Practical steps to smooth separation for employees and human resources

Introduction

Divestitures can be an excellent way to increase a company's focus on core assets and future vision for the company. Divesting any part of a company's assets will impact employees and management on both sides of the transaction, making the people side of a divestiture one of the most important factors to consider.

Employees constitute one of the largest operating expenses of a company. Employee benefit obligations coupled with multi-jurisdictional complexities on cross border deals can also add significant corporate liabilities. However, employees are essential to company operations, and keeping them engaged is critical to executing the transaction and sustaining deal value.

The ability for Human Resources to accelerate closing, manage costs, and secure employee retention hinges on close collaboration with Finance, Tax, Legal, Information Technology (IT), and Corporate Development. It is imperative to drive employee processes and articulate human capital strategies in operational, financial, and legal terms. This paper provides insights into how HR partners with other functions and stakeholders to manage the people side of divestitures across the deal.

The issues our clients face, the actions we help them take

An effective divestiture and separation process emphasizes the importance of getting divestiture fundamentals in place as quickly as possible during a deal to help minimize disruptions and synergies. Rapidly launching divestiture efforts to conduct Strategic Assessment, Set the Course, Plan and Execute the divestiture and Design and Maximize Future-State Operations is a critical success factor. Figure 1 illustrates the divestiture and separation process.

