



Driving transaction value through focus on human capital

A step change approach to transactions – drive value of a transaction by focusing on human capital

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The nature of transactions has evolved, and yet the majority of them still often fail for the same reason: insufficient focus on the human capital factor. We're looking at a step change approach to transaction services by bringing out the importance of people factor: by assigning a financial value to it and implementing an integrated approach to addressing human capital at every stage of a transaction.

There has been a clear shift in transactions over the last decade, with expanding geographic scope and increased complexity. There has also been a recognition that pure financial focus has not been delivering the expected results, and that achieving better integrations can lead to long term value creation.

Nevertheless, transactions have a strong tendency to still be delivered as a short-term business objective. The team structure, the decision making focus, and the stakeholders are often only concentrated on closing the deal. Paradoxically, the key to success lies in considering, from the start, longer-term aspects that will lead to additional value creation. It is a startling observation that up to 70% of acquisitions fail to achieve projected synergies*, resulting in underperformance of the combined business. In too many instances, activities required for successful synergy come too late into focus. As the mind-set changes to transformation aspects of the future business, many of the deferred and delayed culture and people impacts emerge as a consequence.

An EY study shows that 85% of failed acquisitions are attributable to mismanagement of people aspect and cultural issues*. Although this "no-brainer" people factor has been repeatedly discussed among industry experts, failing to close the human capital value gap during in a transaction still occurs frequently.

Our observation is that, although there has been a growing maturity in assessing the value during diligence, limited financial focus and value is assigned to the human capital factors identified during a transaction. A new approach is needed to minimise the risk and ensure the success of a transaction that will include the human capital factors at all phases of the transactions' lifecycle, preparing the grounds for achieving the expected synergies. EY has begun to explore alternatives to find ways to quantify the real value of success on the people topic.

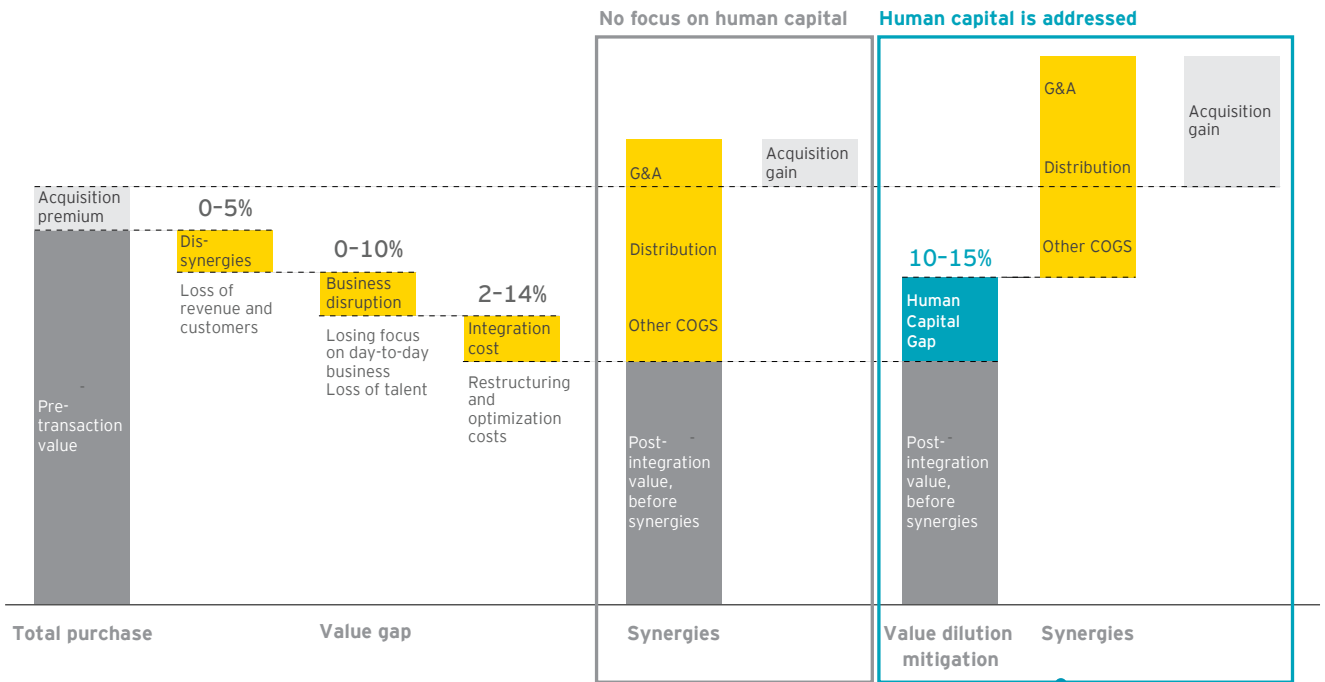


of acquisitions fail to achieve the projected synergies



of failed acquisitions are attributable to mismanagement of cultural issues

* EY study "People drive business success"



Estimated values are shown as percent of purchase price for consistency. Actual values must be estimated for any specific transaction based on the circumstances of that transaction.

