HEALTH WEALTH CAREER

EXECUTIVE SUMMARY: PEOPLE RISKS IN M&A TRANSACTIONS

2016 MERCER RESEARCH REPORT

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Mercer's *People Risks in M&A Transactions* is the first M&A research of its kind, providing an exclusive focus on the key people risks and related value drivers in M&A transactions.

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Download the full report at **www.mercer.com/our-thinking/survey-people-risk.html**

EXECUTIVE SUMMARY

Offering robust data and analysis as well as unique insights and guidance, Mercer's first annual research report on people risks in M&A transactions provides an in-depth view of the human capital issues buyers and sellers are facing in the marketplace. In addition, this report identifies practical solutions and strategies organizations are deploying to effectively hedge these risks and drive deal value.

Our findings are drawn from three distinct data sets:

- **Survey responses from 323 M&A professionals on both the buy (93%) and sell (58%) sides.** In addition to HR executives, 56% of respondents were from private equity deal teams and operations, finance, corporate development, and operational leadership positions.
- **Seventy-eight interviews with corporate and private equity clients**, investment bankers, and M&A advisors between August and November 2015.
- **Analysis of nearly 450 M&A transactions** (of which almost 60% were cross-border deals) during 2015.

RECORD GLOBAL DEAL ACTIVITY IS DRIVING BUYERS TO TAKE INCREASED RISKS

Worldwide M&A totaled $4.7 trillion last year (a 42% increase over 2014 levels), making 2015 the strongest year for dealmaking on record. M&A activity was up 32% globally in 2015; in addition, cross-border M&A activity escalated by 27% over 2014 levels, totaling $1.6 trillion and accounting for one-third of overall M&A volume.[1]

[1] Thomson Reuters. *Mergers & Acquisitions Review* (Full Year 2015).

With global merger and acquisition activity at an all-time high, buyers face a new reality characterized by increased risk, truncated auction timelines, and shrinking access to critical information.

BUYERS MUST NAVIGATE A HOST OF NEW COMPLEXITIES

Buyers face a host of new complexities as they enter unfamiliar geographies and industries, often enticed by the promise of reduced costs in emerging markets. Our findings show that nearly 25% of buyers are more inclined to consider multicountry transactions than they were prior to 2014. Almost 50% of buyers are willing to consider taking on pension and post-retiree medical obligations.

In addition, 41% of buyers surveyed report having less time to complete due diligence before making a binding bid compared to prior years, and 33% say that sellers are providing less information about the asset for sale. This trend is expected to continue, as companies conducting multicountry deals anticipate sellers disclosing less information in the future, due to the competitive nature of transactions.

SELLERS SEEK NEW STRATEGIES TO MAXIMIZE PRICE

Although it's clearly a sellers' market, sellers are not immune to risks. Over one-third of those surveyed are spending more time than in the past on HR issues when preparing for divestitures. Armed with more than $100 billion in capital,[2] activist investors continue to pressure more companies to unlock value for shareholders.

Sellers choosing to divest assets that include defined benefit pension and other long-term employee obligations must navigate pension volatility during the auction process. This risk is evident in the turbulent equity markets witnessed at the start of 2016 as many US pension funds lost roughly 10% of the value of their equity portfolios in the first few weeks of the year. Strategies that demystify pension obligations and limit downside risk for the buyer differentiate sellers that are looking to maximize exit price.

[2] Chung, Juliet, and David Benoit. "Activist Investors Build Up Their War Chests." *The Wall Street Journal*, September 11, 2014.

“The human capital side is the most important part of this [merger].”

Current headlines show that companies recognize that a strong focus on people is paramount to success. When asked about his approach to the $120 billion Dow Chemical and DuPont megamerger/split, Edward Breen, DuPont’s chairman and chief executive and future CEO of the new company, DowDuPont,[3] emphasized that the people issues — particularly reassuring and motivating employees — are a top priority.