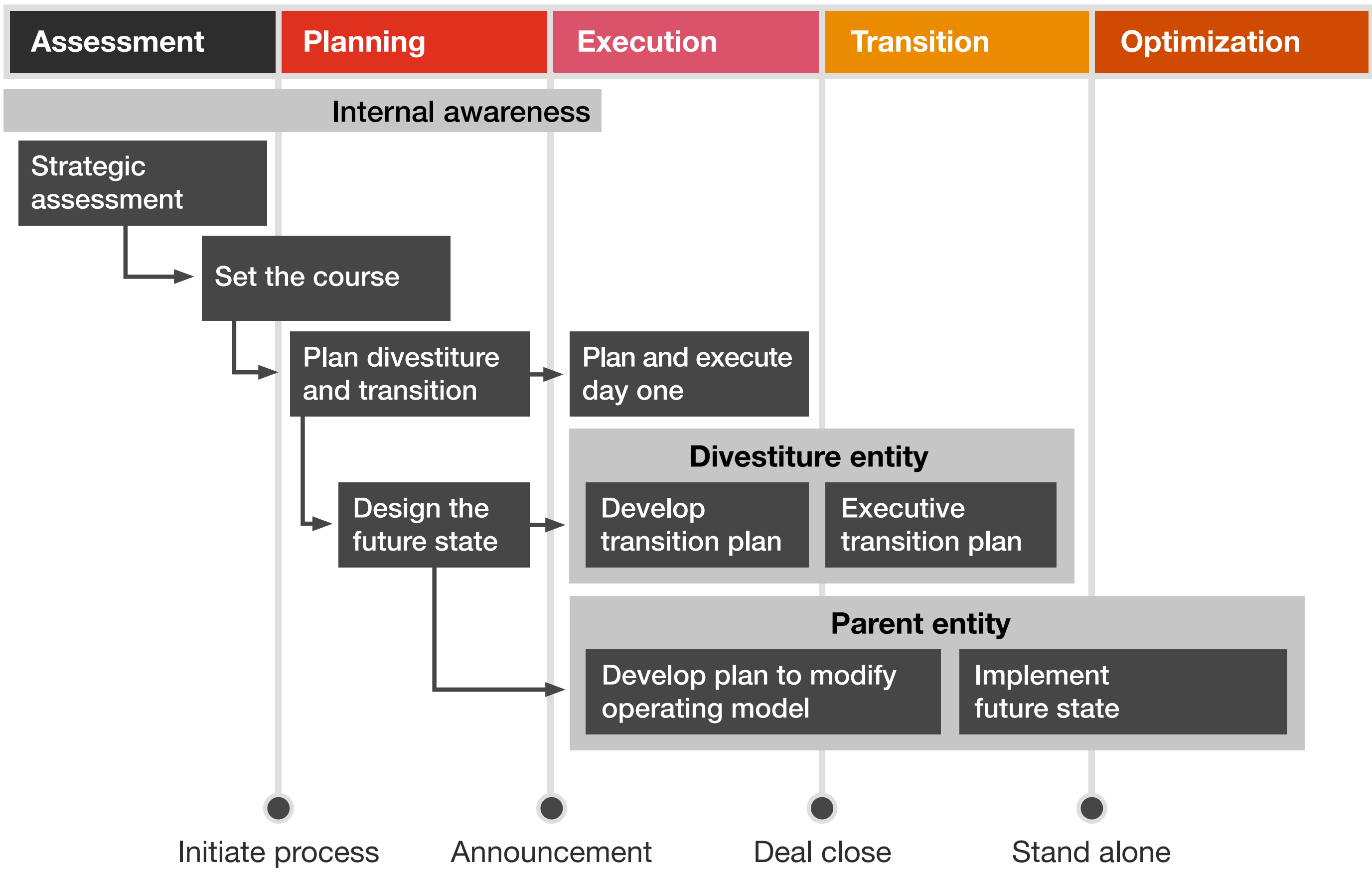

Figure 1 — The PwC divestiture and separation process follows a sequence of coordinated steps to help focus people and capital on the right activities at the right times.

This paper examines the human capital considerations through a four-stage process:

Strategic assessment:
Understanding deal options and value impacts, anticipating stakeholder questions, and preparing for the transaction and negotiations.

Set the course:
Establishing a multi-discipline HR divestiture team that can address operations, financials, labor relations, local culture and regulations, and in-scope and remaining employees.

Plan and execute the divestiture and design the future state:
Applying discipline and rigor to the separation across critical HR areas, including benefits, organization, employee transition process, legal requirements, and transition service agreements (TSAs).

Transition and optimize:
Maintaining a strategic focus to wind down TSAs and retain and reenergize employees.

Strategic assessment

Attaining divestiture success begins with divesting the right business business at the right time to secure lasting value. Achieving the objectives of increasing deal value, realizing a smooth transaction close, and minimizing disruptions starts with conducting a portfolio assessment and aligning the findings with the company's M&A strategy. Before planning can kick-off, basic questions about what is being divested, why it is being divested, and how the divestiture aligns with short- and long-term company goals need to be addressed.

For HR, gaining an understanding of the divested business human capital landscape, anticipating buyer questions, and assessing key data requirements and related costs will be critical in building credibility with buyers and may impact negotiating the right price for the divested business. Performing sell-side HR due diligence can assist the Seller in getting ahead of the due diligence process and providing an advantage on related risks. Strategic assessment for HR typically addresses the following areas.

Identify which employees are in-scope

Identifying in-scope employees (those going with the deal) is a prerequisite for developing accurate financial and operational information for the divested business. Accuracy of employee financial data reduces the risk of downstream surprises and adverse purchase price adjustments. Early and accurate identification of employees provides an opportunity to thoughtfully establish a narrative around employee data, understand potential losses that could be incurred by employees (e.g. opportunities to vest in pensions and stocks), and allow for a longer runway to build solutions, plan employee and labor communications, and manage legal implications, including local legal requirements in multijurisdictional deals.

Create human capital financial models

A strong human capital financial model starts with understanding the key components that make up employee related cost, including transfer of pension liabilities and assets, deal bonus triggers, changes to benefit run-rate cost due to separation, and changes to the respective HR operating models of the divested business and remaining company. HR should assess one-time costs, financial exposures, and impacts to P&L cost and future cash flow. Understanding these human capital financial inputs requires an analysis of workforce issues, such as impacts to relations with organized labor, employee compensation programs, and pension and benefit plans. In addition, HR considerations will include one-time and run-rate costs related to operational changes at the divested business and remaining company. Thinking from the Buyer's point of view allows the Seller to consider any implications that may substantially change costs or affect the analysis and negotiation timelines.

