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The HR 'Stand-up' Challenge

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Hundreds of divisions and operating units are divested or spun off by their corporate parents each year. Some are integrated into the operations of their corporate acquirers. Many others become independent business entities that must stand on their own. This report draws on the experience of Mercer consultants and HR executives who have dealt directly with the challenges of “standing up” former corporate units into independent companies with their own leaders and business functions, including HR.

The collective experience of these direct participants points to four areas where the attention of HR executives is critically important: leadership and talent management; organization culture; legacy programs and costs; and building the HR infrastructure.

What had promised to be an ordinary day for Adam Jenkins, vice president of human resources for EnergyCo, a subsidiary of ParentCo, changed abruptly. ParentCo’s CEO had asked him to participate in an early morning meeting, but provided no clue as to its agenda. Upon entering the conference room, Jenkins was surprised to see that the meeting included three top executives of his subsidiary.

“Adam,” said the CEO, “we have some important information to share with you today – information that you must keep confidential for the time being.” He went on to explain that a private equity (PE) firm had expressed an interest in acquiring EnergyCo and operating it as a private company – at least until it could be taken public or sold to another corporation. “I’m optimistic that we can work out a deal sometime in the next several months.

“I don’t have to tell you what such a deal would mean for you and the EnergyCo executive team,” he continued. “Adam, we’ll need your help in preparing EnergyCo to stand up as an independent company, without the corporate legal, financial, HR and operational support it now enjoys from ParentCo – and you’ll have very little time in which to get the job done.”

As he was returning to his office, Jenkins mulled over the consequences of his company’s divestiture. Hundreds of HR activities would have to be planned in advance of the buyout – everything from the setting up of a new payroll system to designing and implementing new benefit plans to devising a program for retaining key people. He could no longer look to corporate headquarters for those systems and services. “This will either be a nightmare,” he told himself, “or one of the best career opportunities to come my way.” He wondered which it would be.

Adam Jenkins is a fictitious character, but there is nothing contrived about the situation he faced. In 2007, several hundred operating units and subsidiaries worldwide were spun off by their parent companies. Some were integrated into the operations of corporate buyers. Others were cobbled into joint venture companies. More than a few have become independent enterprises owned by private equity firms, and many of these will go public in three to five years.

To succeed without the benefit of their former corporate infrastructure support, these newly independent enterprises have had to do what every great company does well: adopt and implement a solid business strategy, engage the talents of employees, stabilize operations and satisfy customers. There is no mystery about the importance of these activities. The challenge comes in managing the transition quickly and successfully.

Could your unit's HR function stand up to this challenge – and in six to nine months? How would you lead the effort on the people side of the business? This article will help you answer those questions by:

- Identifying the critical issues that HR must address in the transition to independence
- Describing a tested process for approaching the task

The material presented here is based on the collective insights of Mercer consultants who have observed and participated as advisers in stand-up campaigns. It also draws on the experiences of HR executives who have struggled directly with the stand-up challenge. To give a sense of the magnitude of that challenge, we begin with an illustrative case, disguised here to protect the confidentiality of our sources. The elements of the case are drawn from the experiences of several companies.

Transportworks, Inc.

Transportworks, Inc. is a supplier of assemblies and components to the automotive and heavy truck-building industries, with some 7,500 employees working in five plants in the US and Canada. Once a division of a much larger, multiline manufacturing corporation, the enterprise was acquired in 2005 by a US private equity firm in a deal priced at \$325 million.

Day 1 of this new enterprise took place in March 2005. For HR, the challenges of supporting this freestanding company included the following:

- Selecting the right executives for each role and integrating new leadership
- Altering the union wage structure and benefit plan costs
- Helping people to think like an independent company, not a division of a large corporation
- Building a solid HR organization and data infrastructure

- Coping with rapid growth
- Recruiting and retaining managers and engineers
- Running the business while all this is going on

On the labor front

Transportworks employs almost 5,000 skilled, unionized production personnel whose labor contract prior to divestiture provided above-market pay and benefits and imposed job classifications that sapped productivity and flexibility on the factory floor. The PE firm that bought the operation failed to alter that contract in the run-up to its purchase, leaving that responsibility to the new management team, which worked to change its obligations under the contract when it expired 10 months after the deal's closing date.

Given labor market conditions in the manufacturing sector at that time, the union was willing to be flexible. Transportworks' management encouraged accommodation by offering greater opportunities for share ownership and bonuses if the new company prospered. It reminded production workers that the PE firm aimed for a profitable harvest of its investment in three to five years, and that union employees would enjoy some of those benefits if they would trade off the fixed pay they had long enjoyed for pay that varied with business results. In return, employees would receive shares in the new enterprise. The union eventually agreed to a contract that provided for more variable pay, allocated shares to all employees and collapsed the number of job classifications from 22 to eight. Health benefits were also affected, with employees picking up a larger share of the cost.

New faces

Transportworks' transition to a stand-alone company resulted in new leadership. The board brought in a new CEO, CFO and vice president for business development. Integrating those new leaders with the legacy pool of executives and managers, many of whom had worked together for a number of years, proved challenging and slowed the pace of decision making and action just when speed was critical. The new leaders were not accustomed to the organization's culture and, as a result, did not know how to work effectively with the current executives and managers. For their part, legacy employees viewed the new leaders with some suspicion. A full year would pass before old and new employees felt and behaved as members of a real team.

Coping with growth

As a division, Transportworks had experienced the ups and downs of the transportation equipment industry. As it stepped into independence, however, it was fortunate enough to experience an updraft of demand, both from its former parent – now its key customer – and other original equipment manufacturer (OEM) companies in North America and Europe. In order to capture that rising demand, the newly independent company began work on a sizeable new production facility in Monterrey, Mexico. Good news on the demand side, however, created a serious recruitment problem for the company. It had to hire 200 qualified engineers – a challenge in a market where engineering talent was scarce.