MORE THAN EVER, THE CHALLENGE OF MANAGING TALENT — ESPECIALLY IN THE FACE OF ORGANIZATIONAL TRANSITION — IS WHAT MOST CONCERNS M&A PROFESSIONALS

The root of people risks in M&A transactions lies with individuals’ inability to manage uncertainty and embrace change — which can lead to declining organizational performance and loss of transaction value.

These risks can have serious implications for companies and their employees if left unchecked. Buyers and sellers must manage and mitigate people-related risks in order to preserve key customer relationships and maintain productivity.

More than half (55%) of buyers surveyed, including both corporate and private equity buyers, report that talent challenges will remain a significant HR issue in future M&A transactions.

Employee retention is cited as the number one perceived risk, followed by cultural fit and leadership team concerns such as selection, skills/capabilities, and attraction and retention.

Buyers are increasingly recognizing that the people aspects of running a business are fundamental to driving return on investment. When evaluating a deal, buyers are not just looking at customers, products, and access to markets — they’re also looking at the people spend and ROI associated with the deal.

This approach is critical in helping organizations anticipate and avoid people risks in M&A transactions, which can impact the business being acquired in one or more of the following dimensions: strategic, financial, and operational.

[3] Bunge, Jacob, and Rachel Feintzeig. “Dow and DuPont Strive to Find the Right Chemistry.” *The Wall Street Journal*, January 12, 2016, available at www.wsj.com/articles/dow-and-dupont-strive-to-find-the-right-chemistry-1452630298.

"Buyers have the opportunity to manage the people spend with the same discipline and rigor as other capital investments (property, plant, equipment, R&D, M&A, among others)."

Jeff Cox, Global M&A Transaction Services Leader, Mercer

STRATEGIC

People risks in this category result from misalignment between the people strategy and the business strategy. These risks can take the form of employees failing to make needed behavior changes to successfully support the new business.

FINANCIAL

Financial risks relating to employees that are identified during due diligence can be material and must be factored into the business valuation. According to our research, defined benefit pension liabilities, retiree medical program liabilities, the Affordable Care Act (in the US), and compensation and benefit compliance issues are some of the most significant financial risks that can be uncovered during diligence.

Once a deal is consummated, select financial risks relating to people include unwanted turnover and loss of productivity and engagement, which can adversely impact the business and destroy value.

OPERATIONAL

Achieving operational excellence requires the right go-forward operating platform that will allow the buyer to differentiate its business, and attract and retain the best talent while flawlessly executing on the basics of the function, such as payroll, benefits administration, on-boarding, and compensation management.

A seller can maximize deal value by playing an active role with the buyer in transition strategy, planning, and implementation."

Chuck Moritt, North American Multinational Client Leader, Mercer

PEOPLE-RELATED VALUE DRIVERS FOR BUYERS

Assess leadership team and key employee capabilities.
Use skills inventories and competency assessments to gauge selection and ability to execute on strategy, effectively govern, lead people, drive culture change, and deliver business results.

Develop effective retention strategies.
Segment key stakeholder employee groups (beyond the executive team) to determine appropriate severance programs, stay and retention bonuses, roles, and decision-making authority during and after the transaction. This helps keep customer relationships intact and allows for an orderly transfer of the knowledge required to operate the business going forward.

Have a clear culture, communications, and change management plan.
Determine the right pace and amount of disruption, and communicate frequently and transparently so employees understand the new culture, performance expectations, business objectives, and their role in the change.

Evaluate HR service, delivery, and design needs.
Ensure on day one the basic measures are in place to deliver paychecks and benefits to employees while positioning the HR function to enhance business results.

Enlist experienced resources to speed the transition process and make it more efficient.
A project management office (PMO), integration management office (IMO), or separation management office (SMO) will accelerate decision-making, execution, implementation, and, in turn, operating results.

Adopt an enterprise or global view to effectively manage benefits.
The approach to benefits can vary widely in different countries (on average, country benefits costs range from 18% to 50% of base salary).[4] Avoid unnecessary costs and compliance risks by adopting a comprehensive governance strategy for global benefits.