Prepare for the TSA negotiation process

Delivering HR TSAs requires an understanding of scope, costs, and resources required to support the divesting business. A proactive assessment starts by determining HR services that will be required to operate on Day One, and understanding Buyer needs and internal capabilities to reduce employee and financial exposure for the remaining business.

Common HR TSAs provided by sellers

- Payroll administration and processing
- Benefits administration
- HR operations and services administration
- Learning management system (LMS)
- Human Resources Information Systems (HRIS) and data management
- Recruiting
- Training
- Compensation administration

Common exclusions avoided by sellers

- Compensation
- Collective bargaining negotiations
- Expat and foreign national visa administration
- Performance management administration

Anticipate the Day One organization

Gaining an early understanding of the new organization structure is critical to adequately assess divested business capabilities, gaps, and associated costs. The HR team should work with business leaders to design a potential Day One organization and determine new hire needs for positions that will not be filled via in-scope employees. The Day One organization should consider cost effective options for the stand-alone business to make it most attractive for the Buyer. The table below outlines considerations for the three categories of Buyers.

Key priorities by buyer during strategic assessment

Strategic

- Acquire products, services, geography, or intellectual capital to enhance current business
- Leverage Buyer infrastructure to support HR services and exit TSAs faster
- Eliminate duplication of roles and services and harmonize systems and processes

Private equity

- Acquire an investment and a business that is fully operational
- Focus on supplementing talent, capability, and leadership while avoiding excess headcount
- Leverage human capital and talent to increase value realization

SpinCo.

- Maintain business operations and stand-alone a fully operational business on Day One
- Accelerate non-reliance on parent company (Seller) services and financing
- Retain key talent, build new culture, and contain or reduce costs

Set the course

A divestiture transaction, like other corporate change initiatives, is an excellent opportunity to set a new course — both operationally and across various support functions. "Set the course" involves defining clear objectives and establishing clear leadership and role clarity throughout the transition.

Setting the course for HR involves completing HR specific processes, managing internal and external stakeholders, and complying with legal requirements – all in a compressed timeframe. In this phase, HR teams should focus on three primary areas.

Establish HR governance and the HR divestiture playbook

The HR team is part of the overall deal governance and works in collaboration with the Divestiture Management Office (DMO) and cross-functional teams. The HR team should secure the right people to execute the deal strategy, scope, and complexity. The HR team should include a balance of resources, including in-scope and remaining employees, along with corporate and local team members. The team should address all HR functional requirements and enabling processes, including organization, change management, communications, and employee transition.

Establishing an HR divestment playbook will enable consistency in delivery, align teams around decision points, provide common tools and processes, and help establish a clear path for issue resolution and escalation. The playbook should provide an understanding of the sequence of HR activities and interdependencies across the divestiture lifecycle, and include both cross-functional and local legal requirements.

HR Divestiture playbook areas

HR Deal management

- In-scope employees
- Employee transfers
- Transition service agreements
- Employee related registrations
- Labor relations, including works council

HR Operations

- Payroll
- HR information systems (HRIS)
- Compensation and benefits
- HR services
- Policies and procedures
- Vendor management

Employee transition

- Employee retention, recruiting, and redundancies
- Employee communications
- Organization structure
- Culture
- Expatriates and foreign national visas

Manage risks and dependencies early in the planning process

Employment matters are governed by local law requirements, resulting in the need for HR to identify risk areas early. The HR divestiture playbook should clearly define what needs to be completed, when, and by whom, and articulate key issues to watch and manage. It is important for HR to manage high risk areas that require cross-functional collaboration and knowledge of local legal requirements. Areas to consider include the following.

