Mercer

delivering
the deal

The unrealized potential of people in deal value creation

welcome to brighter

Contents

Foreword

Of all the capital and resources a company has, people remain the most important asset. This has become even clearer during a unique and difficult time. The remote, decentralized workflows many had to adapt in 2020 due to COVID-19 emphasized how essential an agile and resilient workforce is to most bottom lines. The importance of people also holds true in deals. The stakes are high: Investors and companies undertake deals to create value. Our research indicates that 47% of deals that fail do so primarily due to a lack of strategic planning and execution rigor related to people risks.

This report examines what that means to dealmakers worldwide as they look ahead, drawing from a wide variety of datasets and insights. The significant body of data explored in this piece reveals practical insights from an in-depth survey of deal professionals across the entire transactional spectrum.

First, we set the stage by analyzing the most recent trends evident across dealmaking data. From there, we examine how dealmakers' priorities and strategies have evolved and are set to change further in the broader context of economic and market environments. We conclude with a detailed discussion of how executives are managing issues pertaining to people — the most valuable and volatile element of a given transaction. Because following the close of a deal, your people are the key to execution.

We address many pressing questions in the following pages: How have people risks in deals evolved throughout the pandemic era? How are they set to change over the next few years? What are the best practices for identifying the talent needed to deliver after a deal is closed? How do you nurture your teams to seize the opportunities presented by a successful merger? How are emerging issues like diversity, equity and inclusion (DEI) being addressed in deals?

47%

On average, of deals that fail, nearly half do so primarily due to a failure to strategically identify and address people issues.

There is a clear connection between the rigor with which people issues are proactively addressed and the likelihood of deal success. Aligning the deal thesis with how leadership acts, the organizational behaviors the culture reinforces, and the talent skill sets retained and attracted is key. We hope you enjoy our analysis, insights and perspectives as we all look to partner with our clients as they transform for the better and move toward a brighter future.

Mercer's Global M&A Advisory Services Team

Key findings

1. Businesses still rely on mergers and acquisitions (M&A) to achieve growth and outpace competition. Given the climate of accommodative financing and stakeholder demand for growth, this trend appears set to intensify over the next decade, especially in sectors most challenged by the pandemic.

2. Investment trends show that even the pandemic did not substantially slow the volume of dealmaking, testifying to its importance. Furthermore, record corporate and financial sponsor cash hoards promise ample supply for future investment, especially in M&A.

3. In the first half of the 2020s, companies will prioritize implementing the digital tools and services in which they've already invested, whether as part of a deal or as organic innovation.

4. Dealmakers rate financial impacts as their primary concern and competition as their main impetus for M&A. Companies will position themselves for success over the next half-decade by achieving scale before competitors — not only across traditional footprints but also through new geographies or offerings after the deal is done.

5. The top priorities of dealmakers throughout a transaction's life cycle are operational stability, customer and client retention, and a bespoke value-creation roadmap for due diligence.

6. There are clear links between people risks and the top business and deal priorities mentioned above. Leadership, critical talent and organizational culture must be prioritized starting in the due-diligence period to help ensure that a company achieves its strategic objectives.

7. The most critical yet underrated aspect of achieving success in deals is people risk management. Survey respondents identify failure to align leadership and ensure the unified business culture supports the deal thesis as the primary detractors to deals following close. Developing a variety of specific strategies to retain critical talent is also imperative.

The most overlooked and undervalued lever of a successful deal is found in the management, or in many cases, the mismanagement of the people element.

CFO, Fortune 500 Company, US$28 billion in annual revenue

Demographics and macro M&A trends

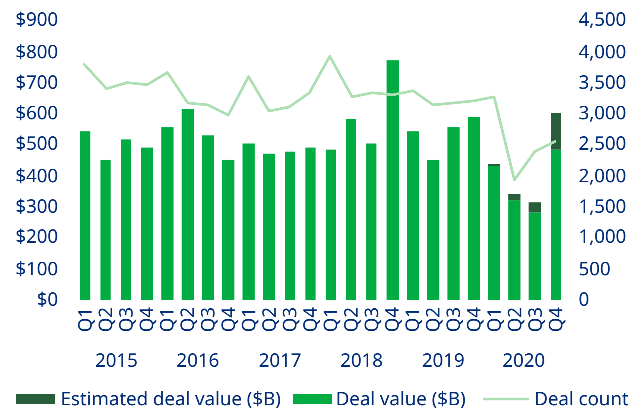
The M&A cycle remains resilient

It is worth providing some context, as the macro market environment doubtless influenced how dealmakers adapted their strategies, especially in terms of their outlook for 2021. After an initial sharp dip in global M&A volume in Q2 2020, there was a modest recovery in activity across most regions, although rebound rates varied. Apart from APAC, however, aggregates of deal value recovered or resurged much more significantly. This resilience was driven not just by significant governmental support through both fiscal and monetary policy but by a recognition by dealmakers of the unique nature of the COVID-19 shock. Some sectors saw unprecedented acceleration, leading to outperformance, whereas others saw multiple businesses experience significant distress. Such pressures led to opportunistic dealmaking, yielding the rebound in the M&A cycle in a sign of overall resilience.

