

DIVESTITURES AND PEOPLE ISSUES: BREAKING UP IS HARD TO DO



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In the world of M&A, successful acquisitions require keen attention to people-related issues. However, the flip side of M&A, the divestiture, may require even greater process and rigor in order to successfully handle the complicated people challenges that can arise.

Companies that pride themselves on having mastered acquisitions may find themselves in uncharted territory when it comes to divestitures. Poorly executed divestitures can result in some very real and unfortunate outcomes, such as unanticipated resource needs, costly ongoing transition service agreements, long and painful separations, and loss of critical talent – all which contribute to deterioration of morale and damage to reputation.

As with an acquisition, HR plays a critical role in the decisions and actions needed to meet the organization’s overall objectives.

While the decision to divest can be driven by the need to rebalance a portfolio, strategically reorganize, or raise capital, the common goal in all cases is to maximize price. As with any complex initiative, organizing the process into defined phases helps clarify the objectives, process, and actions needed to achieve the desired goals.

The five major phases for a seller are in [Figure 1: Divestiture Phases](#).



I. SELLER'S DUE DILIGENCE

A good salesperson knows that in order to sell a product, one must fully understand that product – and divesting is a sales effort. So while the idea of conducting due diligence on one's own organization may seem counterintuitive, doing so serves a twofold purpose:

1. Clarify the current-state HR structure.
2. Identify any and all potential factors that might impact a deal price or decision to buy.

To achieve the first goal, one must understand both the structure of the organization as a legal entity and the overall structure of the deal as well as who “owns” all HR-related provider contracts, plans, programs, and systems.

In addition to clarifying infrastructure ownership, the seller should also confirm the legal employing entity for any and all employees who provide services to the proposed divested business. For some organizations, this may prove to be a simple activity. However, when an organization has multiple employing entities or operates in many countries, it is not uncommon to underestimate the number of crossover or “shared” employees.

Achieving the second goal – identifying potential liabilities or compliance risks – is critical to developing a divestiture strategy, as it plays a part in setting the deal price, developing an approach to information disclosure, and identifying the seller's potential nonnegotiables.

II. ESTABLISHING A DIVESTITURE STRATEGY

Beyond the clear goal of selling the company quickly and for the most money possible, it's important that the seller develop a broader divestiture strategy. With a clear picture of its current state, HR can play an invaluable role in this process by:

- Defining (and potentially improving and/or modifying) the organization to be sold.
- Ensuring post-close success for RemainCo by identifying and addressing any HR infrastructure and/or employee service gaps resulting from the transaction.
- Contributing to “ideal” deal terms by identifying:
 - Factors which might impact the deal price range including HR-related deal “breakers” and/or deal “makers.”
 - HR nonnegotiables.
 - Preferred transition timing.

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In helping develop the divestiture strategy, HR should ask a series of questions, considering each from the viewpoint of both the seller and the buyer:

- Would the entity being sold command a higher price if set up as an independent entity prior to the sale?
- Is there critical talent within the entity being divested that should remain with the seller?
- What position vacancies and/or capability gaps might exist post-close?
- Should any employees be moved to a new entity prior to close, and if so, what actions are needed to facilitate the change (new employment contracts, benefit enrollment and changes, etc.)?
- Will a transaction trigger termination notices, severance payments, new employment contracts, etc., that could impact deal timing and/or deal cost?
- What union and labor-related activities might be required before and after the divestiture?
- Where might the seller or buyer request transition service agreements or employee secondment (i.e., leasing)?
- Who among the transferring employees should participate in and/or be highlighted during the sales process?

The answers to these questions provide the seller with a clear picture of the assets, compliance issues, and/or setup costs a buyer might potentially assume and their impact on the deal price. They also reveal any HR contracts that transfer at close, and the seller should consider how the cost of reimplementing such contracts may impact its ideal price.

III. MARKETING THE COMPANY

Once the seller has answered these questions and established its divestiture strategy, it can begin an effective marketing process by:

1. Defining the ideal buyer.
2. Strategically “packaging” the product.
3. Maintaining employee engagement and motivating the sales team.

Defining an ideal buyer allows the seller to target a specific “market” and customize its sales pitch accordingly. Many HR considerations factor into defining a buyer as ideal. For example, if the seller has significant HR infrastructure gaps, an ideal buyer might have its own HR infrastructure already in place or demonstrate the ability to successfully set one up. Or if the seller’s culture is one of entrepreneurial management and individual autonomy, an ideal buyer might be a private equity firm or an organization that holds similar values.

HR also plays an important role in developing the “marketing materials” used to promote the company by:

- Contributing to development of the “pitch book.”
- Participating in management meetings.
- Strategically populating data room information and responses to buyer questions.