- **Legal entity establishment:** Identify employment implications, complete employee related registrations on time to avoid delayed closings, and plan for any stock or asset deal implications.
- **Labor relations:** Engage counsel to advise on strategy for negotiating with labor unions and works councils, plan for collective bargaining agreement obligations and potential liabilities, and budget for concessions to avoid reactive considerations.
- **Employee transfers:** Manage intermediate employee moves and Day One transfers, and potential costs and liabilities that could be triggered by transfers.
- **HR Information systems:** Create a strategy for divested business systems, requirements, and implications on the chosen HR systems solution, determine level of effort and resources required to support HR systems transition, and manage employee data and related privacy agreements.
- **Transition service agreements:** Determine scope, costs, and level of resources required to support HR TSAs, determine permissibility of desired services as determined by local legal requirements, and gain permission from third party vendors to continue services.

Plan ahead for organizational design and communication requirements

According to studies, 90% of senior and middle managers are psychologically unprepared for the changes in status and organizational structure they encounter in a divestiture environment, and productivity may fall as low as 50% as employees are distracted by potential impacts of the deal.[1] As a result, it is imperative for Sellers to be aware of employee related issues and be proactive about organizational and communication planning early in the divestiture process.

Organization planning should include managing in-scope employees and creating frameworks that help maintain business stability. This should include processes or policies for new hires, transfers, redundancies, promotions, and compensation. In support of this framework, Sellers should consider designing and launching an effective communications program to help minimize common divestiture distractions that may result from uncertainty and fear. This may also assist to increase Buyer confidence.

[1] Source: The Complete Guide to Mergers and Acquisitions – Timothy J. Galpin and Mark Herndon. Survival skills in the age of mergers and acquisitions – Cabreba and Wishard, 2007.

Communication planning considerations

Employees

- Treat each employee stakeholder group differently: in-scope, pivotal executives, and managers
- Determine how concerns will be addressed

Labor

- Consider the current state of labor relationships at the divested company and competing negotiations that may hamper consultations
- Understand local legal notification requirements and required timelines

Customers

- Develop messages to affirm customer benefits from the deal
- Communicate impacts on the remaining company business and how issues and concerns will be handled

Vendors

- Understand critical contracts and legal obligations
- Consider exposure for the remaining company and divested company due to decreased purchasing power

Media

- Communicate deal value drivers for the divested business and remaining company
- Understand impact on shareholder value and implications for employees, customers, and the community

Key priorities by buyer during set the course

Strategic

- Align HR deal team governance, priorities, and activities with the Seller
- Manage local legal requirements on employee transfers, payroll, and benefits set up, and avoid triggering liabilities
- Prepare for Day One organization, first 100 days, and long-term capability and talent requirements

Private equity

- Determine one-time and recurring costs and potential liabilities
- Understand key open roles to be filled pre-close and create plans for retaining pivotal talent
- Ensure HR teams understand Buyer priorities and relevant legal entity decisions to support registrations and manage local compliance issues

SpinCo.

- Determine one-time and recurring costs and potential liabilities
- Understand key open roles to be filled pre-close, create plans for retaining pivotal talent, and avoid talent flight
- Manage downstream effects of local legal requirements on employee transfers, payroll, and benefits set up, and avoid triggering liabilities

Plan and execute the divestiture and design the future state

Even if the best decisions are made as you "Set the Course," much can go wrong before transaction close, absent proper planning and execution. Value leakage can occur in many ways, and experience shows that surprises and delays during the deal process often erode deal value. To mitigate value leakage, it is critical to enable a fast-paced separation that makes early use of disciplined planning, a well-organized launch, and relentless focus on the priority initiatives that sustain and drive value.

During the planning and execution phase, Sellers, in collaboration with Buyers, need to separate the HR function and associated processes while keeping employees focused. Executing these actions requires close collaboration between the business, HR, Finance, IT, Legal, and multiple vendors to separate core HR operations, align payroll and benefits (and related systems), transition employees, and sustain compliance. Success requires a delicate balance in managing four key areas.