Growth also forced the company's leaders to stop thinking like division managers – implementers of plans developed at headquarters. Rather, it required them to begin acting like masters of their own destiny. Developing customer relationships, implementing governance procedures, allocating scarce capital and building a new plant was suddenly their job, not the job of someone at headquarters.

Standing up HR during the transition

HR functions were among the first of Transportworks' critical activities, and planning for them began long before the deal closed. Employees would have to be paid; their health, retirement and other benefits would have to be provided; and they would have to understand the "new" company's business and their role in it – all as of Day 1. Putting the full scope of HR plans and programs – and an HR organization to manage them – in place during an eight-month pre-close phase was daunting. The challenge was complicated by the fact that the division had only a rudimentary HR information system (HRIS) for its 7,500 employees, making access to data for decision making difficult and time-consuming. New systems were needed, but many could not be implemented before closing. There simply wasn't time. The HR director had only eight people on the transition team – and these individuals all had to do their "day jobs" at the same time. Thus, Transportworks contracted for some transitional services from its former parent. Many of those stopgap transition service agreements remained in place for two years after Day 1, slowing the full independence of Transportworks and increasing the cost of its HR services.

The stand-up experience at Transportworks required a herculean effort on the part of the HR leader and her staff. They attended countless meetings and planning sessions and put in more overtime than anyone expected. Yet their hard work, and that of other managers and employees, paid off. When stock prices were high and trending upward, the PE firm decided to cash out via an initial public offering (IPO). As shareholders, every employee, from the C-suite to the production floor, reaped the benefits of independence and ownership.

Four critical issues

Looking at Transportworks' experience from a distance, an HR professional might see elements of both nightmare and opportunity: hard work and long hours, but with a good ultimate payoff. Not every stand-up transition has such a happy ending, nor does each follow the same path. Every deal is unique. Nevertheless, Mercer's experience in helping to "stand up" organizations and our interviews with HR professionals who have been involved indicate that this kind of transition requires the company to confront a set of four critical issues:

1. Leadership and talent management
2. Organization culture
3. Legacy programs and costs
4. Building a smooth-functioning HR infrastructure

1. Leadership and talent management

Leadership is arguably the most critical element in standing up new organizations. "Unless you get the right leaders with the right capabilities into the right roles," says Mercer's New York-based Private Equity M&A leader Bob Braddick, "everything else you do to make the new organization successful probably won't matter." In his experience, private equity owners are more objective and uncompromising in this area than are their corporate counterparts. "I've seen far too many corporations allow loyalty to get in the way of making the right – often tough – decisions, with mediocrity often surviving in place of improved performance," says Braddick. "Laserlike attention to the leadership team and strong alignment of their compensation with business goals account for a great deal of the success enjoyed by PE firms."

HR has an important role to play in enabling the selection and recruitment of leaders for the newly independent entity, and the sooner HR gets involved in that process, the better the outcome is likely to be. Whether those leaders are homegrown or brought in, they must, as one HR executive told us, be able to handle the high level of stress and frantic pace that characterize the many months of transition from the old to the new. Says Bruce Kendrick, vice president of global human resources for Veyance Technologies, formerly a unit of Goodyear, "It's all about leadership, good communications and having the right people on the bus. You need people who can lead and drive change at warp speed. The private equity world is completely different and takes a leader who can be a visionary as well as convey stability during the intense transition period."

HR must also deal with retention and succession planning as the new organization stands up. Those issues were particularly acute for one organization, where less than 5 percent of the new entity's executive population was under age 45. With so many experienced people nearing retirement, it couldn't afford to lose executives for other reasons. The company's retention problems were compounded by the success of its IPO, which gave many managers and executives sudden and substantial financial independence. Many of these key employees now had the means to retire early – and some did.

Another talent management challenge frequently encountered during these stand-up operations is related to corporate-level experience. New stand-ups are often led by seasoned division managers who have little or no corporate-level experience. Consider the case of Numonyx, a new joint venture company created in 2007 by US-based Intel and Switzerland's STMicroelectronics NV. These firms agreed to create a joint venture for the purpose of supplying flash memory solutions for a variety of consumer and industrial electronic devices, including cell phones, MP3 players and digital cameras. Each firm had an existing division dedicated to flash memory design and production. Those divisions, their assets and most of their employees were combined into Numonyx, a new private entity with more than 8,000 employees.

The vice president/general manager of Intel’s Flash Memory Group became Numonyx’s CEO. Like other Numonyx leaders, his experience reflected that of a division executive. After Day 1, however, he and his senior team came face-to-face with corporate-level concerns in governance, finance, marketing, regulation and other areas. In this particular case, deal planners did not recruit new leaders with broader experiences; the venture needed the technical capabilities of flash group managers in its anticipated operations, starting on Day 1. Recognizing the need to support continuing growth of the leadership team, executive development became a high priority for the new organization.

2. Organization culture

Every company has a unique history and way of doing things. Its culture – the common patterns of behavior that make up how work gets done – will deliver the organization’s results. Think of it this way: If employees in the new entity are consistently behaving in ways that add value, then the success of the stand-up will be assured. If, however, employees are consistently behaving in the “old” or counterproductive ways, then it is unlikely that the new entity will achieve the anticipated results in the desired time frame.