Reasons for value loss

Wrongly Identified Value

Lack of vision and strategy
Unclear targets and measures
Inexperience in finding value sources

- **Determinism and inflexibility to change**

Delayed Value

- **Slow mobilisation**
- **Loss of momentum**
Inadequate resource commitment
- **Lack of leadership**
- **Focus on short term synergies vs. long term growth**
- **Culture clash, resistance and conflict**

Lost Value

- **Loss of key talent**
- **Inattention to/loss of customers**
- **Organisational confusion and division**
Unidentified value sources
- **Culture clash**
- **Cultural resistance and conflict**
- **Ignored integration challenges**
- **Inattention to competition**

In many transactions, substantial value is left on the table due to underestimated factors related to people and culture. Factors observed include cultural clashes, conflicts, the loss of focus on the customer, and crucially, the loss of key personnel. Although no two-deals will be the same, it is possible to start predicting from the outset the Human Capital costs that can be imposed upon the organization post-closing.

You can identify this value gap by applying measurable indicators to a buyer's deal models while still in the early transaction stages. Results of the analysis increases awareness toward the need for improved human capital management as well as end-to-end integrated transaction delivery to achieve long-term success.

To meet the shift in services and ensuring success, at EY, we can identify and quantify this value gap by applying measurable indicators to a buyer's scenario while still in the early pre-transaction stages. Results of the analysis increases awareness toward the need for attending to human capital management as well as end-to-end integrated transaction delivery for long-term success.



Value dilution derived from the mismanagement of people element throughout a transaction indicated in financial terms helps to indentify some of the sources of problem and therefore, with appropriate mitigating action, increases chances of a successful deal.

How to assess the value of human capital?

EY has an approach to evaluate the financial impact and the extent of value dilution faced during a transaction when considering human capital factors (for example, employee turnover, transaction delay risk and loss of productivity).

It is estimated that 47% of key employees leave within the first year following a transaction, and 75% leave within the first three years*. EY research indicates that a "Human Capital Gap" can reach a value equivalent to 15% of a company's profit. It is a large enough number to trigger an alert, but the full implications are often overlooked during the transaction lifecycle.

Most, if not all, post-acquisition costs that generate value leakage are related to mismanagement of human capital factors. There are numerous factors that, when analysed individually, can represent only small dents in the overall costs. However, when human capital factors are assessed in a combined and interconnected manner from pre-transition to transformation, the total value will be significant. Some of the intersecting factors to consider are indicated below.

- ▶ "Jumping ship" effect and high employee rotation. Potential payment of retention awards, combined with replacement of open positions due to turnover and costs for on-boarding, contribute significantly to the level of the value gap.
- ▶ Cultural alignment. Another risky combination relates to time lost due to cultural mismatches, conflicts and internal challenges as well as decreased engagement that impacts employee's performance. The impact can be estimated based on average volume of hours that employees lose while struggling with change and time taken after a transaction to return to optimal performance.
- ▶ Productivity loss. Consideration of the value loss due to frequently occurring dips in productivity may not be sufficiently considered. When translated into hard facts, such as the increase in number of sick days, time taken to reach full efficiency following a transition, and low engagement levels impacting employee performance, the contribution to the value gap becomes material.

* Global EY HR transaction methodology, based on Galpin, Herndon, "The Complete Guide to M&A"

Human Capital Gap is estimated to account for 10-15% of the total purchase price

47%

Key employees leave a company after transaction

75%

Key employees leave a company within the first 3 years

9-12

Months taken to reach back full productivity

500k*
hours +

Value based on time lost by employees due to conflicts

50%

Employee's engagement drops during a transaction

200k*
hours +

Work time lost on sick leave due to conflict

1.6M*
CHF

Loss of productivity due to increase in employee turnover

* Estimated values based on an average size company in Switzerland.