Manage legal obligations and cross-border considerations

Multi-jurisdictional deals will encounter complex employment law issues with each market having distinct requirements driven by the deal structure. Sellers should have cross-border divestment teams and engage appropriate counsel to sustain compliance and avoid triggering liabilities and fines.

The HR team should establish the structure to collaborate and manage obligations around critical areas that could derail execution progress if not managed correctly, including establishing legal entities and people related registrations, managing labor consultations, executing the employee transfer process, transitioning appropriate expat and foreign national visas, and adhering to data privacy requirements.

Separate the HR function to support the divested business

When separating the HR function, Sellers should care for both the divested business while addressing implications for the remaining company. The complexity and level of effort for this activity is usually underestimated by Sellers.

- **Benefits and pensions:** The Seller should replicate employee benefits and pensions in accordance with the stock and asset purchase agreement. Components to consider in this process include:
    - » Local compliance requirements associated with changes in benefit plans and eligibility
    - » Review and approval process with Buyer on plan designs, signatories, and payments
    - » Ability to perform benefits administration and understand impediments to providing or receiving payroll TSAs permissibility to deliver services
    - » Alignment with Finance, the Deal team, and Buyer to track and assign costs

- **Payroll:** Cross-functional collaboration with Finance, HR, IT, Tax, the Buyer, and third-party vendors is needed to ensure employees can be paid at close and the divested business remains in compliance with local authorities. The ability to run dual payroll may be required (remaining business and divested company where TSAs are provided), including tax and payroll filings, and benefits and social security requirements. The Seller needs the right level of resources to fulfill these obligations. The Seller should also understand impediments to providing or receiving payroll TSAs and ensuring permissibility to deliver services or make payments on behalf of the Seller.

- **HR Operations and technology:** HR should understand the Buyer requirements for supporting HR technology and operations, including cloning of systems, where applicable. HR should also understand the extent of the HR technology system modifications if needed to support TSAs, data compliance, and other vendor requirements.

Design the organization and staffing

The scope and level of complexity of organizational design work to be completed by a Seller on a divestiture is determined by the type of deal. While the burden of organizational design will commonly lie with the Buyer, the Seller will often require some organizational realignment as well.

Important items to consider during this process are to be transparent about employee selection, announce the organization early to diffuse concerns, rapidly hire critical Day One and pre-Day One roles for the divested business, and collaborate well with the Buyer to enable access to resources for employee selection.

Retain and engage employees

The key to retention is deeply rooted in employee understanding and the future value proposition for their career. Retaining employees requires a balanced use of financial incentives, role alignment, and communications. Common retention strategies include the following.

- Retention or stay bonuses are temporary measures that often result in delayed attrition rates. Consider coupling the bonuses with clear career direction for pivotal employees.

- Enhanced severance, while not as common as retention bonuses, is leveraged to address job security and demonstrate an employee's importance in the future organization.

- Change management and communications are used to bring pivotal employees under the tent early, and provide them with role clarity in the future organization. Delivering training and establishing a knowledge transfer plan will assist in preventing a loss of knowledge that may hamper business operations at transition.

Key priorities by buyer during plan and execute the divestiture and design the future state

For All: Strategic, Private equity, and SpinCo.

- Identify legal entities and related registrations that will enable execution of dependent deal activities
- Manage HR services to continue without interruption – payroll is ready, employees can access benefits and services, and systems are running
- Resolve early labor requirements and consultations without triggering deal related severance
- Engage employees to promote retention and focus on the business. Buyer and Seller should be aligned around pivotal talent retention strategy, liabilities, and addressing employee concerns
- Establish a clear path for managing TSA provisions and focus on early exit plans

Private Equity, SpinCo. Only

- Ensure Day One organization is in place and critical Day One roles are filled

Transition and optimize

Even if the best decisions are made as you "Set the Course," much can go wrong before transaction close, absent proper planning and execution. Value leakage can occur in many ways, and experience shows that surprises and delays during the deal process often erode deal value. To mitigate value leakage, it is critical to enable a fast-paced separation that makes early use of disciplined planning, a well-organized launch, and relentless focus on the priority initiatives that sustain and drive value.

