HEALTH WEALTH CAREER

FLIGHT RISK IN M&A: THE ART AND SCIENCE OF RETAINING TALENT

MERCER RESEARCH REPORT

DATA • INSIGHTS • DIRECTION

EXECUTIVE SUMMARY

MAKE TOMORROW, TODAY

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ABOUT MERCER'S M&A TRANSACTION SERVICES

Mercer's M&A Transaction Services is the pre-eminent global advisor on people issues.

We help buyers and sellers in corporate and private equity transactions mitigate people risks and manage the complex organizational challenges that arise from all types of transactions.

Mercer delivers advice and technology-driven solutions that help organizations meet the health, wealth and career needs of a changing workforce. Mercer's more than 23,000 employees are based in 44 countries and the firm operates in over 130 countries. Mercer is a wholly owned subsidiary of **Marsh & McLennan Companies** (NYSE:MMC), the leading global professional services firm in the areas of risk, strategy and people. With nearly 65,000 colleagues and annual revenue over $14 billion, through its market-leading companies including **Marsh**, **Guy Carpenter** and **Oliver Wyman**, Marsh & McLennan helps clients navigate an increasingly dynamic and complex environment. For more information, visit **www.mercer.com**. Follow Mercer on Twitter **@Mercer**.

Reports Available from Mercer's M&A Readiness Research™ Series

Mitigating Culture Risk to Drive Deal Value joins ***Flight Risk in M&A*** and ***People Risks in M&A Transactions*** as the third in a series of M&A Readiness Research™ reports from Mercer that analyze and recommend best practices in people-related deal issues. To learn more, please visit ***www.mercer.com/ma***.

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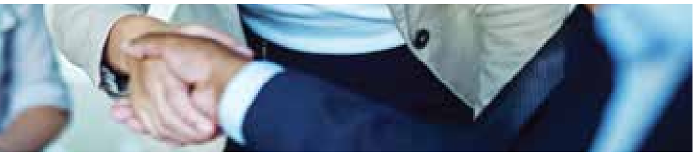
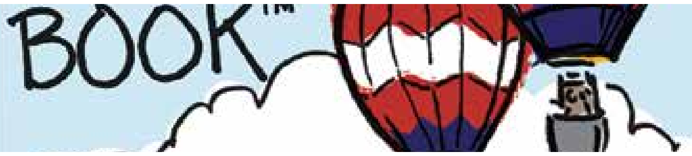




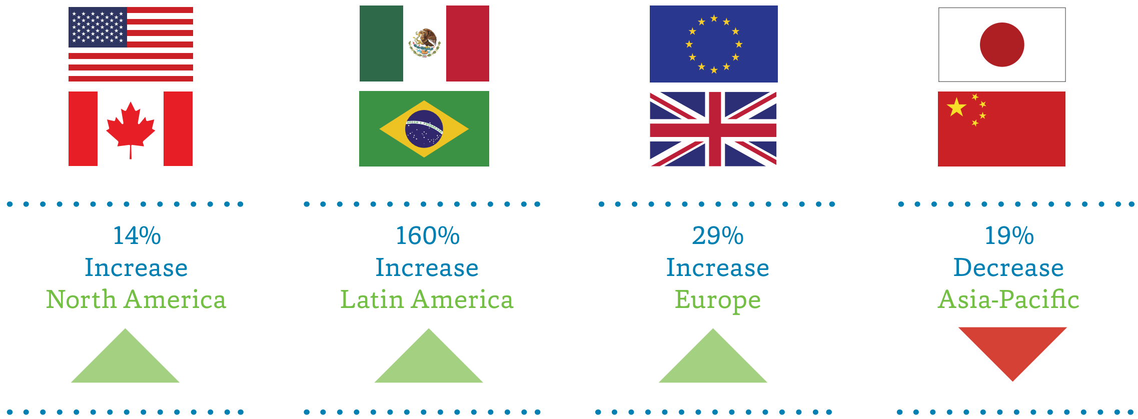
FOREWORD: MAKING PEOPLE THE FOCUS

In spite of the daily geopolitical chaos — be it North Korean military threats, Brexit, Chinese banking reforms, Japan's corporate governance challenges, the Brazilian political crisis or daily turbulence in Washington — **M&A is alive and well.**