The rise of private equity and corporate cash

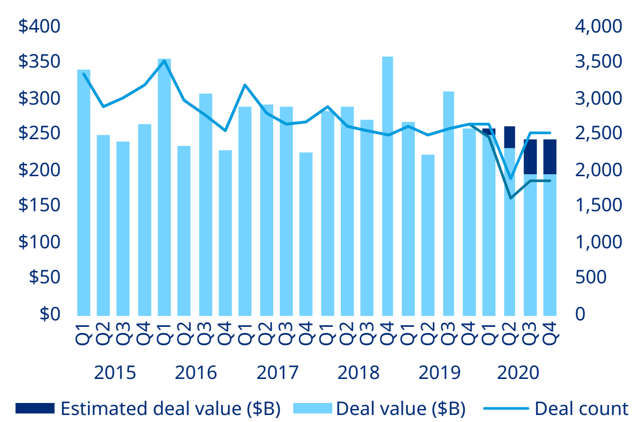
Dealmakers with a focus on both financial and strategic transactions represent a significant portion of the survey population, although private equity (PE) constitutes the majority. This mix of representation aligns with recent findings from the latest editions of PitchBook reports focused on M&A. Financial sponsors

Figure 1a. North American M&A activity



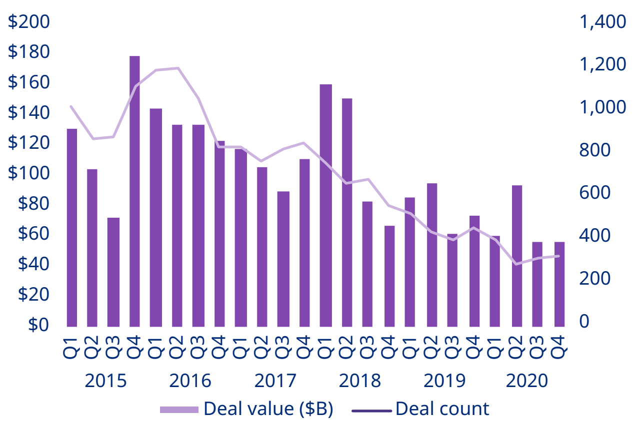
Source: PitchBook

Figure 1b. European M&A activity



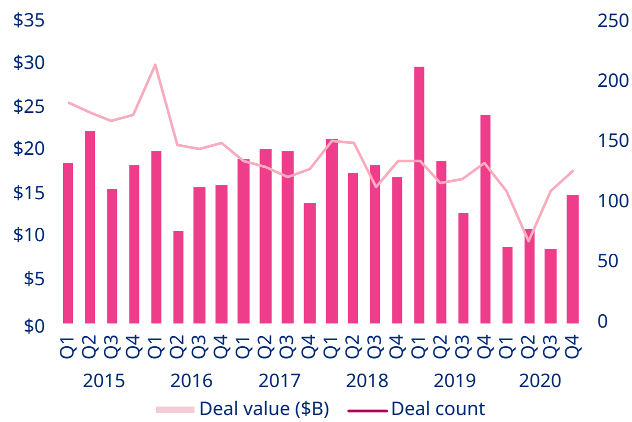
Source: PitchBook

Figure 1c. APAC M&A activity



Source: PitchBook

Figure 1d. Latin American M&A activity



Source: PitchBook

are playing an increasingly important role in M&A, particularly concerning carve-outs. PE drove more than one-third of carve-outs in 2020, marking the highest level since 2006. Such prolific activity is likely to continue. PE firms hold well over a trillion dollars in dry powder per PitchBook data. Beyond that, US nonfinancial corporations alone were sitting on close to US$4 trillion in cash and marketable securities in 2019.[1]

The appetite for dealmaking is strong — and on the upswing

What such an environment suggests for dealmakers, as our survey results also indicate, is significant pent-up appetite for both defensive consolidation and growth via acquisition. The unprecedented boom in special-purpose acquisition companies (SPACs) is another hallmark of the hunger for dealmaking. In the US alone, SPACs have raised more than US$125 billion in capital markets since the start of 2020. By themselves, these acquisitions will help drive a significant number of transactions over the next two years. But in combination with the multiple bullish factors stirring in the market, these trends could lead to a resurgence in M&A to historic levels — in 2021 and beyond.

PE drove more than one-third of North American carveouts in 2020, marking the highest level since 2006.

1. Faulkender MW, Hankins KW and Petersen MA. "Understanding the Rise in Corporate Cash: Precautionary Savings or Foreign Taxes," *The Review of Financial Studies*, Volume 32, Issue 9 (September 2019), pp. 3299–3334.

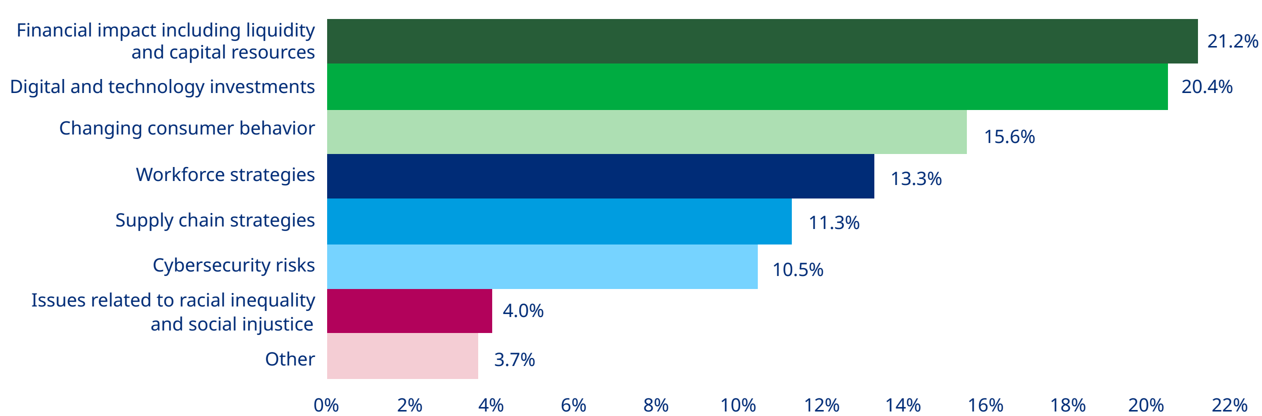
Current and evolving business strategies