During the planning and execution phase, Sellers, in collaboration with Buyers, need to separate the HR function and associated processes while keeping employees focused. Executing these actions requires close collaboration between the business, HR, Finance, IT, Legal, and multiple vendors to separate core HR operations, align payroll and benefits (and related systems), transition employees, and sustain compliance. Success requires a delicate balance in managing four key areas.

Support Transition Service Agreements

The Seller has the responsibility to deliver to the divested business in accordance with the TSAs. The Seller needs to ensure it has sufficient support, understands obligations, and provides services in line with the TSA service levels, costs, and legal requirements. Some tips for the HR team to keep in mind during the transition include the following.

- Confirm the ability to run two payrolls, where needed, instead of one, including two sets of tax and payroll filings.
- Manage disputes according to established processes in the TSA governance structure and manage the dependencies with Legal and Finance through TSA exit.
- Actively hire and train resources to take on any new or divested positions.
- Maintain close contact with the divested business to monitor TSA exit activities, and proactively manage resourcing and stranded costs.

Optimize the go forward business

Throughout the transition, the Seller should look for opportunities to streamline the remaining company, proactively managing resourcing and stranded costs as the TSAs are winding down. The Seller should take stock, and right size the remaining organization, roles, and skillsets around the new strategic objectives of the remaining company.

Reenergize remaining employees

Post close, the remaining company employees are often exhausted and may feel anxious about the future. It's vital for the Seller to reengage and refocus the remaining organization with deliberate efforts to move the business and employees ahead. Some tips for HR to align the go forward organization include the following.

- **Articulate the culture:** Long term success for the remaining company may require defining new ways of working for employees or reinforcement of core values and business strategy.
- **Cultivate excitement:** Strive to win the hearts and minds of the remaining employees. This is an exciting time and the outlook is often positive. Use this opportunity to cultivate that energy and redirect employees who may be feeling anxious.
- **Design and communicate the new organization:** Openly communicate the go forward company vision and structure to establish trust and provide clear direction to employees.
- **Retain employees:** Employees are one of the most valuable assets. Keep managers focused on employee performance and provide a clear channel for employees to provide feedback.

Conclusion

Divestitures can be a valuable tool to increase shareholder value, optimize capital, and regain focus. Though HR and employee challenges can be complex and difficult to manage, particularly in cross-border deals that navigate multiple cultures and regulatory requirements, HR teams should collaborate across functions and geographies to deliver in some critical areas, including:

- Building a strong negotiation position early
- Understanding the financial implications of decisions
- Minimizing disruption to the business
- Communicating early and often
- Making employee retention and engagement a priority

Teams that are able to anticipate human capital issues early and help position employees for the separation can increase deal value and drive the transformation that comes from confidently divesting the right assets at the right time to secure value.

How PwC can help

For a deeper discussion on the content of this paper or other deal considerations, please contact one of our practice leaders or your local PwC partner.

Shungu Chigariro, Principal
PwC Deals – Delivering Deal Value, Human Capital
646 818 7552
shungu.chigariro@pwc.com

Barrett Shipman, Principal
PwC Deals – US Divestitures Operational Readiness Leader
512 708 5651
barrett.j.shipman@pwc.com

Paul Hollinger, Principal
PwC Deals – Delivering Deal Value
408 817 8295
paul.j.hollinger@pwc.com

Gregg Nahass, Partner
PwC Deals – Delivering Deal Value
213 356 6245
gnahass@pwc.com

About our deals publications:

PwC provides tactical and strategic thinking on a wide range of issues that affect the deal community. Visit us at www.pwc.com/us/deals to download our most current publications.