Q1 results, however, point to noticeable shifts. To name a few,[1] global M&A volume is down 9%, but deal value is up 12%; the value of China's outbound transactions has dropped by 85%; the value of cross-border deals increased by 10%; activists are now targeting and disrupting companies in North America, Europe and Japan; private equity fundraising has reached record highs; and the average EBITDA multiples (globally) upon exit are at record levels (14.9x).[2]

Consistent with our research findings last year ("People Risks in M&A Transactions": download at www.mercer.com/peoplerisk), buyers continue to take greater risks, operate with much less information, invest in new geographies and deploy unprecedented levels of capital in leveraging cheap debt and credit.

GLOBAL DEAL VALUE[3]



In taking a broad view of business and industry around the world, we see that one common denominator drives deal value: PEOPLE.

In our experience advising on more than 1,200 deals annually, we see clear evidence that buyers who consistently drive exceptional operating results have a disciplined process for identifying, engaging and motivating key talent.

In this report, we dig into the issue at the top of every executive's mind: how to retain and engage key talent during and following a merger or acquisition.

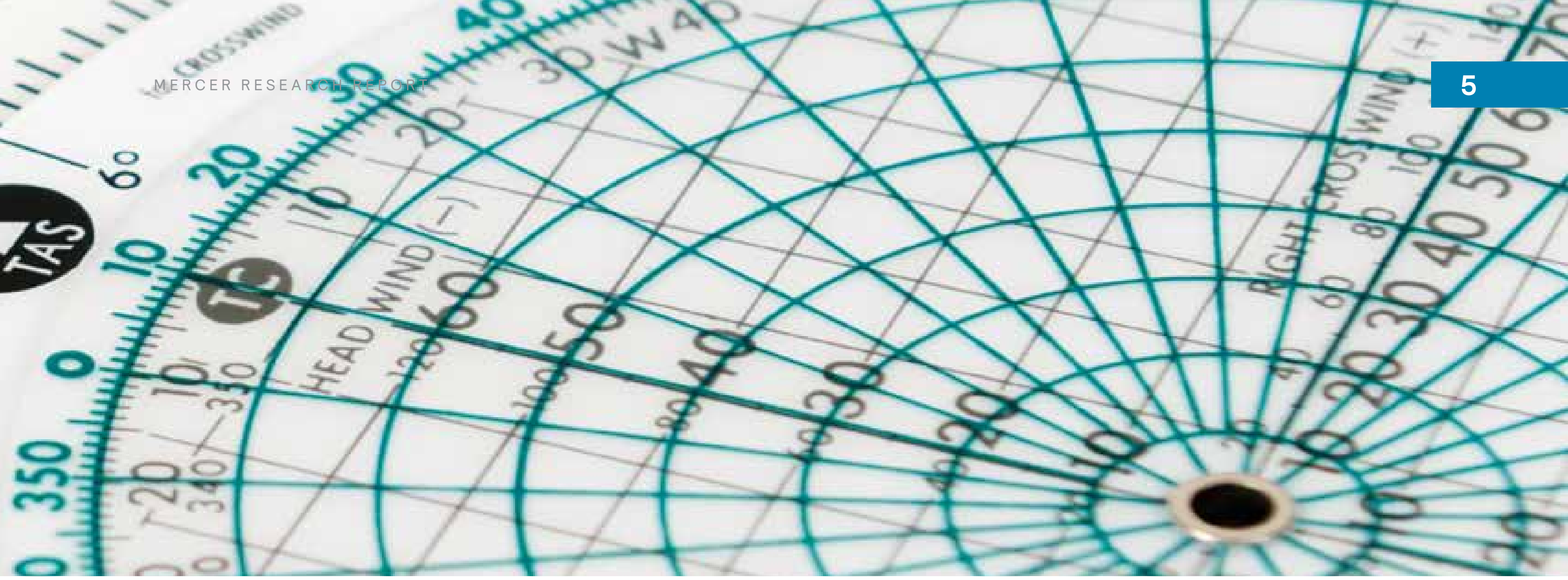
Last year, we researched the people aspects of mergers and acquisitions to help you sharpen your focus and learn about emerging trends through the lens of deal experts. We shared insights that highlighted people-related transaction risks and introduced practical strategies and solutions to help deliver economic value.

