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Key Employee-Retention Strategies To Practice In M&A Deals

By **Roger Lee** (April 21, 2022, 4:59 PM EDT)

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Strong merger and acquisition activity in 2021 and into 2022 has been helped by easy access to capital, low interest rates and a recovering global economy.

These same factors have kept the labor market extremely tight, setting up an unprecedented labor shortage in the U.S. economy amid the Great Resignation.

Additionally, these factors have put a renewed focus on talent retention following an M&A transaction. The most common tool for talent retention remains the straightforward retention bonus and, in today's tight market, combining such retention bonuses with more involved retention strategies can lead to success for parties hoping to adapt to this challenging climate.

One of the greatest obstacles to a successful transition for the acquirer following an M&A transaction is uncertainty among the acquired employees and their perception that the transaction brings along with it possible downsizing, feelings of loss of organizational culture and betrayal, and general confusion leading to greater stress.

These issues can lead employees to look for new jobs in a market that favors employees and, thus, the acquirers should focus on talent retention to avoid immediate headaches and ensure a long-term successful transaction.

Two case studies showcase the difference attention to these matters can make.

In the first hypothetical situation, an executive looking to sell his transportation industry consulting firm lost some of his best talent to some high-profile startups in the sector because of his lack of transparency.

He feared that news of a company sale might trigger more departures, and he kept a tight lid on the ongoing negotiations, telling only those individuals who the buyer requested to speak with during its due diligence process. The buyer's interviews with staff unearthed that this lack of transparency and reticence produced an uncertainty that led several key employees to seek employment elsewhere.

Contrast that with the second hypothetical, in which a buy-side entertainment industry company requested that the seller be open and forthcoming with its employees. The two parties worked together to

- Identify key employees;
- Hold town hall meetings to relieve some of the stress and tension in the workplace;
- Assure the team that the leadership would remain in place; and
- Assure that the transaction would lead to growth with abundant resources rather than contraction and cost-cutting.

In addition to open communication and transparency, the company provided access to several programs aimed at employee retention:

- A time-based retention bonus;
- A performance-based earnout bonus;
- Stock equity plans for both management and employees alike; and
- Assurances that the current leadership and office space would remain in place.

In the first scenario, only upper management received retention bonuses, and the integral workers required to generate revenue were absent from any conversations and targeted by headhunters. The buyer's diligence process unearthed a general atmosphere of confusion and uneasiness with the ongoing process within the ranks.

While no employee initially disclosed any plans to terminate their employment, the unhappiness of the workforce cast doubt to the buyer on the ability to retain the necessary talent to maintain a successful business after the acquisition.

Certain concessions were requested by the buyer, including a readjusted earnout structure that effectively conveyed the buyer's concern over talent retention.

On the other hand, the entertainment company provided heaps of pre-transaction organizational and managerial support, backed by promises of additional post-transaction support. The company made it a priority to build a sense of excitement, rather than fear and uncertainty, around the acquisition.

They established open lines of communication to discuss the benefits of the acquisition for the growth trajectory and its workforce, combined with assurances that the current leadership would stay onboard and continue managing the business.

The single biggest factor in the employees' excitement to stay was very likely the fact that the buyer understood the labor market and knew that financial incentives would immensely help in retaining talent. While the company might have been able to negotiate a higher selling price in lieu of the financial incentives provided for its workforce, ultimately, the retention strategy will likely pay dividends since the workforce interests are entirely aligned with the company's, and all will be remunerated upon achievement of earnout targets.

The most common retention strategy is financial remuneration. However, as can be seen in the example above, retention strategies should not end there.

Retention strategies have evolved to include:

- Open communication and information sharing;
- Managerial and organizational support; and

- Financial awards.

Critical to success is, whenever possible, open communication within the organization and across organizations to share information in order to build relationships that will cement the transaction's short- and long-term viability. Most employees need and want to feel respect and support within their organization.

Including them in the process, even just to share post-transaction plans, will demonstrate that the organization values each employee's contribution and well-being. And this helps to build trust and loyalty.

Messaging from management and the buyer assures employees that all changes will benefit all parties and will assist with employee buy-in for the vision of the newly acquired organization. Of course, a retention program with a cash component helps.

Parties can strategize on how to most effectively provide such awards, whether through a time-based or performance-based metric and, if available, equity incentives that could be time or performance-based.

It is important to consider the entire workforce, not only the buying and selling parties, when entering into an M&A transaction. In the past, retention strategies that included cash bonuses may have been enough to ensure a successful transaction and high workforce retention.

Times have changed, however, and in today's climate, while a straight cash component is important, parties should be aware that cash alone will not address employees' need to feel important and valued. Furthermore, with the hot labor market, buyers and sellers need to differentiate themselves from other potential employers, who are undoubtedly offering large cash awards to prospects.

As such, a well-implemented strategy must begin prior to the transaction closing, commencing with communication from both the buyer's and seller's management team. This will ideally allow both organizations to provide the support employees need to understand their roles in the new organization and demonstrate via remuneration and transparency that the organization values the human capital that leads to success.

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