Business leaders are primarily seeking growth via acquisitions

For years, a persistent low-growth environment across much of the globe has encouraged corporations to seek growth via acquisitions. M&A is likely to intensify in 2021 as companies seek to adapt strategies and fortify their businesses in response to the uncertainties of the COVID-19 pandemic. Nevertheless, the extreme volatility currently characterizing both economic and financial markets means efficiency will be paramount.

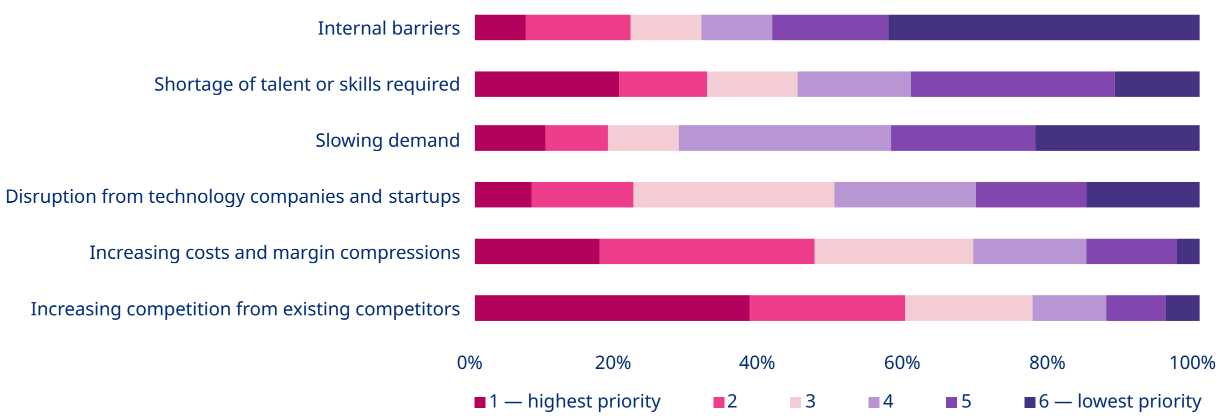
Optimism is waxing. A recent survey of 39 forecasters performed by the Federal Reserve Bank of Philadelphia showed an expectation of real gross domestic product (GDP) growth at an annual rate of 4.5% in 2021.[2] This would make 2021 one of the best-performing years in some time. However, substantial risks remain, inducing caution in operators based on how highly they rated the financial impacts of 2020's challenges. While seizing and prioritizing opportunities for organic growth where they can, executives are still focused on efficiency and ensuring robust, safe return prospects for investments and transactions.

Figure 2. Top business concerns



2. Federal Reserve Bank of Philadelphia. *First Quarter 2021 Survey of Professional Forecasters: Stronger Economic Rebound With Lower Unemployment*, February 12, 2021.

Figure 3. Breaking down the most significant barriers to growth by priority



Digital: The primary focus area for optimization

Digital capabilities and overall technological improvement are high among deal priorities. But it's just as crucial to find the right people to implement those improvements — or retain the right people to execute digital initiatives that are often part of the transaction. The pandemic essentially mandated robust digital infrastructure and offerings for nearly every company. Although executives across sectors were already aware of this digital evolution, the rate of change varied considerably before 2020.

Executives are now assessing previous investments into technology and outstanding technological needs as they seek to capitalize on rebounding economic growth. The importance of having secure, remote-enabled workflow tools and processes across all business units is well-known. What remains uncertain is what further technological evolution is needed to unlock employee potential and deliver on the implied synergies from any deals or investments. Possible answers are being explored.

For example, some companies are trying to establish more fluid and holistic integration across communication channels to avoid burnout and help employees with various personalities and work styles thrive. As executives consider new vendors and partners to empower their teams, investment into digital tools and services critical for future growth and efficient product and service delivery will continue to motivate acquisitions.

Keeping up with competitors and managing costs

Consolidation in many key industries has been a primary feature of market and M&A cycles of the past decade. As competitors grew, companies came under greater pressure to bolster offerings and reduce prices to maintain an edge—a finding backed by our research. Surveyed executives ranked increasing competition as the most significant barrier to growth heading into 2021. This motivation is a key indicator of high M&A volume, further explaining the increased appetite for dealmaking. It also explains the emphasis on solidifying the core base, growing into adjacent businesses and entering new markets as strategic drivers for M&A.