Understand the market competitiveness of rewards, and leverage your total reward programs to attract and retain the right talent.
This includes base pay and total cash to market, internal equity, incentive metrics/targets, and noncash rewards.

PEOPLE-RELATED VALUE DRIVERS FOR SELLERS

Identify critical employee groups and consider a retention program.

Programs targeted at employee groups that influence key customer relationships or important operating initiatives can minimize any pre-close exit disruption and maximize the purchase price.

Leverage experienced sell-side advisors and separation specialists (including SMO resources).

Taking a rigorous approach to sell-side diligence (including the auction management process and dissemination of key data, insights, and facts) can help improve the purchase price and expedite the sales process.

Consider providing a sensible, appropriately priced (cost-plus) transition services agreement (TSA).

These arrangements allow you to mitigate reputational risk, cover your costs, and create an orderly exit. If a TSA is not an option, consider standing up the organization prior to sale.

Document a clear talent management/ staffing plan.

Establish and communicate the infrastructure of the entity being sold, and determine which employees will stay with the parent and which will go to the new organization.

Applying these principles throughout a transaction will help organizations — whether they're buying or selling — mitigate risk and maximize return on exit.

ABOUT THE REPORT

Our findings are based on 847 unique data points, including survey responses from 323 M&A professionals, 78 interviews, and analysis of nearly 450 transactions (of which almost 60% were cross-border deals) during 2015.

Forty-four percent of firms we surveyed had more than 10,000 employees, and 39% had revenue exceeding $5 billion.

323

corporate and private equity buyers and sellers surveyed

78

interviews with deal professionals and advisors

446

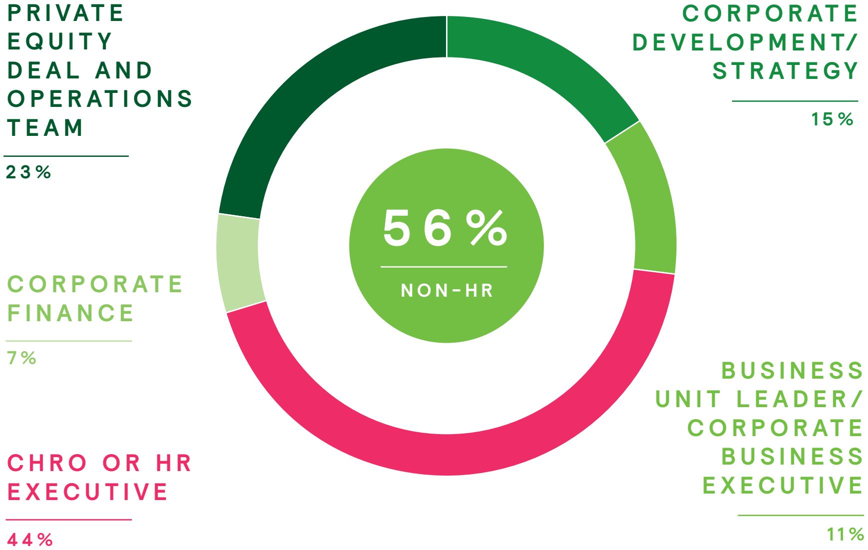
transactions analyzed

FIRMS WE SURVEYED

NUMBER OF EMPLOYEES GLOBALLY (N=319)		ANNUAL REVENUE (N=302)	
Fewer than 500	7%	Less than $100 million	3%
500 to 999	7%	$100 million to less than $500 million	15%
1,000 to 4,999	30%	$500 million to less than $1 billion	11%
5,000 to 9,999	12%	$1 billion to less than $5 billion	32%
10,000 or more	44%	$5 billion or more	39%
Mean	**18,214**	**Mean (in millions)**	**4,911**

A total of 323 corporate and private equity buyers and sellers were surveyed between April and August 2015 by our research partner SSRS, a leading independent research company with deep expertise across multiple industries, including health care, technology, and financial services. In addition to human resources (HR) executives, 56 percent of respondents were from private equity deal and operations teams, corporate development, finance, and operational leadership positions, bringing a diverse range of perspectives to our research.