Still, both the buyers and the sellers we polled needed specific data and a process to help them identify and retain key talent during transactions.

This year's report documents effective strategies and evolving trends in employee retention. We pinpoint specific actions that organizations can take to hedge flight risk, engage key talent and drive an affordable retention plan as part of an M&A transaction.

THE TOP FIVE PEOPLE ISSUES IDENTIFIED (IN RANK ORDER)

1. EMPLOYEE RETENTION
2. Cultural and organizational fit/integration
3. Leadership team (determining the quality of the management team/executives for the new company)
4. Compensation and benefit levels (market pay concerns)
5. Talent availability, as well as identifying, assessing and placing talent



Making the wrong investment decisions in talent can cripple a deal. Often, organizations operate in a silo, focusing on the necessary nuts and bolts of transactions, like operating margins and cash flow, while overlooking a critical aspect of the deal — people.

Too frequently, retention schemes focus only on those at the top. Our research shows that the “Rising Middle Stars” are essential to keep organizations operating smoothly during and after a merger or acquisition.

This report introduces effective strategies for employee retention, leveraging new data to significantly improve your chances of a successful transition.

I would like to thank all the participants who shared their experiences, perspectives and expertise in helping us prepare this valuable research. Equally deserving of thanks are the dedicated Mercer professionals who helped bring this report to life.

JEFF COX
Senior Partner
Global M&A Transaction Services Leader, Mercer

> “The idea that an organization’s workforce is an asset — rather than simply a business cost — is now broadly embraced by business leaders everywhere.”
>
> — Haig R. Nalbantian
> Co-Leader, Mercer Workforce Sciences Institute

EXECUTIVE SUMMARY

LITTLE ROOM FOR ERROR

We are experiencing another year of a brutally competitive, full-on seller's market around the world. As such, buyers are paying record multiples and taking on unprecedented risk in order to complete transactions. In today's environment, where capital is abundant and cheap, the opposite is true for talent. Top performers are expensive to replace. And buyers are vulnerable to the flight risk of key talent in most transactions. The organizational change involved in most deals puts people on edge, and they opt out or disengage without an added incentive to stay focused.

"The common denominator consistently driving economic value is having the right people on board to execute post-close. At no time globally have we seen it so critical for buyers and sellers both, who want to drive shareholder value, lock down talent at the top and including those 'Rising Middle Stars' critical for execution," said Konrad Deiters, Mercer's EuroPac M&A Transaction Services Leader.

Successful acquirers around the world routinely manage their people assets with the same rigor and discipline with which they manage balance sheet risk. They concentrate on three primary people practices to drive value:

RETENTION BONUS PREVALENCE*

89%	Japan
76%	United States
68%	Europe (Excluding UK)
64%	United Kingdom
63%	Canada
58%	Latin America
58%	Asia (Excluding Japan)

* Buyers regardless of target location

1

ENGAGE THE WORKFORCE

The first step is to commit to an investment in change management communications. This starts with defining a culture that is tangible, assigning decision-making rights, risk management, accountability and governance.

2

EVENT MANAGEMENT AROUND RETAINING TOP TALENT

Retention programs are viewed as insurance policies to hedge against flight risk in transactions. By applying Mercer's framework, buyers and sellers can effectively lock down critical talent and drive operational excellence post-close.

3

ALIGN REWARDS WITH BEHAVIORS

Aligning total rewards (compensation, long-term incentives, benefits, etc.) is foundational to driving behaviors within the organization to unlock true value.

