

Compensation During and After a Merger

While much time and effort is spent on preparing the financial analysis in a merger or acquisition, there is rarely much time spent on analyzing the impact on intangible assets and human capital.

A study conducted by the Hay Group in 2007 of due diligence during mergers showed that 70% of organizations failed to audit the human capital and cultural fit of the organizations. Maybe that explains why 9% of organizations in post-merger surveys say they achieved their goals.

For greater success, keep in mind the following elements of compensation when considering a merger or acquisition.

Change-in-Control (CIC) – Design and implementation of CIC plans are critical to ensuring that your key staff stay through the due diligence and pre-merger phase.

Severance Plans – Many organizations have redundant staff and an appropriate program for terminating those employment relationships is critical. Be sure to look at individual employment agreements to ensure you have an understanding of the potential costs. Be sure to look at policies and analyze the potential costs of severance.

Retention Plans - Successful acquirers use retention bonuses 92% of the time versus other companies' use of retention bonuses only 54% of the time. Successful acquirers also used personal outreach by managers 3 times more (74%) than other acquirers (24%).

Compensation Philosophy - Comparing Target and Buyer compensation philosophies during the due diligence phase is rarely done yet we have seen very negative effects in several cases. In one case, a firm with a "Wal-Mart" pay philosophy merged with a firm with a "Nordstrom" pay philosophy. One of the primary goals of the acquisition was to expand management talent and provide a larger pool of potential talent as the combined organization grew. The acquiring firm had large unexpected labor expenses to align the very disparate pay systems and allow for the transfer of management talent.

In a similar case where organizations with two very disparate pay philosophies combined, the acquiring firm with the lower pay levels lost significant talent when word got out about the lower pay rates that were in place.

Stock and Deferred Comp Plans – There are many tax pitfalls for executive compensation in the structuring of a deal. If your business has restricted stock, outstanding compensatory stock options, equity compensation plans, golden parachutes or deferred compensation plans, be sure to consult a professional. There are restrictions on deferred compensation under 409A and 457A, and IRC Section 208G imposes limits on golden parachutes to executives.

New Compensation Structures - Development of new compensation structures for base pay, short-term, and long-term incentive programs is important. When significantly different pay plans or philosophies exist in the two companies, starting completely over may be the best approach.

Even if the plans themselves are very similar to what existed in the previous company, there are often different administration processes in place that must be communicated and clarified. In addition, employees are trying to find the WIIFM (What's In It For Me). Being able to communicate details about new career opportunities and related pay potential can go a long way to retaining key talent.

Communication is Critical – Although confidentiality is important pre-close, communication to staff about how they might be impacted is one of the major factors employees use in determining whether to stay or leave. The information shared can be quite general and not detail-oriented, but the main point is to let employees know that you are concerned about them and will provide additional information as soon as it is available.

After a deal closes, communicate via multiple channels including face-to-face meetings, training sessions, intranet, email, newsletters and personalized documents that explain the employee's new role and any compensation changes. Employees prefer to hear this information from their manager, so train your managers on the new compensation philosophy and pay guidelines.

Surveys show that employees who understand the What, How and Why of their pay are much more satisfied with their pay and their jobs overall, and that will lead to better retention of your top talent.

If you are considering a merger or acquisition, let us know if we can help. Compensation Works is a trusted advisor to business executives on compensation matters. We're happy to chat about your unique situation and share our experiences.

