are going to be higher post-sale because of such promises to employees. To increase your ability to get the deal closed at the price you desire, the best practice is to document any such promises made to employees and make sure the buyer is aware of them from the get-go.

Of course, there is always a push pull between the seller and the buyer when it comes to such information. Sellers only want to disclose what is positive and favorable. And a buyer who learns such information at the last minute may feel like the seller has been playing fast and loose with the financial facts.

This is where having an investment banker involved in the process can benefit the seller. We can credibly deliver the news about HR-related costs that will impact post-deal financials by assuring the buyer that retention bonuses and similar offers to employees are standard among our clients.

WHO TO BRING INTO THE TENT

The issue of retention bonuses is closely linked to another major question that arises when a company is put up for sale: Who do you tell and when do you tell them? As Steve Wasserman notes, "In a perfect world, you'd like to tell everybody." But few companies operate in a perfect world.

For public companies, information about a potential sale needs to be closely held, which often requires executives to mislead people during the process. But when the deal is announced, people understand why the executives were not totally forthcoming.

With privately owned companies, however, management has a free hand about deciding who to tell and when to tell them. There are two schools of thought that operate on this issue. One is that if you keep everybody informed and tell them they're going to be part of a company with more resources that will help assure the success of your product or service, many people will respond positively. They will feel like they're being treated as adults and will at least stick around long enough to give the buyer a chance to win them over.

But many companies—in fact, probably most companies—don't tell people what's going on. The news is not revealed out of fear that people will immediately start to think about their own futures and many may leave, making the company less valuable.

Regardless of which path feels right for your organization, Wasserman advises careful and advanced consideration of who needs to be involved at each step of the transaction process. Then bring these people into the process early. "For example, it's more difficult to bring in an engineer to explain something technical during due diligence when he hasn't been part of the team and doesn't know what's going on," Wasserman points out.

The fear that your most valuable assets will walk out the door the instant they know the company is for sale may well be unfounded. While people read about huge layoffs when the likes of Procter & Gamble are sold, the reality is that generally with small private companies, few people are impacted by a sale. Wasserman reports that in the three companies he's been with during their acquisitions, only a tiny fraction of the workforce left in each case.

Keeping a company's most valuable assets in place during a sale is in the interests of both sides of the deal. When seller and buyer work in unison to resolve human resource issues, the outcome should be a positive one for all involved.

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