FOCUS ON RETAINING TOP TALENT, NOT JUST TOP EXECUTIVES

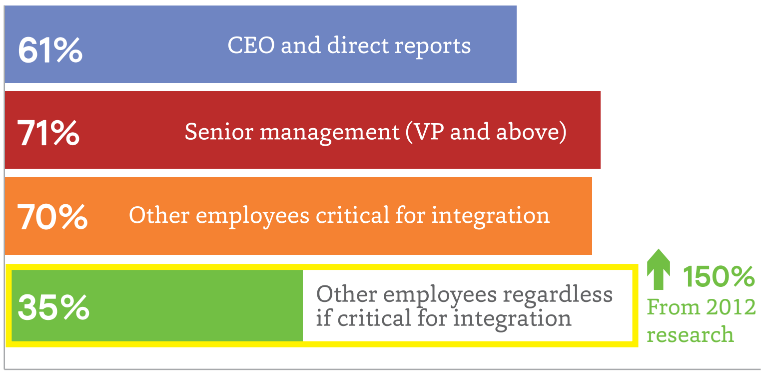
We uncovered some key insights that are important to call out because they were quite different from the last time we looked at retention in M&A back in 2012.

One significant finding is that successful acquirers are taking a people-first, bottom-up approach when designing retention programs. They're not first budgeting for retention and distributing to employees ("top down" approach); they're focusing on talent first, making sure retention is designed with a focus on key employees.

This bottom-up approach also revealed another significant trend — retention programs are expanding outside of the C-suite. Buyers and sellers are definitely getting more nuanced about whom they offer retention to and how deeply and broadly to go into the acquired organization.

> "We reached deeper down into the organization [with retention] just to make sure that nothing critical was going to break after close."
>
> – M&A deal professional, health care company, 2,100 employees, €1.06 billion in revenue

ELIGIBILITY FOR RETENTION BONUSES GLOBALLY

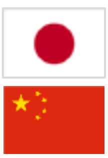


This research was triggered by last year's "People Risks in M&A Transactions" *(www.mercer.com/peoplerisk)* report, which found that **employee retention was (and continues to be) the number one perceived people risk for global deal makers**. We based these findings on comprehensive survey responses from 243 global business professionals reporting on 212 discrete closed transactions. We also conducted 82 in-depth interviews with a combination of investment bankers, lawyers, private equity deal leads and corporate buyers/sellers. Collectively, the participants have been engaged in over 1,500 closed transactions in the past five years. Most companies (69%) represented by respondents had 5,000 or more employees, and 77% had annual global revenue exceeding US$1 billion.

Consistent with our experiences working on over 1,200 transactions annually, **smart buyers are more frequently leveraging enhanced severance programs to drive affordable short-term retention. Of course, all have access to market pay data for budgeting to ensure they do not overspend.**

RETENTION BONUS AS A PERCENTAGE OF BASE PAY

	25th percentile	Median	75th percentile
CEOs	51%	100%	200%
Executives (CEO's direct reports)	39%	75%	150%
Senior management	25%	50%	100%
Other critical employees	15%	25%	50%



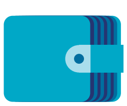
Asia Outbound

↑ **50%**
All Levels on Average

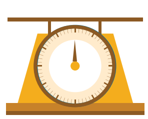
Technology Industry

↑ **49%**
All Levels on Average

OUR RESEARCH ANALYZED THE MOST COMMON PRACTICES OF RETENTION PLAN DESIGN, INCLUDING:



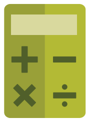
Vehicle for payments
cash vs. equity



Conditions for payment
time vs. performance

Number of payments
one, two or more

Timing of payments
pre-close, post-close, etc.