As executives respond to the digital investment mandate, they are increasingly concerned about rising costs contributing to smaller margins. They seek to trim expenses by acquiring any technology that will automate time-consuming, expensive processes. The opportunity for better bargains from suppliers and vendors provides further incentive for M&A. Adding nuance to current dealmaker motives, our survey found that optimism abounds, with most respondents expecting sales revenue to increase over the next 12 months.

However, many respondents also anticipate a rise in employee costs, most likely driven by a recovering labor market in key sectors.

These findings paint a picture of drive and optimism. Executives are looking to grow primarily through M&A, seeking to stay abreast of competitors. However, they also remain cautious about costs, which creates even more pressure to realize the implied synergies post-transaction. If nearly half of deals fail due to poor anticipation and management of the talent required to realize the incipient benefits, increasing pressure around managing the people aspects will continue to characterize the M&A landscape.

57% of survey respondents indicate increasing appetite for M&A over the next 12 to 24 months.

Figure 4. Eager to strike deals

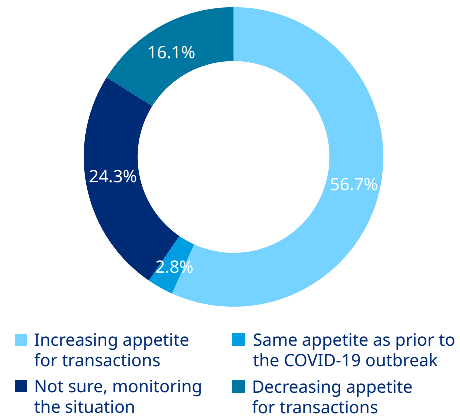
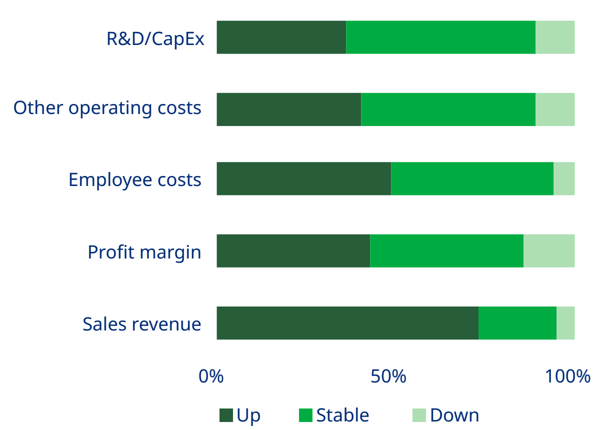


Figure 5. Expectations* around changes in financial metrics



* Based on current business performance.

Priorities across the deal life cycle

Value creation is critical and complex

Everyone agrees that value creation in a deal should be a priority. But how does it play out across all other issues that dealmakers must prioritize? What are the actual steps toward value creation? Weaving together insights from survey respondents and case studies, we find the following top priorities across deal phases:

1. **Operational stability:** Most executives agree this is the best place to start. One of the most important variables in a company's operations — its talent — requires a firm standing to keep the business running smoothly while undergoing the close of a deal and during longer-term integration. Because the prime motivators of M&A are solidifying competitive positions and achieving growth, organizational structures and sector-based knowledge need to translate across both cultures — no matter how different they are. Although our research and deal experience have shown that coordinating these can be challenging, when parties explicitly plan for it, this stability enables ultimate deal value achievement.

2. **Customer and client retention:** Retention is often the result of such operational stability. Executives cite retention as another high priority, to be mapped out through value-creation analysis during due diligence. But at the core of retention is the relationship between key players across teams. These connections highlight the importance of