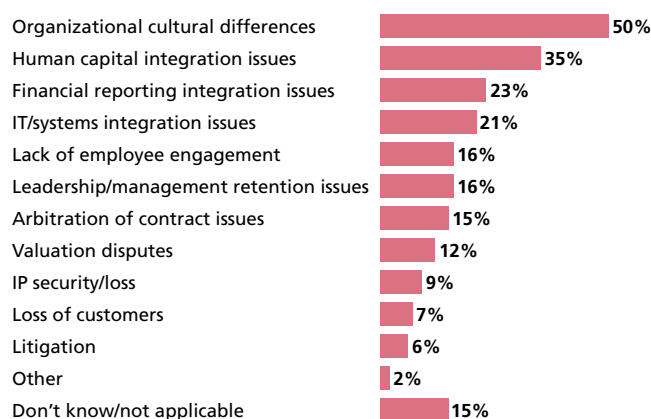
We know that culture has been cited as the primary reason that transactions – of all types – have failed to deliver on the promises made earlier in the courting phases. Indeed, a recent Economist Intelligence Unit study sponsored by Marsh, Mercer and Kroll, titled *M&A Beyond Borders: Risks and Opportunities*, found that “organizational cultural differences ranked as the most significant challenge in transactions.” (See Exhibit 1.) And we know from our own global research that culture is viewed as a critical success factor in transactions (Mercer’s *Cultural Integration SnapShot Survey*, October 2007). But despite this, relatively few organizations have put in place a robust process to address cultural integration.

So let’s consider a situation in which we are contemplating spinning out an operating unit. What questions would you ask yourself about the role that organization culture plays in the success of the stand-up? The following may well be on your list:

- What are the outcomes we’re looking for in this transaction?
- What are the critical behavioral patterns that will deliver these new outcomes?

- Which of our current cultural characteristics will stand us in good stead in achieving the outcomes we need for the new entity?
- Which of our heritage cultural characteristics will work against what we’re trying to achieve?

Exhibit 1 Most significant issues faced by respondents following their previous transaction



Likewise, when dealing with joint ventures that combine operations from two or more companies into stand-alone entities, cultural differences come into play:

- Which cultural characteristics of each organization must we preserve and reinforce, as they directly contribute to integration success?
- Which behavioral patterns need to be minimized or de-emphasized in each organization as we go forward?
- What cultural aspirations for the new organization do we need to build up together?

Our experience tells us that this situation is all the more fraught with difficulty, since driving desired outcomes often requires the creation of a “third” culture, which is different from either organization’s current way of working.

So, by clearly working through a structured process, it is possible for the leadership team to understand current patterns of behaviors, develop a clear view about what is required in the culture going forward, and identify where the sticking points and risks might be when the entity is formed and needs to stand alone.

As an example, a business unit of about 2,000 people was being spun out from its parent, a large portfolio company of health care-related products. This division had never before been in a position to have to fend for itself. As a natural part of the transition, the organization took much of the old culture with it: Employees who left often described it as being slow, bureaucratic, reactive, very command-and-control, and a place where it was safer not to “rock the boat.” Now, with the spin-out, the leadership team realized that these behaviors were going to be a liability. They agreed that if the organization was to build a reputation for customer service, innovation and efficiency in the new world, it needed a culture that was much more responsive, risk-taking, faster-paced and empowered. So the leadership team set about identifying the levers that were going to reinforce the new behavior patterns.

For many organizations, the transition to independence also provides an opportunity to reshape the existing culture in ways that will make the emerging enterprise more efficient and competitive. Veyance made a conscious decision to do that during its transition from being a unit of Goodyear to being an independent entity. “We spent a lot of time up front trying to define the culture of our new company,” says Kendrick. He and his colleagues used the company’s move to a new headquarters building to encourage the culture they hoped to develop. “We used the layout of the new building to set the standard. Where our prior facility was dark, hierarchically arranged and had an industrial feel, we designed the new space with areas designed for collaborative work. We eliminated most private offices and opened it up with lots of natural lighting. We also cut back on the number of layers and normal titles.”

By understanding the cultural change that needs to be made, leadership teams have the opportunity to review the range of levers available to them, and to make considered choices about which will have the most impact in bringing about the required shift. From our experience, the key levers often tend to be related to:

- How people are rewarded and recognized
- The behavior and actions of leaders and other influential groups in the organization
- How key messages are conveyed, reinforced and “lived out”

- The nature of, and conditions relating to, people’s work

Mercer’s cultural integration leader for M&A, Elisa Hukins, says, “Accelerating cultural change is just as important in the context of a spin-out as it is for many other transactions where significant value is contributed by people and how they operate together. A thoughtful yet pragmatic process will help a stand-up refocus employees on new behavior sets that will smooth the transition, focus them on the ‘things that matter’ and bring results earlier than otherwise would have been possible. In effect, managing culture is really about managing and mitigating risk.”

Some newly formed organizations contain substantial cultural differences. One was Los Alamos National Laboratory (LANL), a US Department of Energy (DOE) facility with an unusual mission: to develop and produce nuclear weapons, provide stewardship of the nation’s nuclear stockpile, and store highly radioactive plutonium. LANL had been operated by the University of California (UC) under a government contract almost from its inception after World War II. In 2003, however, DOE forced it to reapply and (for the first time) to compete for that contract. UC was successful in winning the contract, but did so through a new, private entity: Los Alamos National Security LLC, a consortium that included UC, Bechtel Corp., Washington Group International and BWX Technologies. The award was announced in December 2005 and became effective in June 2006.

“Accelerating cultural change is just as important in the context of a spin-out as it is for many other transactions.”

LANL, under its new management, employed more than 10,000 people, most of whom were highly paid technical professionals: physicists, engineers, chemists, materials scientists, computer scientists, mathematicians and other specialists. Ben Glover, LANL’s newly appointed division leader for human resources, quickly discovered a culture that was in conflict with the culture of the new management group. LANL’s

culture was one in which layoffs were practically unheard of; where science, not business results, drove everything; and where a sense of entitlement was deeply entrenched. People did not welcome changes that would upset this stable culture. Change proposals ran up against a wall of resistance from highly educated people who knew how to push back. “They would create mathematical algorithms to prove that our actuaries were wrong in figuring benefit calculations,” Glover recalls. “To complicate matters, LANL’s new management team came from UC Lawrence Livermore National Lab, Bechtel Corp., Washington Group International and BWX Technologies – each with their own different cultures and varying experiences in recognizing and dealing with culture change issues. They often saw the world through very different eyes.”

The clash of cultures resulting from the Los Alamos deal called for an intensive program of change management at the very time that HR had its hands full of routine but essential “stand-up” responsibilities.

