When two become one

How a professional, carefully planned and executed people management strategy is key to merger success

May 2014
The Big Think

Dealmakers look to extract major economic benefits from a merger. Yet often those hoped-for advantages prove elusive because buyers forget how important it is to manage one key aspect of the transaction effectively – people. In this, the second edition of The Big Think, we show that dealmakers can boost their chances of success if they aim to achieve best practice in handling all the complex employment issues that arise when two companies become one.

The Big Think is written for HR practitioners, in-house counsel, and anyone with an interest in the topic being considered.
When two become one

How a professional, carefully planned and executed people management strategy is key to merger success

There’s a hard commercial logic behind most M&A transactions

Mergers are about achieving significant economic benefits by capturing financial and operating synergies, boosting market share, gaining access to new technologies, talent and customers, or gaining the sort of scale that will give a buyer a new competitive edge.

Yet surprisingly few transactions – as few as 30% – achieve the benefits planned for by the buyer.1

There are many reasons for this low success rate, of course.
Planning and carrying out a major transaction is an immensely complex task. There are a huge number of hurdles to leap to complete an acquisition – tax, regulation, antitrust, supply chain, intellectual property – to name but a few. These issues are particularly challenging in a cross-border deal involving two or maybe many more jurisdictions. And then there’s the subsequent integration of two companies, where the process of commercial engineering rises to a new level of complexity.

The transformation to achieve those hoped-for economic benefits involves a series of deep, and at times, painful changes that can create anxiety and confusion in the people the newly merged company will depend on most; its employees.

Almost without exception, when two organisations come together to create value, they also create a plethora of complex employment issues which need to be managed as deftly and as professionally as any other.

If done badly, this can undermine productivity, erode employee engagement, derail efforts to create value, sour customer relationships and – in extreme cases – provoke expensive legal action or even disruptive and damaging strikes.

If done well, the exact opposite is true.


© Allen & Overy LLP 2014
“At a time when people are naturally anxious, there’s a real danger of making people, who will be important to you, distrustful and demotivated.”

**Common sense above compliance**

So, planning and managing the employment, human resource and people integration aspects of any transaction will be crucial to the success of any deal.

It’s especially important for a cross-border transaction where – quite apart from meeting different legal and regulatory requirements on such things as informing and consulting employees – the buyer also needs to understand the significant cultural differences that apply in different jurisdictions.

It’s a question of knowing both the law and the lie of the land.

The transaction team needs to devote equal, if not greater, resources to understanding these cultural challenges and focus fully on achieving best practice, whether or not that is a requirement of the local law. The message is clear: even if common legal standards do not apply – as, very often, they do not – then common sense should.

As Hans-Peter Löw, Global Head of the Employment & Benefits group and a partner in our Frankfurt office, explains: “Most lawyers know the legal stuff, but not many know what constitutes best practice. We have Allen & Overy’s bespoke online restructuring resource to guide clients through employment law issues. Covering 35 jurisdictions, it offers them a Restructuring Roadmap. But we also know what the market standard is in different countries and what should be the benchmark for good practice in each. Achieving that benchmark is often the difference between a successful transaction and a failed one”.

Sarah Henchoz, a partner in London, agrees. “Many investors regard the employment agenda as a sideshow to the main deal or something that can be mopped up later when the transaction is complete,” she argues.

“Some definitely do skimp on a best-practice approach and tend to park the employment issues. But they forget that gaining employee confidence in the new organisation is very important. At a time when people are naturally anxious, there’s a real danger of making people, who will be important to you, distrustful and demotivated.”

**A&O’s online Employment Restructuring Roadmap**

Covering 35 jurisdictions, A&O’s online Employment Restructuring Roadmap service is an immensely valuable tool for clients embarking on cross-border deals. It enables them to identify the different employment law requirements that need to be met in different countries and to assess the knock-on cost and timing impact for the deal.
**The importance of planning**

At every stage of the transaction – before, during and after – the team needs to ensure that both the short-term and long-term employment issues are anticipated, planned for and given proper weight next to other key concerns, whether economic, regulatory or tax-related.

Creating a balanced team with the right levels of expertise in these areas is vital, insists Paweł Krzykowski, a senior associate in A&O’s Warsaw office. “If there’s an imbalance – too many people on the financial side, for example – it’s very likely that certain key HR matters will be forgotten.” Yet too often, the people issues are placed further down the agenda, particularly by investors from comparatively less regulated markets such as the U.S. and UK.

Where employment issues are concerned, detailed forward planning is a must. Even the way a deal is structured will affect the post-deal integration strategy and the legal requirements that apply.