Figure 6. The top priority when preparing for a sale

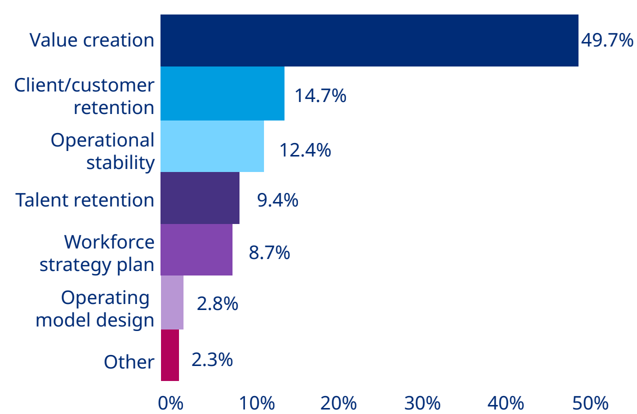


Figure 7. Significant post-close issues that hamper value creation

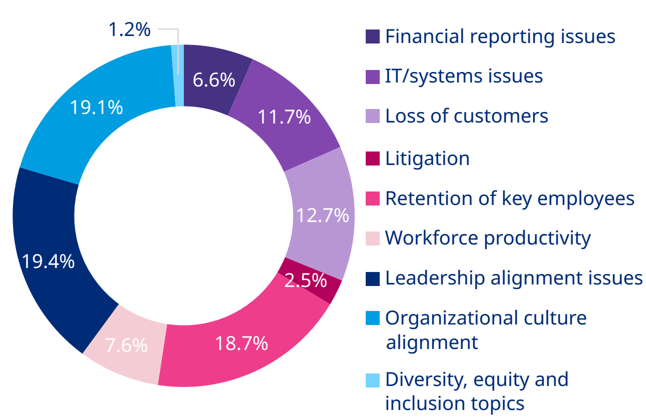


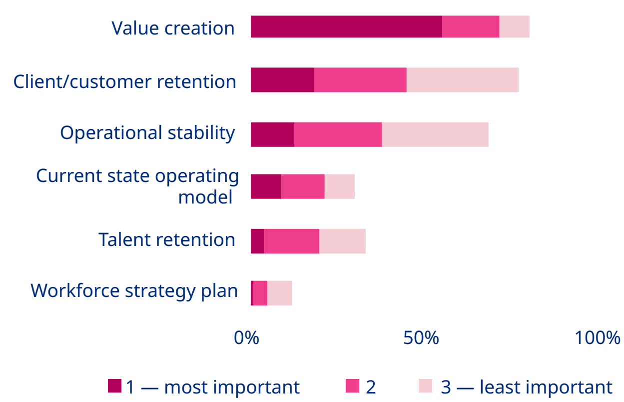
Figure 8. The most important value creation levers

retaining critical talent — the linchpins of essential customer relationships during any period of transition.

3. **Bespoke value-creation:** This process is essential for due diligence and sale preparation on both sides of the deal. Because every value-creation process is unique, companies need to understand which factors will differ in advance. In the current environment, however, the most critical levers of value creation to pull are the following:

   - **Strategies for acquisitive growth:** Especially in current market conditions, a crucial step in many transactions is identifying other

Figure 9. Value creation from most to least important



Broad and deep workforce due diligence is key to successful M&A and collaborations: Value resides in people, from the bench to the leadership team.

Founding partner, private equity, assets of US$38 billion opportunities to consolidate market share. Ensuring that business and technical systems, such as payroll, are fully integrated before closing on more acquisitions is essential. Integration across talent also matters; changing priorities should only occur after the initial deal is safely completed and synergies are achieved.

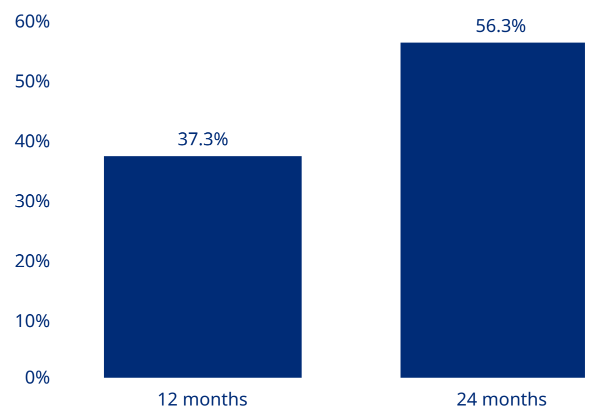
- **Channel strategy optimization:** To respond to changing purchasing behaviors, companies should consider their current roster of channels and how it may need to evolve. Any changes should be clearly aligned with investment into digital tools or services. Companies should also evaluate any additional skill sets and talent they may need to deliver on current or new channels.

- **New product development:** Along with channel evolution and expansion, companies need to identify desired changes to product and service inventory in response to changing customer preferences. This will require innovative thinking and market research on the part of multiple players across teams. It may also require new leader and broad workforce skill sets. Thus, advance coordination will be essential.

13%

Average overall integration costs were estimated at just over 13% of total deal value.

Figure 10. Overall proportion of projected revenue synergy obtained over time



Assessing spend across a deal's lifecycle

All this requires a delicate spending balance. Our research indicates that average overall integration costs were estimated at just over 13% of total deal value. But intriguingly, the average amount of revenue synergy achieved between 12 and 24 months grew by approximately 19%. This implies that executives could spend more on integration to increase that figure and maximize the pay-off from successful deals to further hedge against a deal not delivering. Regardless, value creation can be a lengthy process, and trying to accelerate it without all aspects planned out is difficult and even dangerous. Nothing can be left to chance in such a high-stakes game. As we show later in this report, strategies for transforming a merged entity's workforce are critical and need to be approached with discipline.

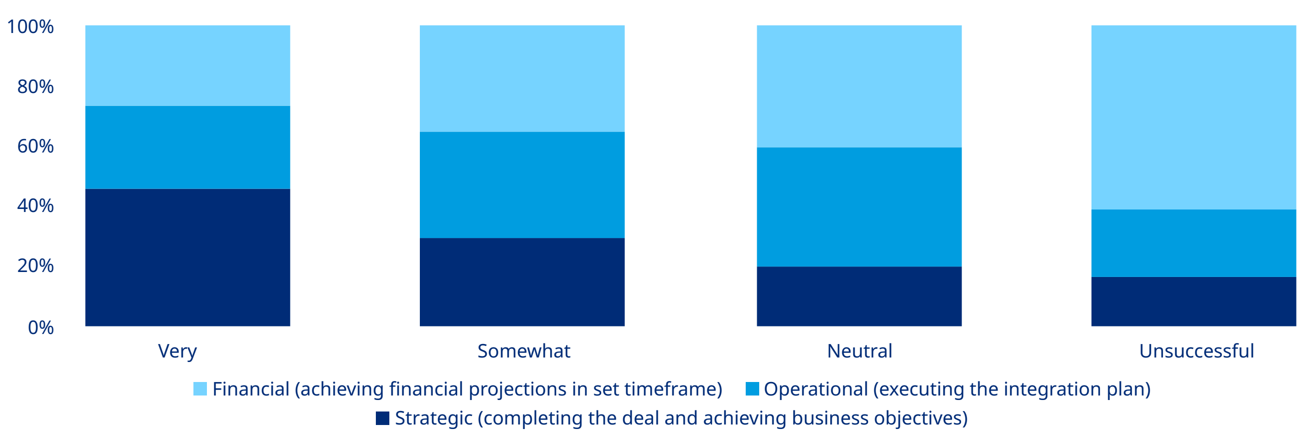
> **Value creation happens when you are able to reduce friction — streamlining processes and understanding what is needed to be successful in each stage.**
>
> Managing director, private equity, assets of US$95 billion