3. Legacy programs and costs

Creating a new entity provides the opportunity for fresh beginnings on many fronts: New behaviors can be promoted; work processes can be rethought and improved; new vendor affiliations can be established; and so forth. Leaders also have the opportunity during the startup period to address legacy costs that would hamstring the new venture’s future profitability: labor contracts, compensation arrangements for non-union employees, benefits, staffing levels and other HR policies previously supported by the former parent company.

Often, fixed costs are shifted to variable costs, with employees given opportunities for performance-based rewards. Union employees often give up some wage guarantees and begin contributing a larger share of their benefits cost in return for greater incentive pay and possibly share ownership.

The leadership philosophy of the new entity frequently includes shifting away from programs with large ongoing liabilities to plans that can be operated on a pay-as-you-go basis. For many of these organizations, this will mean that traditional pension plans will be replaced by defined contribution savings plans, sometimes with additional “profit-sharing” contributions at the end of the fiscal year to reflect positive financial performance on the part of the new company.

Reward and cost structure changes are often combined with downsizing, which complicates management’s attempt to generate enthusiasm among employees for the new venture. When this happens, the leadership must communicate the business case for change to employees and give them the information they need to understand the logic of the unfolding transition and the likely effect on them personally. This communication must be frequent and compelling, with a focus on the future.

4. Building an HR infrastructure

This is a difficult area for HR leaders to handle. Before being spun off, the new enterprise may have received some HR services from its corporate parent or affiliates – typically payroll services, benefits and reward programs and administration, and HR information systems. The new enterprise must now provide these services, programs and systems for itself. As a smaller entity, it may find that it has fewer options, and it may have to accept less expensive alternatives with lower service levels than were available to its larger parent. As one HR executive put it, “That means saying no when managers ask us for internal travel booking services. There’s simply no money for frills.”

Plug-and-play HR programs

Private equity buyers of stand-alone businesses often have an exit strategy that contemplates selling the business at some point in the future. As a result, many newly formed entities are destined to be sold within five years or so, either to corporate buyers or to the public, through an IPO. Other new companies may be the foundation for continued expansion within their industry, as investors find additional opportunities to expand into new products and markets. Given those likely outcomes, many stand-up entities make a conscious effort to design HR programs that will be easily transferred to a future buyer or are flexible enough to take on additional employees: programs that are plug-and-play ready. Instead of creating interlocking plans and long-term commitments to payroll/benefit vendors, transition teams create simplified arrangements that may be transferred or expanded.

Recalling his experience in the pre-deal phase of Numonyx's formation, Intel's Tom Galvin and his counterpart at ST sought opportunities to establish HR programs that were more basic and less costly than those used by their parent companies. Outsourcing seemed the way to go, offering solutions that could be quickly implemented and were more affordable. That strategy had to be modified, however. "On paper," says Galvin, "our strategy made sense. Implementing it, however, was difficult given our purchasing resources. We had too few HR people to find and develop outsourcing relationships, and to get programs in place in the short time available to us." Indeed, an earlier round of cost-cutting resulted in Intel having few HR personnel available to help. "Though Numonyx represented \$3.5 billion in revenues, we didn't have enough people to handle the work. We were putting things together with chewing gum and bailing wire."

Time and resource constraints resulted in a hybrid solution to standing up Numonyx's HR: Some processes were outsourced while others were provided through transition service agreements with the two parent companies.

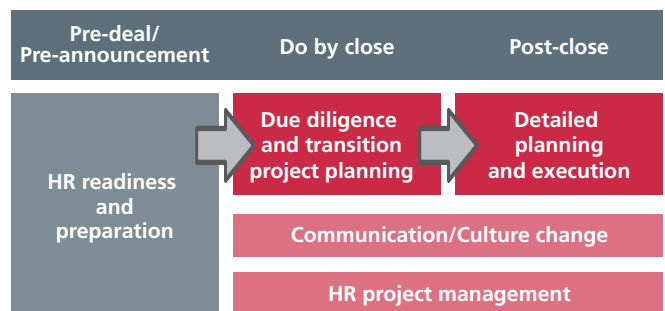
Leadership development was another program that had to be delayed because of the new company's limited HR resources. For Galvin and others on the transition team, leadership development was clearly necessary, and the new CEO wanted it. But with limited time and resources, that priority would have to take a backseat to those areas deemed more critical over the short term at Numonyx: cultural integration, payroll, benefits, staffing and relocation.

A process for managing the transition

The four issues described above are not the only ones that matter when a unit of a larger organization is spun, but they are often the most critical. How would you handle them if you and your colleagues were asked to plan and execute a stand-up operation for your part of the organization? If you had only six to nine months to prepare, could you get all your plans in place before Day 1 of the new organization? Would you have enough experienced people to develop your plans and carry them out? Would you have a road map to follow so that critical activities would not be missed?

Whatever your experience or level of resources, a field-tested process for managing the transition will improve your odds of success. We offer such a process here, as described in the high-level process map shown in Exhibit 2. This process map, a simplified version of one used successfully by Mercer consultants in dozens of past engagements, has three phases: pre-deal preparation, doing the deal and post-deal. HR should be involved in each, though at varying levels of intensity. In order to obtain the best possible outcome, each phase should include substantial communication with employees and managers.

Exhibit 2
Transition process map



HR readiness

"Transition-ready" HR leaders and professionals can make a big difference in the success of a stand-up deal. They are ready and able to take responsibility for planning and implementing an HR infrastructure for the stand-up organization. They know how to conduct and learn from due diligence. They are prepared to communicate with employees during the stressful period of transition in ways that maintain productivity and retain key employees. And they can provide executive decision makers with the strategic advice required to effectively manage the people aspects of the transition.