Financial estimation of human capital impact is a step change approach in a transaction that ensures success and drives higher value of a deal

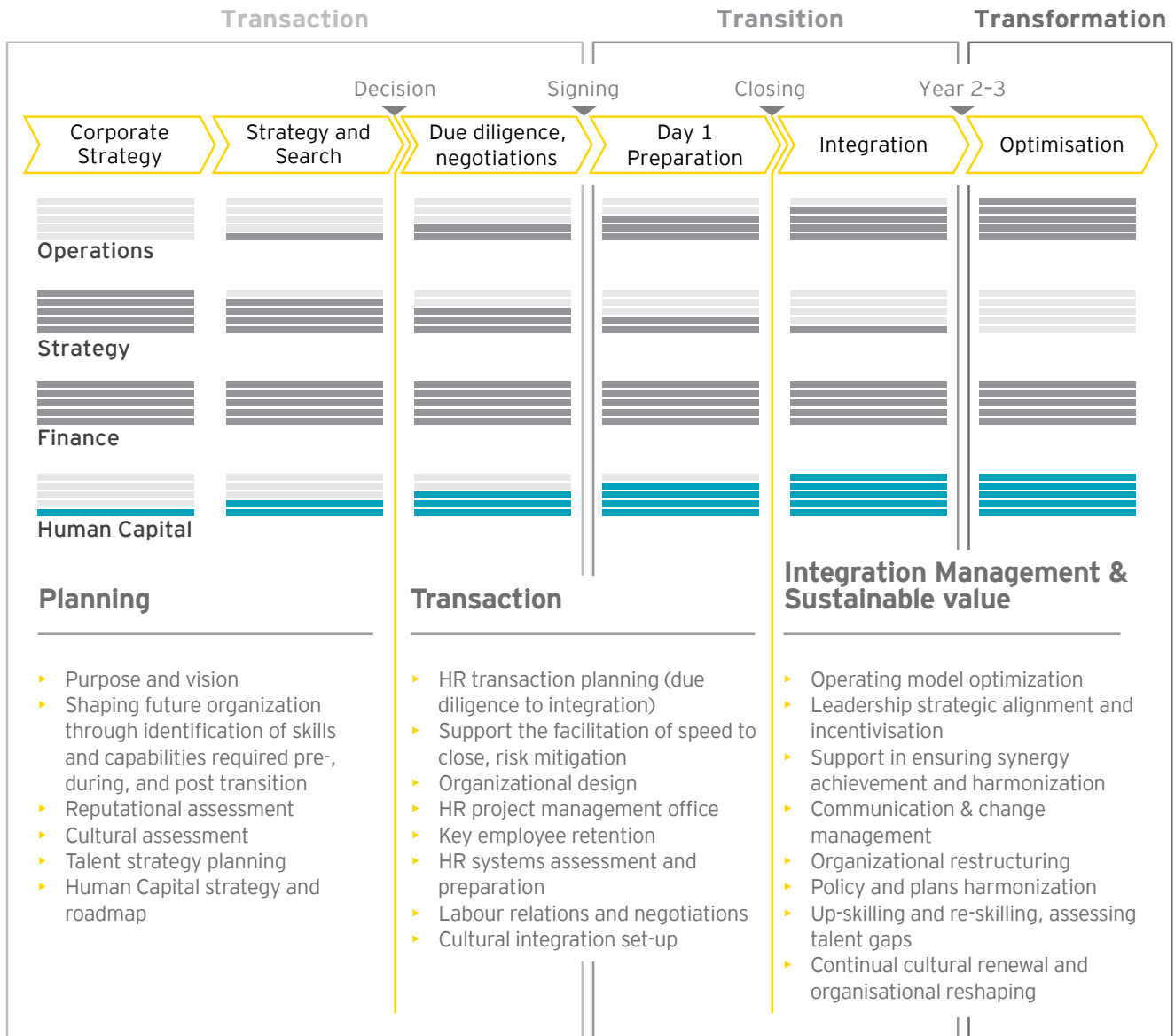
What can companies do to avoid this value loss?

Having a measurable financial impact of the people factor helps underline the risks in a clear and understandable manner.

The analysis of the people element impacting bottom line has not only indicated the financial impact of the people factor mismanagement during a transaction, but more importantly also indicates critical elements that should be carefully considered from early stages of transaction planning until the post integration phase. This approach secures smooth, timely and cost effective transaction delivery.

Human capital as an overarching element that should be addressed at every stage of a transaction increasing incrementally from early preparation stages through to pre-closing, day 1 readiness, integration and transformation. Strategic considerations are a key focus initially, while operational contributions increase throughout the transaction lifecycle. Financial attention certainly remains equally important throughout the whole process. This end-to-end approach ensures deal-triggered risk mitigation, accelerates transaction value, identifies employee related value considerations, and mitigates HR costs. At EY we address the human factor with multiple workstreams including: HR PMO, total rewards, labour relations and negotiations, organisation design and talent strategy, employee experience as well as HR operations, change and cultural management.