But despite the lengthy process, the marketplace's recent appetite for dealmaking suggests that the value creation is worth it. Academic evidence confirms this. For example, a 2017 study in the *Journal of Corporate Finance* finds that a likely improvement in corporate governance has helped M&A generate greater value creation since 2009.[3] However, integration cost estimates from relevant literature in the mid-2010s ranged lower than the average estimate by executives in our survey. Integration costs have likely risen since those estimates due to the increasing size and complexity of organizations engaging in M&A. PitchBook data showing larger median sizes of M&A deals, particularly those involving PE, bear this out. But even if it's worth it in the long run, such significant spending requires careful scrutiny to avoid achieving the strategic at the expense of the financial.

Have dealmakers been successful? Not always — and not necessarily on time

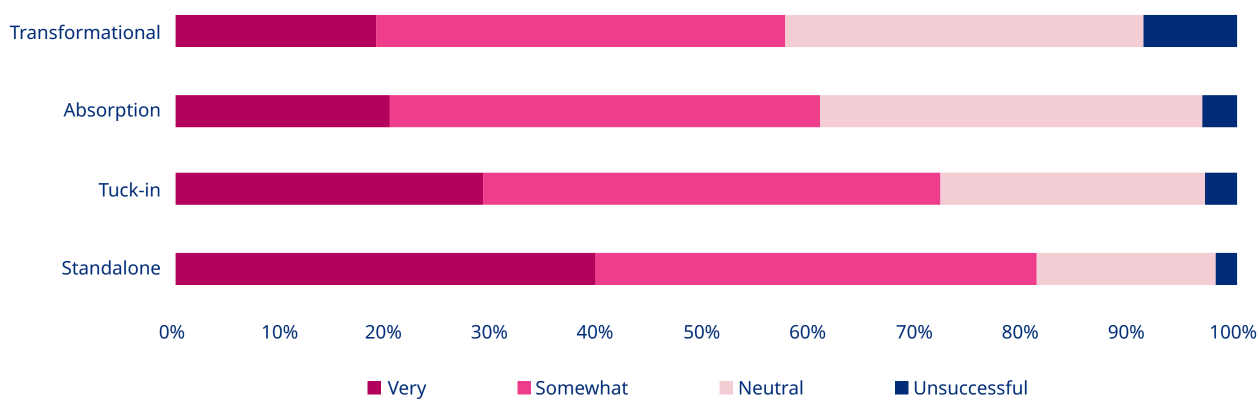
One of the most beneficial insights from the surveyed dealmakers is their candor regarding success in transactions. Overall, respondents indicate that they view the strategic aspects of past M&A as most successful. In other words, the deal closed, and the company met its business objectives. Intriguingly in

Figure 11. Success rates by deal aspects



3. Alexandridis G, Antypas N and Travlos N. "Value Creation From M&As: New Evidence," *Journal of Corporate Finance*, Volume 45 (August 2017), pp. 632–650.

Figure 12. Success rates by deal type



light of increasing integration costs, a clear majority of respondents note that the financial aspect of past deals was only somewhat successful. Namely, achieving financial projections in a set timeframe was not always or even often the case.

Deal type, of course, influences success. The vast majority of surveyed executives agree that standalone deals tend to be very or somewhat successful. Interestingly, transformational M&A has the least success. Placing both those highlights in context is instructive, as it gives us some idea of the types of M&A many dealmakers will pursue in coming years. Transformational M&A is likely the most difficult due to the nature of the deal. Still, mixed opinions regarding the success of even tuck-in or absorptive transactions underline the need to manage all kinds of risks as diligently as possible.

In summary, investors and business leaders are primed to focus on M&A in the coming years. Their priorities as they enter a deal are clear: 1) operational stability, 2) customer and client retention, and 3) generating a bespoke value-creation roadmap as part of due diligence. The stakes of integration are high, so preparation is well worth it. But perhaps the most salient and commonly underestimated risk is the core of operational stability: the people.

> **Trust of leadership, whether new or even existing, once the original founders of a company sell, is critical to post-close value creation.**
>
> COO, healthcare company, US$800 million in annual revenue

How people strategies affect M&A results

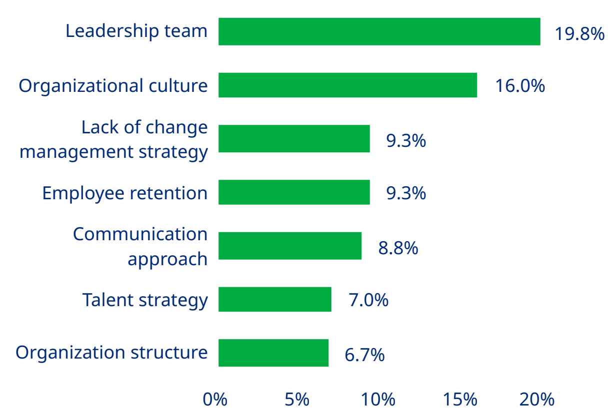
The stakes of ignoring people risks are high

With the ever-increasing complexity of deals and pressure for their success, one vital area of value creation remains consistently untapped: people. The stakes may be even higher than we think.