Individual retention bonus
as a percentage of base pay

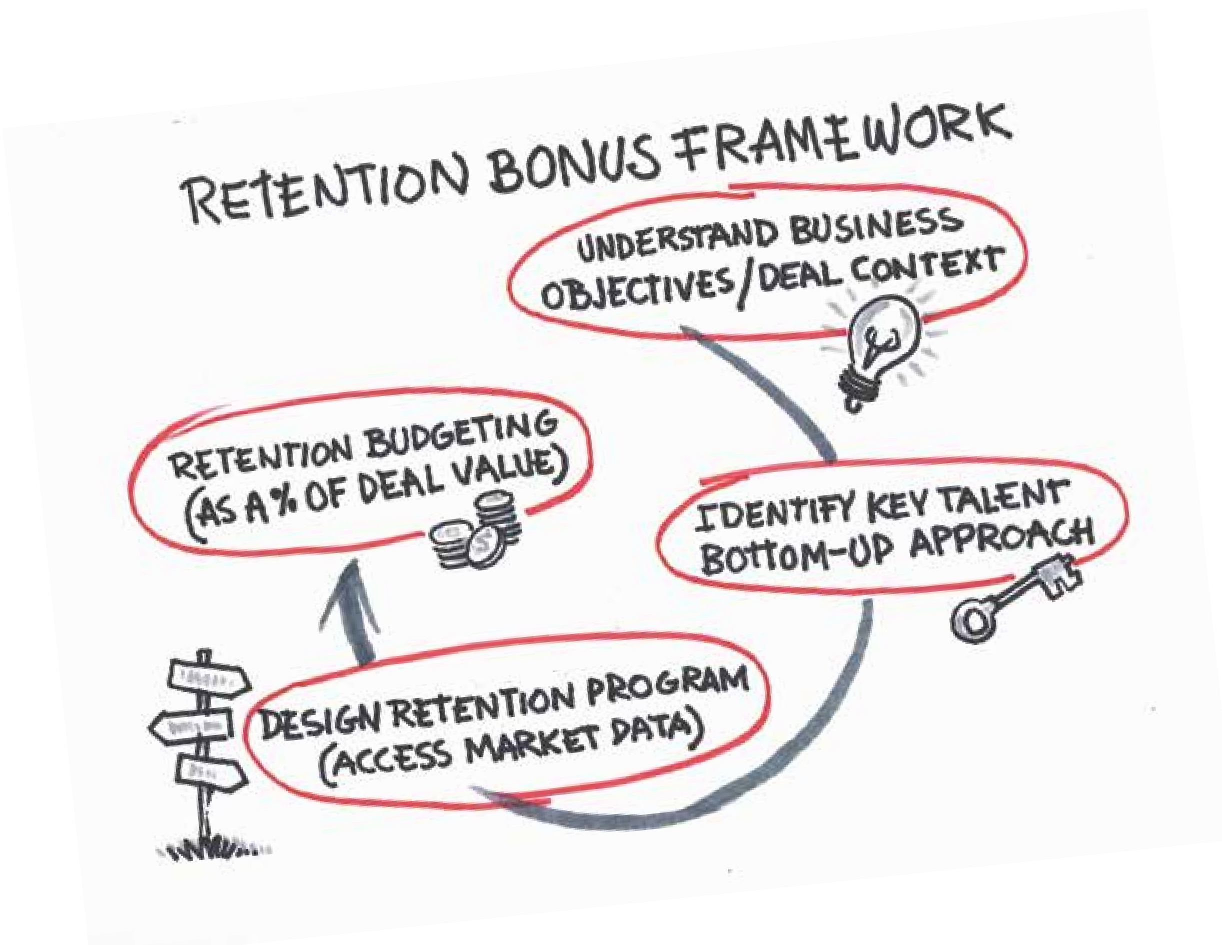
> "When you're in the professional services industry, your greatest asset walks out the door at 5 pm … balancing the art and science of retaining talent is critical to driving deal value."
>
> – Corporate development leader, professional services firm, 60,000 employees, US$12 billion in revenue

FRAMEWORK FOR SUCCESS

The research was conclusive. Well-designed and implemented retention programs are viewed as "insurance policies." They keep the right people focused and engaged through integration. There is, however, no one silver bullet for buyers trying to solve deal-specific talent retention needs. While analysis of the global data uncovered regional and industry differences crucial to understand, everyone must first start in the same place in the process — with a clear understanding of the deal thesis.

"Successful buyers have elevated their retention strategies from an art to a repeatable science. The results are tangible and clear — increased productivity, engagement, owner-like behaviors and accountability," said Jeff Cox, Mercer's Global M&A Transaction Services Leader.