Human capital – not only a value creation, but also a competitive advantage

Any integration and transformation gives company a chance to ensure a more agile and nimble operating model in order to protect against risks and deal value dilution. At the same time focus on human capital can be an opportunity to gain a competitive edge by harnessing future business opportunities and prepare for a technological shift (e.g. AI or RPA, digital economy) in order to thrive in a fast changing business environment.

What do our clients say?

When asking EY clients about the importance of focus on human capital across all transaction stages, their answer is unanimous. Their experience has shown that it is vital to setting up the post-transaction organisational vision during the deal closing stage. This allows their taskforce to move to the transition phase faster, avoids mixed messages and prevents delays in the mobilization of resources.

Organizations we work with tell us they prefer having a long term focus and a clear value case, with the transaction journey not ending at closing. It is important to have a clear understanding of where the organization is going post-closing so the value case can be achieved. During the integration people are more likely to stay in a culture with a clear purpose and vision employees identify with and for an inspiring leadership. Key is to emphasise strongly the need for leadership skills and to keep key personnel. Having an integrated management team to set up the business structure, transition and communications as well as cultural alignment are key factors. A multi-disciplinary task-force team is ideal, and preferably one that can move along through the end-to-end approach in a coordinated manner, focusing on achieving synergies.

Case Study

Chemical Industry, End-to-End support on People Advisory Services

From Divestiture conception to Setting-up a new Stand Alone Entity

Background

EY assisted a global chemical company with over 30 countries in scope in the divestment of four business units. Part of the support included the transition preparation, from signing to close, but the differential was the fact that EY team members continued supporting the newly formed stand-alone entity to also integrate and transform. The team ensured the smooth establishment this new global organization by supporting its purpose and vision to continue based on the original pre-transaction vision.

People Support

The EY team was involved throughout the entire deal lifecycle. EY considered factors related to people at each phase of the project, for example, through a thorough in-scope employee list management and a strong change and communications approach, including labour relations and employee concerns management in each country. During the transition phase, EY had full oversight on the HR topics, from planning to execution. Work streams involved during transition included HR strategy set-up, HR policies, organizational design, job evaluation, review of compensation packages and incentive plans.

People Value delivered

The early involvement of EY and through the whole process resulted in early identification of people related challenges and in the maximization of synergy opportunities related to Human Capital. Moreover, at the end of the transformation, the interconnected approach to people considerations taken by EY ensured a high retention rate with high employee satisfaction as well as an integrated company tailored to its future strategy.



EY provides a multi-disciplinary team that can provide integrated transaction support

Benefit from EY Transactions Advisory Services

- ▶ **Multi-disciplined teams:** EY can support you throughout the deal lifecycle, from strategy, to valuations, to due diligence, operational services to restructuring and reorganisation. We provide an integrated service offering, with dedicated deal experts available as and when you need them
- ▶ **Transaction experience:** Our team has industry leading background in transactions and shows a proven track-record in advising our clients regularly on complex transactions. We have experience worldwide through thousands of mergers, acquisitions, divestitures, joint ventures and initial public offerings
- ▶ **Human capital experience:** We focus on creating long term client value and consensus driven solutions that factor in corporate culture and seek to align human capital programs with our client's long-term business goals
- ▶ We apply a holistic approach to human capital transaction and offer People Advisory Services such as:
 - ▶ Pre- and Post-Transactions Support
 - ▶ Rewards and recognition
 - ▶ Organisational Design
 - ▶ Workforce Analytics and Management
 - ▶ Talent Development and Enablement,
 - ▶ Change Management
 - ▶ HR Transformation, Integrated Mobility
- ▶ **Global capabilities, Swiss experience:** With global scale and connectivity we help companies drive growth and fast-track value creation by focusing on their capital and transaction strategy right through to execution. We also have all relevant capabilities covered in our Swiss team. Our Swiss consultants know the market and the specificities for transactions involving Swiss companies
- ▶ **Market leading:** We have the global critical mass to access niche expertise across the team
- ▶ **Approach:** Our approach is flexible and practical, and our methodologies are built to drive high quality results in a time pressured situations
- ▶ **Issues-led approach:** moving beyond a risk-based approach to diligence, towards opportunity identification and potential upsides for prospective buyers





Summary

The human capital factor is commonly overlooked in a transactions process, having a negative financial impact and jeopardizing the success of a deal. EY offers a step change approach to:

- ▶ Quantify the human capital factor to highlight the critical value drivers and direct the focus on the root-causes of people risk,
- ▶ Apply an integrated, end-to-end approach to transactions with a focus on human capital at every stage of a transaction.

Our twofold method helps our clients mitigate deal risk, reduce transaction cost, and increase the chance of exceeding synergies targets in a timely and smooth manner.

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