47%

The average proportion of deals that fail primarily due to not adequately anticipating and addressing people risks

Figure 13. Key aspects of people strategy that derailed deals when left unaddressed



> **In a deal, people cannot be left to chance. Failure to address pain points in your people strategy can have catastrophic consequences.**
>
> CHRO, global supply chain and logistics company, US$48 billion in annual revenue

Figure 14. Primary causes of a failure to meet financial targets outlined in deal modeling

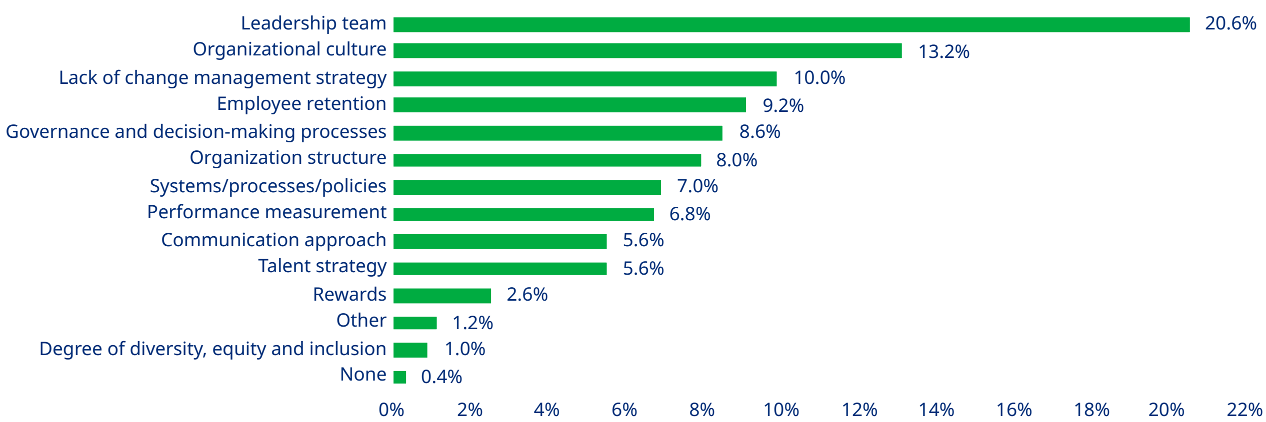
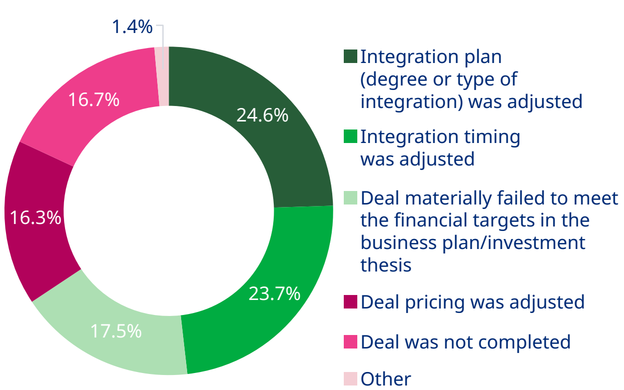


Figure 15. Outcomes due to failure to address workforce issues



The survey findings indicate that even excluding the pandemic's impact, on average, nearly half of deals fail. Moreover, of those failed deals, an average of 47% fail primarily due to people risks.

From that proportion alone, it is easy to conclude that people are critical to delivering on the deal. However, nearly 44% of executives report that workforce risks were not quantified or built into financial models. It is far too common to see people issues deprioritized, not incorporated into due diligence and left unaddressed until post-close. Many leaders still believe people issues cannot be quantified or actioned due to their unique nature; this view ironically heightens overall deal risk. Not only did we find that a significant portion of M&A deals materially fail to meet financial targets due to inadequate planning and management of workforce issues, but integration completion suffered as well.

So the question emerges: How does a company construct a successful people strategy and incorporate it into M&A considerations? First, priorities must be set.

What are the priorities for people strategy in deals?

In any deal, due diligence is the ideal phase in which to consider workforce risks. Some respondents indicate that they opted to start talking through people issues during negotiations. But this isn't how commercial, tax or regulatory elements of the deal thesis are handled. As with those issues, it's best to prioritize the people considerations from the start. As the deal thesis or rationale is being formulated, the impact people will or need to have on both revenue and cost synergy assumptions should be articulated. Based on the significance of post-close issues that hampered value creation, respondents cite their top areas of focus as:

1. Alignment of leadership
2. Alignment of organizational culture
3. Retention of key employees

Leadership

Underscoring the importance of those three factors — the most critical components of people strategy — is the fact that nearly 21% of respondents say poor leadership team performance was responsible for failing to meet financial targets. Respondents also cited a lack of change management strategy. However, when we compare this to the factors that most affect long-term value, it becomes even more apparent that aligning leadership and the overall operating culture of new organizations truly determines realization of deal goals and longer-term results.