Ideally, transition readiness is developed during the pre-deal phase of the transition, when senior management is considering a deal. Senior management asks critical questions during this phase: Would divesting a particular operating unit make sense for our business? Would joining one of our units with resources from another company, in a joint venture or alliance, position our enterprise to exploit a business opportunity in a changing market? Transition-ready HR leadership will inform senior management's thinking during this critical phase by advising on the human capital risks and opportunities in any acquisition, divestiture or joint venture proposal.

This is also the time when the organization needs to assess its ability to support major organizational change. The HR leaders should ask:

- Do we clearly understand and have agreement on the transaction's business objectives and context?
- Are our HR professionals well-equipped with the skills of due diligence, project management and organizational change?
- How effective are our current deal-specific programs, such as change-in-control, retention, severance and change communication?
- How well has HR performed in previous M&A transactions?

If specialized skills are lacking, the HR leader should formulate a plan to develop them or, if there is not enough time available or capacity to do that, should arrange for external advisers.

Due diligence and transition project planning

Once management decides to move forward on a transaction, HR and others must move quickly to the next step: due diligence and transition project planning.

Due diligence analyzes the financial, legal, human capital and business aspects of a potential transaction. Its findings form the base upon which virtually all key decisions – both strategic and operational – are made. HR's contribution to due diligence is considerable, and includes the analysis of people-related risks, liabilities and opportunities. The critical HR issues examined during due diligence include:

- Organization culture
- Employment practices
- Labor and employee relations
- Compensation programs, including executive change-in-control provisions
- Health and retirement benefits
- HR compliance
- Leadership talent and depth
- Workforce strategy and critical jobs for future success
- Retention and severance programs
- HR service delivery – governance, staffing, structure, technology and sourcing

Experience matters

In terms of HR readiness, few qualities are more valuable than direct experience with previous transitions. Ben Glover, division leader for human resources at Los Alamos National Laboratory, had experience on his side when his four-organization consortium took responsibility for managing that huge research complex. As an HR manager for Bechtel Corp., one of the consortium partners, he was assigned to assist with transition issues during the pre-close deal phase, and expected to return to his regular position after the takeover date. Putting together the nuts and bolts of a new set of HR programs was the responsibility of the person slated to be the new HR leader. One month before the deal's effective date, however, that person resigned and Glover was asked to step into her shoes. Fortunately, he brought plenty of know-how to the job, having been part of the takeover team for the Oak Ridge Environmental Management Program in 1998 and at the Oak Ridge Y-12 National Security Complex subsequent to that. "If I hadn't had that experience, I would have had to hire someone with experience to guide me," he says.

"During the first [takeover], I had an HR manager with me who had been through five previous transitions. He helped me to develop a plan and to modify it when that plan wasn't working. That taught me the importance of finding someone with experience who can assist you through the thought processes. Of course, Mercer helped too, in standing up the benefit plans in several transitions. Here at Los Alamos I've also been aided by a Department of Energy partner who really understands the ins and outs of HR, and two HR managers on my team who have been through several transitions."

Parallel to due diligence, teams of managers and specialists must plan for Day 1. HR's planning role is critical because on Day 1, the new organization must have leaders in place, a roster of managers and employees, and a system for paying and motivating them. The deal team must use every available tool to (a) learn more about what the operations of the stand-up business will look like and how much they will cost, and (b) identify transition and leadership issues as early as possible.

“There is simply no substitute for a clear decision-making mechanism during organizational transitions.”

Exhibit 3 provides a structure that companies may use to organize the effort. It includes a ground-level set of work teams, an intermediate-level team of HR advisers, and a senior-level decision-making body.

This planning structure rests on a number of HR work teams, each assigned to review, make recommendations and report on a discrete aspect of the HR infrastructure. These teams, aided by outside advisers when necessary, analyze each of the HR functions and services required by the new stand-up entity. They ask three essential questions:

1. **Which HR functions or services will the new entity require on Day 1 to accomplish its immediate business objectives?** This is the “triaging” of HR services described earlier. Taking this approach demonstrates that HR sees the long-term view but can also meet the business’ immediate needs.
2. **Which HR functions and services do we currently have that can (and should) be carried over to the new entity?** (Remember: The new organization may not have enough resources to provide the “gold-plated” services to which managers and employees are currently accustomed.)
3. **Which functions and service are missing, and how can they be obtained in time for Day 1 (through outsourcing, building from scratch or transition arrangements with the parent company)?**

Work-team findings are reported to an HR advisory team composed of the HR leader, his or her direct reports, and (if needed) experienced external advisers. The advisory team’s job is to make sense of the detailed findings of the various work teams and use them in making recommendations to the executive steering committee. In practice, the HR advisory team reports its findings and current progress on a weekly basis, keeping momentum strong and HR in sync with the overall transaction.

The top level is occupied by a steering committee of executives with decision-making authority for all aspects of the organization’s transition – not HR alone. That committee must eventually approve a high-level plan for the stand-up entity’s HR infrastructure, a set of priorities and deadlines, and the financial and human resources needed to do the work. The steering committee plays a vital role. There is simply no substitute for a clear decision-making mechanism during organizational transitions. Without decision-making clarity, the work of transition teams will be frustrated by second guessing and by an inability to reach closure quickly on important plans during the critical “do by close” phase.

Exhibit 3
Organizing the transition-planning effort



In an ideal world, every operational aspect of the stand-up organization would be planned in advance and ready to go on Day 1. In reality, the doing-the-deal phase is often too short (three to nine months) and the resources available are too few to achieve an ideal outcome. And in the case of mergers and joint ventures involving erstwhile competitors, antitrust regulations may forbid the sharing of information needed to complete their work.

Detailed planning and execution

The final major step takes place in the run-up to the deal closing and continues into the post-close period. Armed with priorities, deadlines and resources, the work teams and HR leadership develop action plans for each area on the people side of the business that needs attention, as described in Exhibit 3. The goal is to have executable plans in hand before the close for all the HR functions/services that the new entity will require in order to achieve its objectives. One team, for example, may focus on retirement. It must ensure that a plan for employee retirement, employer/employee contributions and any switchover from the old plan are completed as the closing nears.