Data can be disclosed in phases. For example, in the initial stages of a competitive auction process, a seller may limit the type of data provided in order to prevent sensitive information (e.g., key talent or compensation data) from being disclosed to organizations that will ultimately remain as competitors.

HR can also provide input about what kinds of data the seller may decide to withhold, for a number of legitimate reasons, including:

- Data privacy restrictions (which may vary by country).
- Data needed to conduct due diligence. This can be an issue when a wholly owned subsidiary or operating division participates in an enterprisewide set of plans and programs.
- Disclosure of competitively sensitive information.

HR can also contribute to the marketing process by motivating the divestiture team while continuing to drive employee engagement through broad-based communications and targeted retention awards.

The fact that most deals are highly confidential in the early stages can make initial communications challenging. But once the deal can be disclosed, being open and candid with affected employees is critically important. Employees want to know what the impact of the deal will be on their jobs, their pay, and their futures. In order to keep them engaged and allow business to continue without undue disruption, sellers must be open and honest about these issues.

Retention rewards can be effective, but the seller must identify a sufficiently motivating reward amount and weigh that cost against the risk of employee attrition. The seller should consider factors such as talent demand in the market, the windfall income an employee would receive through change-in-control payments or accelerated equity vesting, and finally the impact these obligations might have on a buyer’s offer.

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IV. DEAL NEGOTIATIONS

Once a buyer is selected, the seller can utilize its deep understanding of its own organization and well-developed deal strategy to support its position during negotiations.

Examples of HR negotiable items include:

- In-scope HR infrastructure and employees and/or process for identifying these items.
- Requirements regarding future benefit treatment (e.g., comparable to current benefits by employee, in the aggregate, equal to buyer's current benefits, etc.).
- Treatment of long-term incentive awards (including equity).
- Requests for representations and/or indemnifications.
- HR transition service agreements (TSAs).

Among these items that HR can play a critical role in defining, the one that has the most significant future implication is whether to enter into a TSA. A TSA is frequently utilized where either the buyer or the seller is not fully functional on Day 1 and requires continued support for a defined period of time. A TSA may seem a good solution in such cases, but entering into one raises a number of significant issues, such as appropriate costing of services, potential third-party contract consent and revisions, potential multiemployer welfare and/or pension risks, and, in some countries, potential legal restrictions.

Before entering into a TSA, the seller must evaluate the potential long-term impact of such an agreement. It is important that the seller clearly establish the price and duration of any TSA prior to close in order to avoid extended reliance on the TSA and reinforce the need for the new entity to independently support its own HR infrastructure.

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V. OPERATIONAL CONTINUATION AND TRANSITION

One of the most important and challenging aspects of any divestiture is preventing operational disruption to the outbound business during the divestiture process. Operational disruption could not only impact deal price but could also potentially threaten completing the deal. Once a deal is announced, management and HR must work together to help employees find some level of comfort in an otherwise unknown and changing environment.

In order to prevent operational disruption, divesting organizations should plan for, and rigorously manage, completion of any standalone readiness requirements. Ensuring readiness could require disengaging the target company from the seller's HR benefits, systems, or service. Alternatively, it could require replacing HR programs or functionalities where shared HR functionalities may go with the target entity as part of the divestiture. Sellers frequently underestimate the complexity of, and resource demands related to, successful divestiture standalone readiness.

By taking the following actions, a seller can better prepare itself and manage the divestiture process to ensure operational continuity:

1. Identify the standalone readiness date (e.g., pre-close, close or end of a TSA period).
2. Map out the detailed activities needed to ensure Day 1 readiness.
3. Understand resource needs in light of resource availability and/or capability.
4. Develop a governance process to facilitate the making of critical decisions.
5. Implement a project management process with appropriate tools and resources.

While mishandling a divestiture can clearly affect deal price, its potential impact on a company's reputation – especially as it relates to the treatment of employees – is perhaps less clear yet even more problematic. Shareholder and customer perceptions of a company's ability to deliver as well as its fairness, trustworthiness, and loyalty must be maintained during the divestiture process, or the company risks damaging hard-won goodwill.

CONCLUSION

Breaking up is never easy for any organization. Particularly challenging are the people-related aspects of a divestiture. From the seller's perspective, the ultimate success of a divestiture relies not only on the clarity of the organization's strategic vision but also on HR's ability to translate its business strategy into effective people decisions.

Given the enormous challenge in readying a business for divestiture, it's crucial not to underestimate the time, effort, and cost required to make a divestiture an all-around win.

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- Bring clarity to the business context
- Provide analytical support, solutions and proprietary tools for all people-related matters
- Offer guidance in managing and deploying the workforce
- Prepare and help organize HR to be successful in deal work and to help ensure that business goals are met

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