In many ways, leaders are the culture of an organization. What they do and how they act send signals to everyone else. These actions are often more powerful than what is said. Companies must retain both formal and informal leaders — the aforementioned key employees — to implement the changes required post-close and achieve projected synergies and strategic objectives.

Figure 16. Average percentage of critical talent retained post-deal

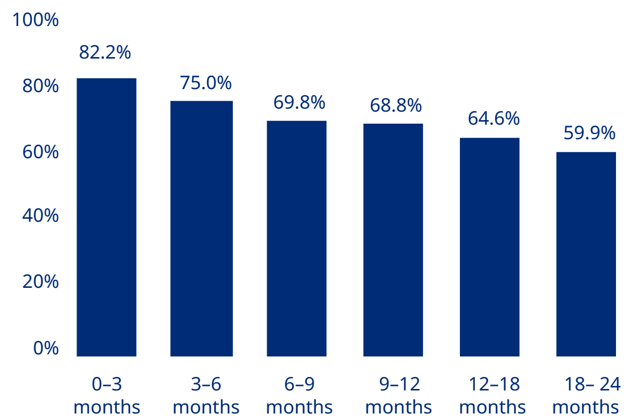
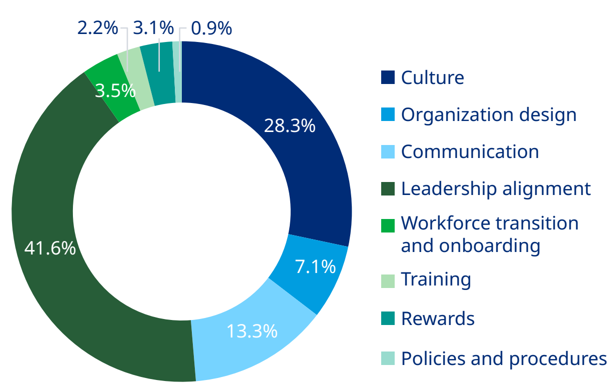


Figure 17. The most critical drivers of long-term value



Talent

It is sobering to note that just 18 to 24 months following the conclusion of a deal, companies retain only 60% of critical talent. This figure is even more sobering when remembering that business leaders view operational stability and customer/client retention as keys to deal value delivery. There are numerous mechanisms to help retain talent. Our findings indicate that the better the alignment of compensation and similar incentives with specific milestones across the integration roadmap, the higher the chances of overall success.

Culture

Respondents view clear accountability and governance as the best tools for empowering leadership and maintaining organizational culture within a merged entity. However, these tactics must be built into the deal process. A deal is more likely to succeed if a company's deal strategy considers the impact people will or need to have holistically, even in the early stages of a transaction. This may mean a plan to preserve or reinvigorate culture or clear procedures for retaining talent and aligning with leadership.

Approximately 40% of critical talent is lost 18-24 months post-transaction, yet leaders cite operational stability and customer retention as deal keys.

When it comes to integration following the close of a deal, it comes down to a simple answer: people, people, people.

CEO, consumer holdings company, US$9 billion in annual revenue

What does it all mean?

Deals are done to create value in the form of revenue and cost synergies. The structure and form may vary, but the bottom line is value creation. This bottom line is put at risk when key people issues are not strategically and proactively considered, such as:

- What behaviors do we need the leadership team to model and reward?
- What cultural components will reinforce the required operating environment?
- How do we retain and attract a workforce with the skill sets needed to deliver the deal thesis?
- Will differences in each organization's approach to DEI hinder our strategy?

These and many other people-related questions can be better understood and addressed as part of a robust deal process. It is up to business leaders to demand that this happen in each deal.

About Mercer's M&A Advisory Services

Our network of global advisors develops custom solutions that leverage the deep expertise we've gained working on more than 1,400 deals per year, 60% of which are cross-border, as well as through our global insights and world-class capabilities across all facets of business.

Mercer believes in building brighter futures by redefining the world of work, reshaping retirement and investment outcomes, and unlocking real health and well-being. Mercer's more than 25,000 employees are based in 44 countries, and the firm operates in over 130 countries. Mercer is a business of Marsh McLennan (NYSE: MMC), the world's leading professional services firm in the areas of risk, strategy and people, with 76,000 colleagues and annual revenue of over $17 billion. Through its market-leading businesses, including Marsh, Guy Carpenter and Oliver Wyman, Marsh McLennan helps clients navigate an increasingly dynamic and complex environment.

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Methodology

All data within this report was sourced from PitchBook or was collected through a survey that captured the insights of more than 750 experienced deal professionals from Fortune 1000 companies or private equity firms. The goal was to understand the future state of M&A and to examine and demystify the importance of people as they relate to value creation in a deal. Respondents were screened to ensure their firsthand knowledge of the deal ecosystem.

Sixty-seven percent of respondents were at executive management levels or higher, with titles including, but not limited to, CEO, founder, CFO, COO, SVP and chair of the board. Respondents were diverse in experience, including deal advisors, business developers, investment bankers, management consultants, lawyers, strategists, human resources professionals and operations professionals. Fifty-six percent of respondents were private equity professionals, with the remaining 44% representing Fortune 1000 companies. The report uses PitchBook's standard methodology to define mergers and acquisitions (M&A) and includes both strategic and financial acquisitions.

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