**“It’s best to have
leaders in place early.”**

Priorities will need to be determined among the areas listed in Exhibit 4 on page 12, and some may need little immediate attention. For example, in some transactions, the sales force of an operating unit that is standing up through a divestiture may pass through the transition period intact. Other areas, in contrast, may need substantial attention. These changes must be planned out in sufficient detail – with timelines, accountabilities and budgets – so they can be executed before or upon the deal closing.

Give early attention to leadership

Every organization needs a leadership team for making important decisions. During the stand-up process, as in any M&A transaction, it’s best to have leaders in place early, during the pre-close stage, when hundreds of decisions about the new organization must be made. In the absence of decision authority, transition plan approvals and resource allocations will be delayed. This, in turn, will create confusion in the ranks and jeopardize the success of the venture.

Exhibit 4**Targets for detailed planning and execution**

Human resources	<ul style="list-style-type: none">■ Design HR service delivery model – governance, talent, process, structure, technology and sourcing■ Finalize and implement transition services arrangements with sellers and others■ Secure/organize needed employee data
Leadership	<ul style="list-style-type: none">■ Identify leadership behaviors■ Select/deselect leadership; develop transition arrangements■ Establish performance standards
Total rewards	<ul style="list-style-type: none">■ Develop framework and philosophy for pay, benefits and career-related programs■ Design and cost initial compensation and benefits (and other employee) policies and programs
Workforce and staffing	<ul style="list-style-type: none">■ Assess competencies transferred from parent and define new requirements■ Perform initial employee selection/deselection■ Develop retention/transition strategy■ Determine development needs
Sales force	<ul style="list-style-type: none">■ Perform customer and sales analyses■ Design new sales force structure■ Perform initial sales force selection/deselection■ Align customer service programs
Performance	<ul style="list-style-type: none">■ Identify behaviors and achievements required for success■ Design program and measures for multilevel performance tracking and management, including link to pay
Compliance	<ul style="list-style-type: none">■ Resolve compliance issues – for example, qualified plans, employment practices, vendor performance, etc.■ Establish approach and accountability going forward■ Resolve issues raised by employment practices

Cross-border deals

Transition planning and execution are more complex when two or more countries are involved. The legal requirements for severance and restructuring, plant closures, and retirement and benefits provisions vary from country to country. HR practice norms are also likely to vary. Each location may involve a different payroll vendor. These differences must be recognized and accommodated during transition planning.

As Veyance's Bruce Kendrick put it, "We had people in the US and Canada; in four Latin American countries; in the UK, Slovenia, France and Italy; and in several Asian nations. Each of those locations had its own payroll and benefits program – even locations that had no more than one or two employees. It took a long time and great effort simply to get a complete inventory of those programs."

One proven approach to handling these complexities is through a work team dedicated to cross-border differences. That team should include members from each of the larger locations. Their role is to clarify the situation and issues for their location and to coordinate solutions and action plans with the larger team.

Communication to accelerate results

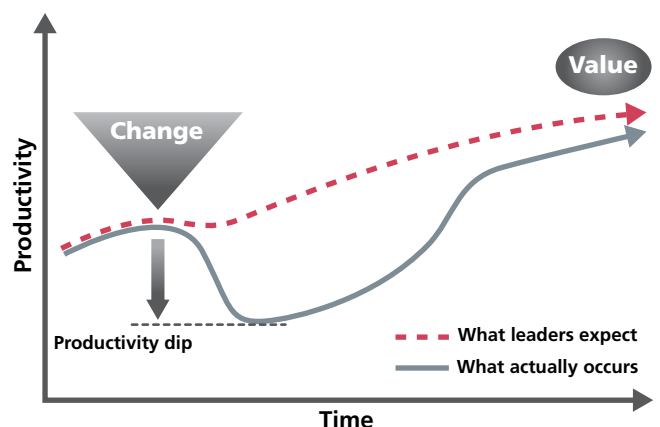
Anyone who has been through a merger, divestiture or other transaction knows what happens once employees get wind of the impending change: Emotion kicks in. As soon as the deal is announced (or even suspected), employees may experience many, if not all, of the emotions ranging from grief and anger to commitment and engagement.

Further, leaders and employees usually have differing views about the transaction. While leaders are focusing on the strategic vision for growth and greater profitability, employees are grappling with uncertainty. What leaders envision as a new beginning, employees typically experience as loss, resulting in a productivity dip. (See Exhibit 5.)

Leaders often have difficulty understanding this employee view on the change. Therefore, they need to acknowledge the perception gap – and intentionally address it with convincing and compelling communication. They need to build employee understanding, create a sense of urgency and engage the workforce in the change.

A commitment to approaching communication in this way can accelerate the change process for employees and help the organization get to the value of the transaction more quickly. To say it another way: How organizations help their people deal with change directly drives business outcomes.

Exhibit 5
The impact of change on productivity

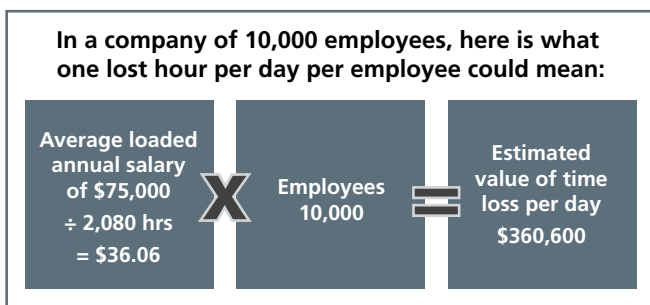


Another benefit of accelerating the change process and the productivity dip is financial – the dip costs the organization money. And the longer it takes for employees to get on board with the new organization, the more expensive it is.

Let's take an organization with 10,000 employees and an average annual salary of \$75,000. With just one lost hour of productivity by each employee each day, the company loses \$360,600 per day. So the longer the change takes, the more the company pays. (See Exhibit 6.)