In a deal structured as a share sale, where the identity of the employer does not change, legal obligations will tend to be less onerous. But in an asset sale, more difficult issues arise. EU countries insist that existing employment terms are safeguarded when assets change hands. Some non-EU countries, including Canada, Singapore and New Zealand, offer similar protection to some groups of employees. In many EU states, an asset sale will also bring with it legal requirements (unlikely to be triggered by a share sale) to consult with employee representatives on the deal itself and on any subsequent restructuring.

**The communications challenge**

This is an area where clear, consistent and transparent communication is absolutely key. Getting the communications right is not an option, it’s essential. As we’ve noted, transactions give rise to feelings of great uncertainty among employees. Speculation is rife; uncertainty abounds. Poor communications can be a drag on morale, performance and motivation and can disrupt the smooth transfer of ownership.

We’ve seen this in highly regulated markets, like France and Belgium, and, equally, in less regulated ones.

Susana Ng, a consultant in our Hong Kong office and Co-Head of our Greater China Employment practice, points to China’s southern manufacturing belt as an example. “In the absence of well formulated requirements on worker consultation, the power of the grapevine is huge – not just within, but even between neighbouring plants,” she says. Workers are vulnerable to stage walkouts and protests, where rumour has replaced proper information from management. It’s an issue for both domestic companies and international investors. In one recent case, the management team were locked in a conference room by protesting workers and received death threats. The standoff took a week to resolve, at huge financial cost.

“There is a statutory regime on employee consultation in China”, Susana explains, “but it’s not well developed and lacks details. People have very different understandings and expectations of it”. Nor is there any sign that the Chinese authorities are likely to introduce major changes in this respect to toughen employment laws – there appear to be other, bigger legislative priorities. That means there’s an added onus on investors to apply their own standards and they need to be high.

But even in jurisdictions where the rules are more rigorous, the communications challenge is not just about staying on the right side of employment laws. “It’s not principally about meeting legal requirements, important though that is”, says Inge Vanderreken, counsel in our Brussels office. “It’s really about common sense. If you want to make a success of the transaction, you need to communicate effectively, to gain the trust of the employees.”
“All managers working on the deal must stick to the same storyline. It’s very dangerous when people get the idea that there’s a mixed message.”

Consistency across borders

Planning that communications strategy is vital, not least in a cross-border transaction where, once again, legal and cultural differences are at play. It’s important to combine the legally required information and consultation procedures with internal workforce communication in a way that gives employees a real chance to understand the deal and express their views and concerns.

Hans-Peter Löw advises clients to develop a clear one-or two-page storyline to describe the rationale for the planned transaction: “In any cross-border transaction it’s important to handle it as an international project, not a series of national ones. The whole process should be coordinated in the same way, but take into account cultural differences, country-to-country. It’s a balancing act, but there must be a plan”, he says. “And all managers working on the deal must stick to the same storyline. It’s very dangerous when people get the idea that there’s a mixed message.”

Sarah Henchoz underlines the point: “One of the first things I say to clients is: ‘Think about the person you are putting in front of employees. That person has to be credible; someone who has got sufficient authority and knowledge to answer questions, rather than saying: ‘I’ll get back to you on that one’. Tip two: keep something back so that there is room to make concessions, if, as is often the case, employee representatives make legitimate demands in return for giving their backing to a transaction’”.

France looks for new consensus

Recent reforms to French law were, on the face of it, more employer-friendly, but a trade-off was envisaged. In return for greater flexibility and time limits on works council consultations, companies are being asked to be more transparent.

Companies with more than 300 employees are now being asked to set up a database by June 2014 of current performance and future plans. They must consult works councils and employee representatives on these plans each year. It brings France closer to Germany’s “Social Partnership” model, but many French businesses are worried about potential breaches of confidentiality and fear that French unions remain combative rather than cooperative.
Finding the right communication channels and getting the timing right

The question of confidentiality arises, too. How sure can an investor be that details of the deal will not leak out in one place, before it has been announced in another? That’s something that ought to be more of an issue in Germany’s “Social Partnership” model, where consultations will be required with representatives on a range of other committees, including supervisory boards, which include elected worker representatives, and the economics committee of a works council. In truth, confidentiality procedures usually work, although not always.

No investor wants to say too much about future plans, but there’s a downside to willing ambiguity. It may not be a breach of the law if employees hear about a deal or a restructuring programme second-hand (say, via the media or on the commercial grapevine), but it will almost certainly be seen as a breach of trust. And a key employee that an investor wants to retain may not feel like staying with the company if left out of the loop or lied to.

Planning the timing of the communications strategy is, therefore, very important. “An investor should always try to implement a deal at the same time in all the countries affected by a cross-border deal, but build in enough time to deal with a communications process that may take longer in some countries than others”, says Claire Toumieux.