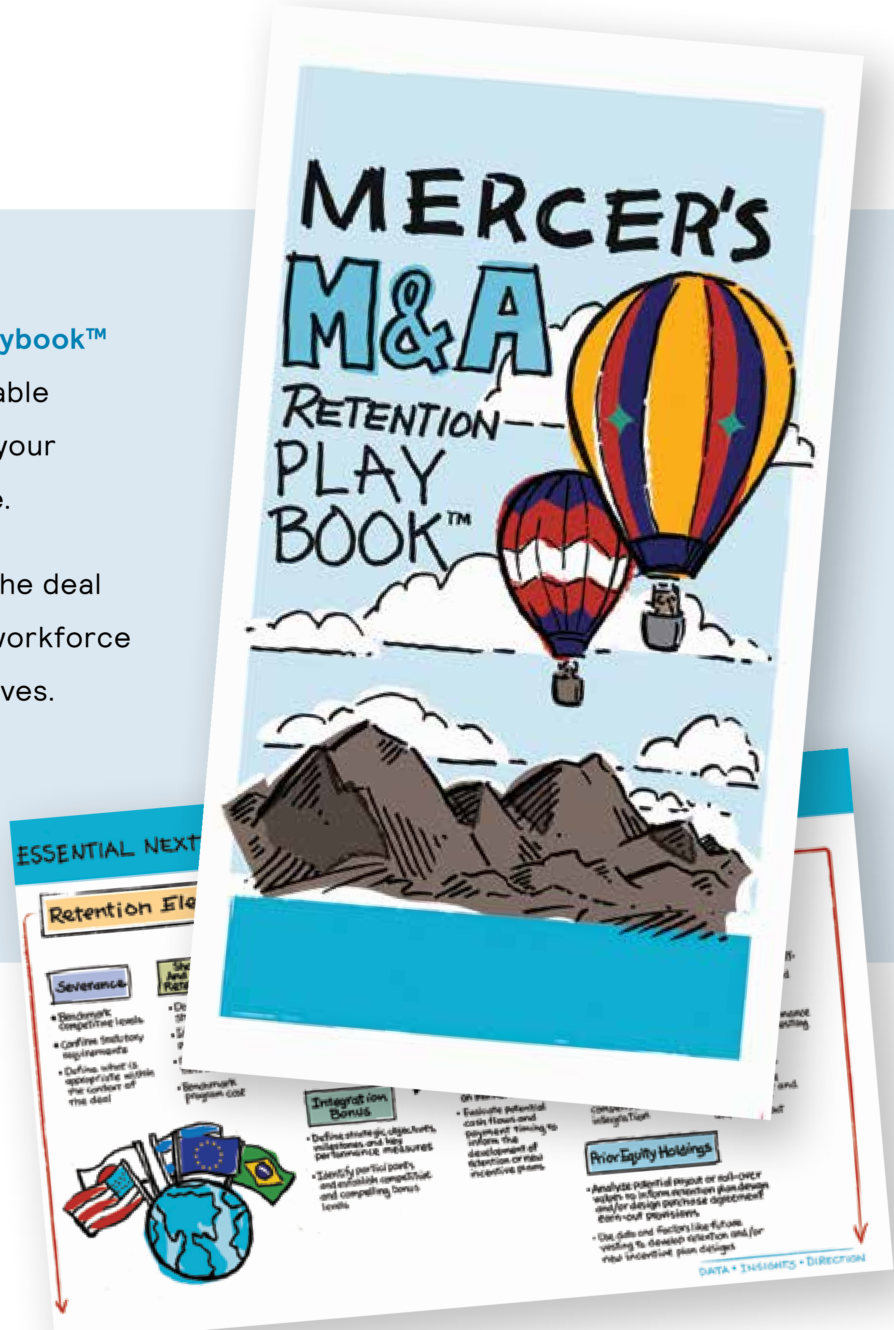
This report introduces a best-in-class retention framework (Mercer's Retention Playbook™) for structuring financial incentives that are time sensitive, market competitive and aligned with business objectives. Adopting this framework will arm you with a comprehensive, repeatable process that will drive operational certainty with engaged and focused talent post-close.



MERCER'S RETENTION PLAYBOOK

Mercer's M&A Talent Retention Playbook™ provides a comprehensive, repeatable process framework to help retain your most valuable asset — your people.

It's important to first understand the deal objectives and then segment the workforce needed to deliver on those objectives. from there, you have options. To learn more, please visit **www.mercer.com/retention**.



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