Exhibit 6

The productivity dip translates into lost time and dollars



The people side of change

Companies going through a divestiture or spin-off put many resources into developing new structures, processes and operations. While these “harder-edged” concerns are essential to address, it’s equally important to develop proactive strategies for the “softer-edged” people issues.

As Laurie Barnes, Mercer’s Midwest leader for work-force communication and change consulting, indicates, “It’s tempting to neglect the people side, since getting employees to think and behave differently is difficult, complex and emotional. That’s why the ‘soft’ side is actually the hardest work of change. In our experience, about 60 percent of the hard work of change is all about people.”

Even though business leaders know that successfully executing a business transaction depends on engaging their people – and numerous studies provide strong evidence to back this up – those driving the change are not likely to focus on the people. Instead, they commit more attention to structure and process initiatives than to the people who are the structure and who perform the processes.

The role of communication during a transaction

Communication is a key to the people side of change – what is said, how it’s delivered and the effort that is invested in it. As John Kotter (Harvard Business School) put it, “Most leaders under communicate their change vision by a factor of 10. And the efforts they do make to convey their messages are of the least convincing variety – speeches and memos.”¹

During change, communication should be extensive and ongoing – and should continue well into the post-close period. The more conversation, the better. Personal communication in face-to-face forums where people can engage in dialogue will be far more effective than written memos about corporate strategy. Highly effective change communication should share the vision, articulate the new direction and desired behaviors, create consistency, deliver information, and solicit formal feedback.

And the communication should not come from HR or corporate communication or an outside consultant – it needs to come from leaders.

¹ Harvard Business School Professor John Kotter is widely regarded as the world’s foremost authority on leadership and change. Professor Kotter is the author of 15 books, a collection that has given him more honors and awards than any other writer on the topics of leadership and change.

Engaging the workforce through communication

A highly engaged workforce can produce significant business returns, as Mercer's proprietary *What's Working™* research shows. The study, conducted in 22 countries globally, confirms the importance of effective communication during periods of major change.

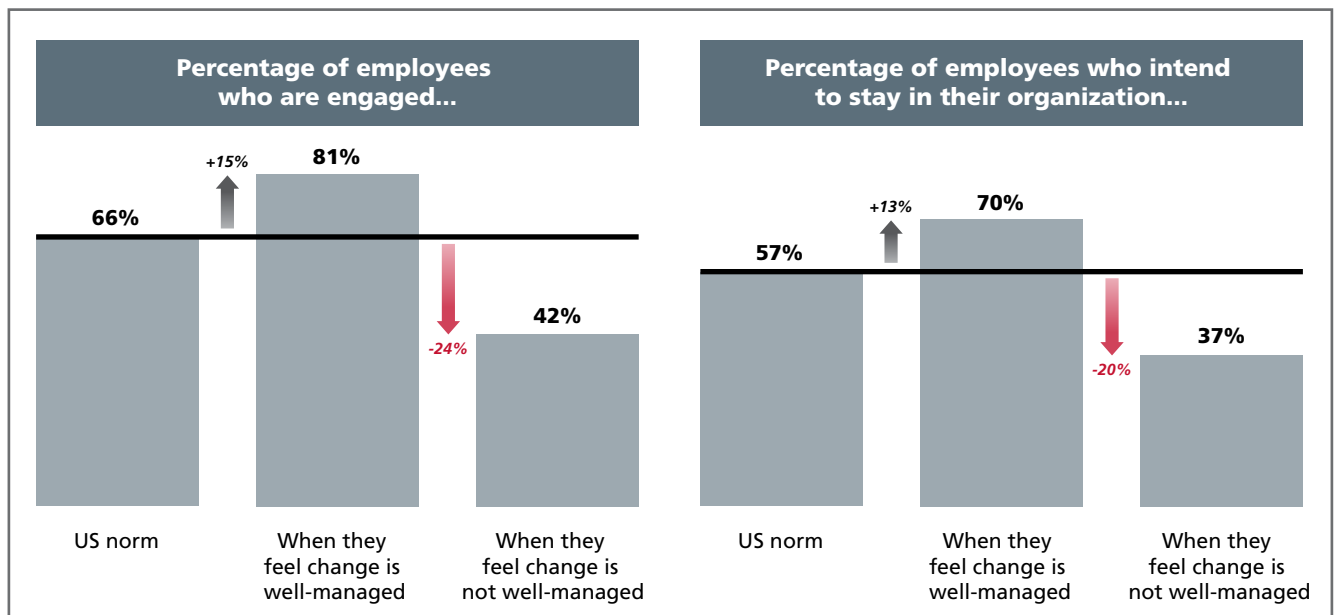
If employees feel that change is well-managed, the study shows, they will be more engaged in and committed to their organization. According to Mercer's engagement index, when employees feel that change is well-managed, four out of five (81 percent) are engaged. In contrast, when employees feel that change is not well-managed, only 42 percent are engaged. (See Exhibit 7.)

Similarly, if employees don't agree with the change or how it's executed, they're likely to look for another job opportunity. In Mercer's research, 70 percent of employees who felt that change was well-managed intended to stay with the organization, compared to 37 percent who intended to stay when they felt that change was not well-managed.

Employees identify communication as a driver of engagement when it is seen as a positive element in the work experience. But communication can be a cause for alienation when it is viewed as a failing organizational process.

Exhibit 7

Mercer's global research confirms the critical role of communication



Source: Mercer's *What's Working™* survey.

Helping employees understand my company, my work, my deal

As the transaction proceeds, communication must become more tactical and specific, getting beyond high-level vision and direction to what employees really care about. Address employees' personal needs by talking to them about the new value proposition – where the company is headed, the impact the change will have on each employee and the opportunities it will create for the future. (See Exhibit 8.)