We try to show clients that the works council is actually a very good communications channel, if handled well. It’s a great way to get messages to employees and it’s the first opportunity a buyer has to convince employees about its plans for the future and to motivate them at a time of high anxiety. It gives people a chance to judge what the future of the company is likely to be.”

Brian Jebb, senior counsel in our New York office, agrees. Many U.S. investors are used to a much more individualistic employment law system that is governed by individual contract rather than collective regulation. They, therefore, struggle with the requirements they meet when first doing deals in EU jurisdictions, although in his experience, it is rarely a deal-breaker.
“U.S. companies have a big learning curve, here. For those doing a first deal in Europe, this is a totally new world and they need to wrap their heads around not just the EU requirements, but all the different rules in different jurisdictions”, he says. Often they are reluctant to deal with trade unions, or might try to avoid it, he adds. “What they should consider is that unions and works councils can be a positive influence in some workplace situations.”

Hans-Peter Löw has seen similar reluctance on the part of some UK investors, too. He recalls representing a UK client trying to buy a German business whose management insisted the deal would be off unless it won clear backing from the works council. “I had to convince my client that the German company was absolutely serious about this point. Sometimes clients wonder which side we are really representing! But if they don’t understand this approach, they won’t be successful.”

Planning the information and consultation process doesn’t stop with the signing of a deal, particularly if the buyer is planning a major rationalisation post merger, with redundancies threatened. In key EU states – Germany, France, Luxembourg and Spain – the law requires any company planning major redundancies to put a social plan in place, offering those laid off proper severance rights and opportunities to be retrained and redeployed.

Even where such rights are not enshrined in law, some investors see the benefit of offering such support off their own bat, and, certainly, unions increasingly expect it. Again, it comes back to common sense. Inge Vanderreken, counsel in our Brussels office, notes that “even if there is no legal requirement in Belgium to negotiate a social plan, companies planning major restructurings generally agree to start social plan negotiations. Examples in the press have shown that employers who refuse social dialogue have faced a hornets’ nest of problems, including union protests, negative press, and sometimes even damaged relations with customers.”

As Claire Toumieux puts it: “Really it’s a matter of social responsibility rather than legal requirement – good practice over obligation.”
Retaining key people

Retaining key employees during the integration phase of a transaction is a major challenge, not least as this tends to be a time of change and disruption.

All too often, investors think that offering short-term financial inducements is the best way to hang on to employees they see as central to future success. But often a more subtle approach is needed. There is no “one-size-fits-all” approach to retention; diverse employees require diverse approaches. It’s vital to create a broad team of accountants, HR professionals, executives, lawyers and consultants that understands these nuances and has the skills to respond to differing employee needs.

Retention incentives and deferred compensation have become a particularly big issue in the U.S., but for tax rather than employment law reasons, says Brian Jebb. Section 409A measures, introduced in the wake of the Enron scandal, mean that an increasing number of incentive and compensation schemes are falling foul of the law because the payment form and timing has not been fixed, transparently, in advance. “If you are caught by this law, employees, not employers, get stuck with a 20% penalty. The law tends to sneak up on you. It catches a lot of situations you wouldn’t expect it to catch and it can apply to U.S. taxpayers wherever they are in the world”, he cautions.

Although Europe tends to be more flexible about such incentives, this issue points to a wider concern. For employees, mere financial compensation is often not enough in itself; they will often be looking for security of a different kind.

As Inge Vanderreken puts it: “Companies often focus on the immediate compensation they can offer. But employees are looking for something broader than that – they want to know about the long-term strategy and be confident the company has longevity.”

Again, effective communication here has a very high value, but it’s one many investors fail to recognise. And the same applies to the handling of large redundancy programmes in the wake of a merger. The way an employer handles the formal legal requirements around lay-offs and its own internal process of communication may well be a decisive factor for the workforce staying on.

Brian Jebb again: “I always advise clients: ‘Don’t just think about the people being laid off, but about the survivors. They will not look well on an employer who treats severed people badly’”. Get this wrong and an investor may find that the people it most wants to retain vote with their feet and quit the new organisation or are demotivated to achieve their full potential.

Terms and conditions

Bringing two companies together will almost inevitably involve a process of harmonising the terms and conditions enjoyed by two sets of employees. Indeed, failure to do so can leave a company exposed to claims that it is breaching separate rights to equal treatment.

In EU jurisdictions, TUPE regulations offer strong assurances for employees that their working conditions will not be threatened. TUPE covers big issues such as pay, benefits (with some exceptions for pensions) and holiday entitlements. But here, as Sarah Henchoz points out, there can be big sensitivities around what might seem relatively small issues – like changing the payroll day from the end to the middle of the month.