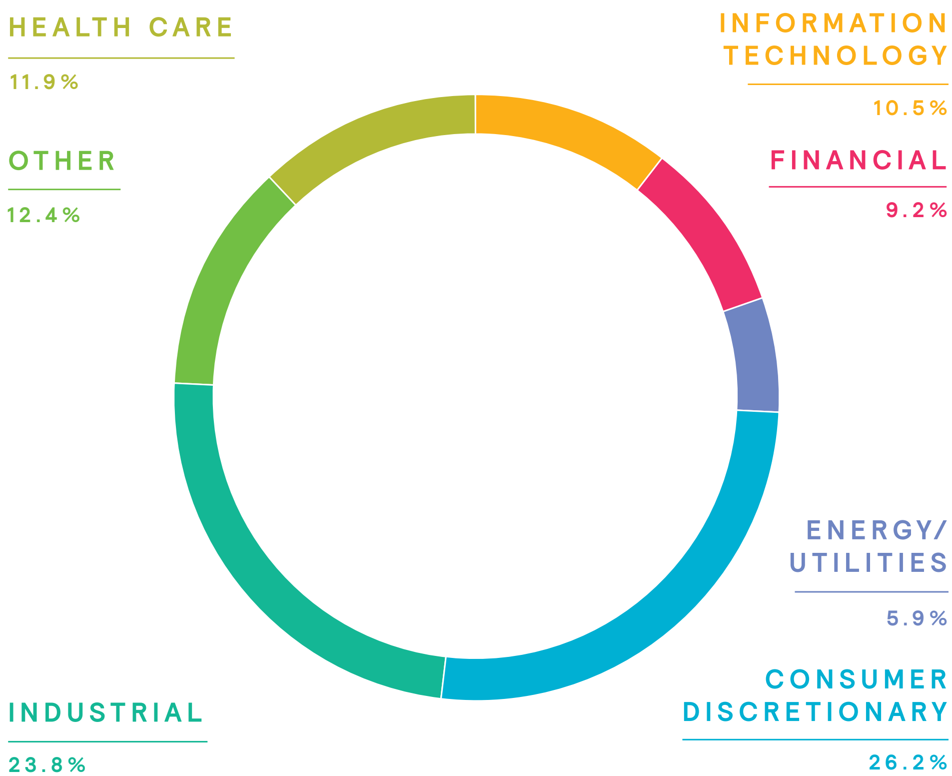
SURVEY PARTICIPANTS: JOB RESPONSIBILITIES/TITLES



Mercer also conducted interviews with 78 private equity and corporate clients across a broad range of industries between August and November 2015. We interviewed business unit leaders and M&A advisors and consultants; executives in corporate development, strategy, and finance; private equity deal teams and operations teams; and CHROs and HR executives to find out how they're responding to the heightened challenges of this competitive marketplace.

In addition, we analyzed 446 transaction-related projects from 2015 to identify the top areas of focus for buyers and sellers in managing the people-related risks involved in transactions. Approximately 60% of the transactions we analyzed included more than one country.

INDUSTRY BREAKDOWN OF DEALS WE ANALYZED



ABOUT MERCER'S M&A TRANSACTION SERVICES

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

We help buyers and sellers in corporate and private equity transactions mitigate people risks and manage the complex organizational challenges that arise from all types of transactions.

Mercer is a global consulting leader in talent, health, retirement, and investments. Mercer helps clients around the world advance the health, wealth, and careers of their most vital asset — their people. Mercer's more than 20,000 employees are based in 43 countries and the firm operates in over 140 countries. Mercer is a wholly owned subsidiary of **Marsh & McLennan Companies** (NYSE: MMC), a global professional services firm offering clients advice and solutions in the areas of risk, strategy, and people. With annual revenue of $13 billion and 57,000 colleagues worldwide, Marsh & McLennan Companies is also the parent company of **Marsh**, a leader in insurance broking and risk management; **Guy Carpenter**, a leader in providing risk and reinsurance intermediary services; and **Oliver Wyman**, a leader in management consulting.

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