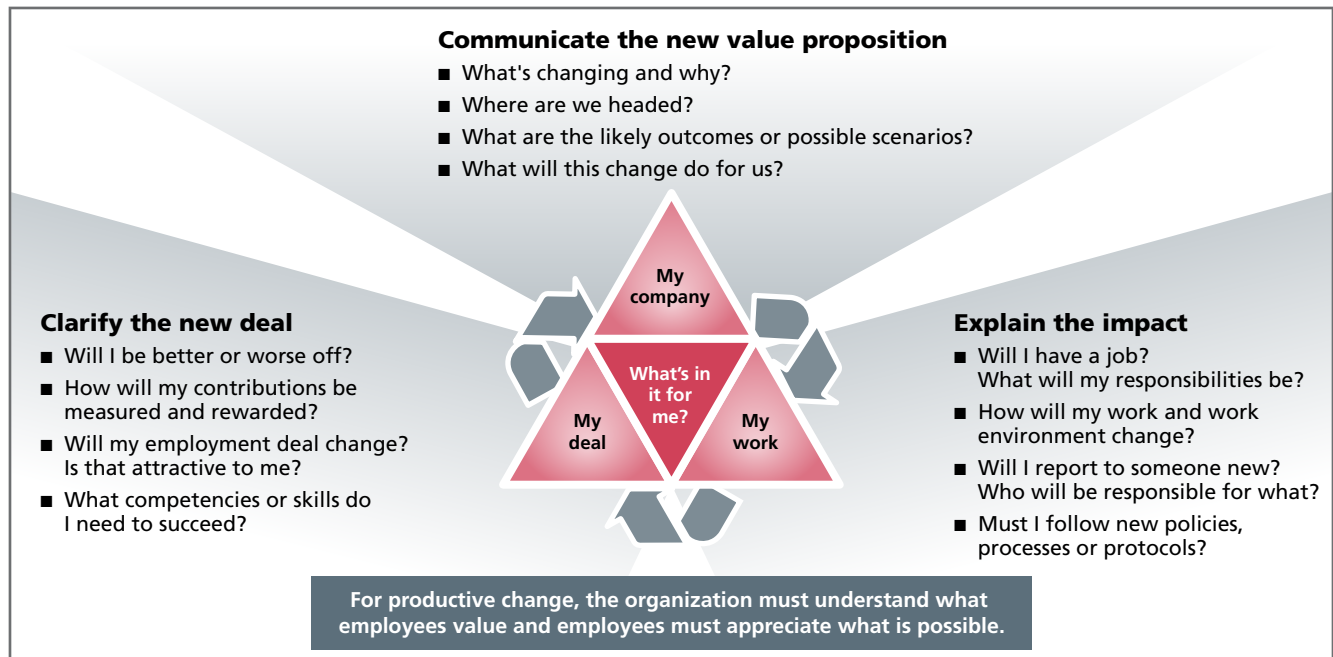
Leaders can address these issues by:

- Clearly communicating the new value proposition
- Translating the change so people understand the personal impact

- Clarifying the new deal – what's expected in the new environment

But it's not enough for leaders at the top to be visible spokespeople and change agents who present the straight story, model the right behaviors and hold others personally accountable for supporting change. Leaders – in particular, supervisors – are the most trusted, credible source of information in most organizations. They need to be recruited, engaged and equipped to help communicate. "Employees certainly listen to what their leaders say, and they watch what their leaders and colleagues do even more carefully."²

Exhibit 8 Change happens only if individuals change



² Howard Gardner, "The Ethical Mind," Harvard Business Review

What would you do?

We began this overview with a hypothetical HR leader, Adam Jenkins, getting some very big news: He would have to prepare his department to support an independent company and do most of that work in a relatively short time. All the corporate HR supports that he, his staff and employees had taken for granted would soon be gone. What will this HR leader's work life be like during the six or eight months before the deal closes officially?

“Standing up the HR function for a new entity gives HR leaders a rare opportunity to demonstrate the strategic value of their calling to senior management and to the rest of the enterprise.”

Informed by Mercer's experience with HR professionals who have experienced similar transactions, we can speculate that Jenkins will be amazed by the level of effort required and the number of meetings that he and others will have to attend simply to get the basics of HR infrastructure in place by Day 1. Even then, some key HR services may be unresolved by that time, forcing the new entity to rely on transition service agreements with its former parent company. Resolution of those agreements, which generally end in a year or two, and other issues, including unexpired labor agreements and leadership development, will then spill over into the post-closing period. One client, who had done an excellent stand-up job, continues working on the transition two years after the close. In her words, “There hasn't been a quiet day since the close two years ago.” Thus, the HR leadership team should not expect its burdens to be miraculously lifted shortly after Day 1.

In the end, the HR leader will discover what our interviewees learned in standing up their organizations:

- A significant amount of work must be done, both before and after the close. The HR leader and staff must attend to stand-up work in addition to their day-to-day responsibilities during those periods.
- Transition planning and execution benefit enormously from good project management skills. It's wise to develop these as part of HR readiness.
- Teamwork among HR, finance, sales and legal is imperative.
- The HR leader must coordinate closely with operating people throughout the company.

Is all of this work worth it? Our experience indicates that most clients think so. Standing up the HR function for a new entity gives HR leaders a rare opportunity to demonstrate the strategic value of their calling to senior management and to the rest of the enterprise. It's an opportunity to go beyond the routine responsibilities that keep the people side of the business working smoothly, to create something new and better to support the success of the newly independent entity. And it's an opportunity to grow professionally. Says Veyance's Kendrick, “I learned more in six months [of the transition] than I had during the previous 20 years of my career.”

Few HR professionals ever encounter the type of opportunity represented by a spin-off or divestiture. Fewer still can reflect back on the experience and claim success. Those who achieve success do so because they understand the issues that HR must confront – including the four critical issues outlined in this paper – and they had the foresight to create a sound process to guide them through the immense undertaking of “standing up” the HR function.

Acknowledgements

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- My fellow M&A professionals within Mercer's M&A consulting business

Len Gray, Americas M&A Business Leader

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