While TUPE remains a mystery to many U.S. investors, it is not as inflexible a system as they sometimes perceive it to be. There is still room for conditions to be changed by negotiation and agreement in certain circumstances. While making unilateral changes is a drastic option some investors do contemplate, the reality is that unions will usually be willing to negotiate a new package, provided that the end result leaves their members in a better position. “The secret”, says Sarah, “is that you need to make these changes over time and balance off the package overall to convince employees that they are in the same or a better position with the new organisation”.

Inge Vanderreken agrees: “In practice, unions are willing to negotiate a new, harmonised package and if those negotiations are handled well, with clear evidence of give and take, they will often take a practical approach – as long as the new conditions are broadly beneficial to employees”.

© Allen & Overy LLP 2014
“Companies often focus on the immediate compensation they can offer. But employees are looking for something broader than that – they want to know about the long-term strategy and be confident the company has longevity.”

**Striving for best practice**

This is an immensely complex area of the law, yet it is one that investors ignore at their peril.

Our approach is to look beyond the pure legal requirements and urge our clients to reach for a best-practice approach that takes full account of different cultural expectations and market standards in human resource planning that apply in different jurisdictions.

More often than not, this approach offers the best guarantee that a transaction will achieve the wider commercial benefits that the investor will have been banking on from the moment the merger was planned.

As Hans-Peter Löw puts it: “When I look at the low success rate of most mergers, I’m increasingly convinced it’s less about strict compliance with legal requirements and much more about understanding the importance of culture. That’s, primarily, what the success of the combination hinges on and, in our practice, that’s what we try to get our clients to think very carefully about”.

**Companies often focus on the immediate compensation they can offer. But employees are looking for something broader than that – they want to know about the long-term strategy and be confident the company has longevity.”**

**Contributors**

**Belgium**

Inge Vanderreken
Counsel
Tel +32 2 780 2230
inge.vanderreken@allenovery.com

**China & Hong Kong**

Susana Ng
Consultant
Tel +852 2974 7015
susana.ng@allenovery.com

**France**

Claire Toumieux
Partner
Tel +33 1 40 06 53 57
claire.toumieux@allenovery.com

**Germany**

Hans-Peter Löw
Global Head of Employment & Benefits
Tel +49 69 2648 5440
hans-peter.loew@allenovery.com

**UK**

Sarah Henchoz
Partner
Tel +44 20 3088 4810
sarah.henchoz@allenovery.com

**Poland**

Paweł Krzykowski
Senior Associate
Tel +48 22 820 6169
pawel.krzykowski@allenovery.com

**U.S.**

Brian Jebb
Senior Counsel
Tel +1 212 610 6354
brian.jebb@allenovery.com

**Contributors**

**Belgium**

Inge Vanderreken
Counsel
Tel +32 2 780 2230
inge.vanderreken@allenovery.com

**China & Hong Kong**

Susana Ng
Consultant
Tel +852 2974 7015
susana.ng@allenovery.com

**France**

Claire Toumieux
Partner
Tel +33 1 40 06 53 57
claire.toumieux@allenovery.com

**Germany**

Hans-Peter Löw
Global Head of Employment & Benefits
Tel +49 69 2648 5440
hans-peter.loew@allenovery.com

**UK**

Sarah Henchoz
Partner
Tel +44 20 3088 4810
sarah.henchoz@allenovery.com

**Poland**

Paweł Krzykowski
Senior Associate
Tel +48 22 820 6169
pawel.krzykowski@allenovery.com

**U.S.**

Brian Jebb
Senior Counsel
Tel +1 212 610 6354
brian.jebb@allenovery.com

If you wish to discuss this topic further, please feel free to approach your usual A&O contact at any time.
GLOBAL PRESENCE

Allen & Overy is an international legal practice with approximately 5,150 people, including some 525 partners, working in 43 offices worldwide. Allen & Overy LLP or an affiliated undertaking has an office in each of:

Abu Dhabi
Amsterdam
Antwerp
Athens (representative office)
Bangkok
Beijing
Belfast
Bratislava
Brussels
Bucharest (associated office)
Budapest
Casablanca
Doha
Dubai
Düsseldorf
Frankfurt
Hamburg
Hanoi
Ho Chi Minh City
Hong Kong
Istanbul
Jakarta (associated office)
London
Luxembourg
Madrid
Mannheim
Milan
Moscow
Munich
New York
Paris
Perth
Prague
Riyadh (associated office)
Singapore
São Paulo
Shanghai
Shanghai (associated office)
Sydney
Tokyo
Warsaw
Washington, D.C.
Yangon

Allen & Overy means Allen & Overy LLP and/or its affiliated undertakings. The term partner is used to refer to a member of Allen & Overy LLP or an employee or consultant with equivalent standing and qualifications or an individual with equivalent status in one of Allen & Overy LLP’s affiliated undertakings.

© Allen & Overy LLP 2014  I  CS1404_CDD-39202_ADD-45204

www.allenovery.com