HaRe Group newsletter: **17 October 2006**

Subject: **Merger money matters**

In any industry, a merger of companies sends a strong message to the market: the successor company will be dedicated to growth and to new business strategies that will improve the new organisation's performance. Another less desirable message is that talented employees may be unsettled by the merger (or any large transformation) and will be more vulnerable to poaching.

Market surveys generally show that the greatest concern of merging companies is retaining their best people. In response, these companies usually offer "stay-on" (retention) incentives to the employees they need to keep focused on the future of the new organisation.

A critical factor is how much "walk-away" money employees would receive from the merger. For people without share ownership (and usually with less means to walk away), stay-on incentives should at least cover their walk-away money. These incentives could be half of three, six, or nine months of a competitive salary (depending upon how valuable the employees are). Staggered payments at key intervals can help provide a good solution.

Some executives who have predecessor company shares may need a stay-on incentive of up to their Total Annual Remuneration (including latest bonus payments). Top executives may require 100% of TAR, *plus* the value of their annual equity grant. In many cases, it may help to provide executives with half of their stay-on payment in cash and half in performance rights, so they are more motivated to make the integration successful.

Retention incentives are often phased over time. For example, one successor company offered a group of "acquired" managers a stay-on bonus of 20-50% of salary, accruing monthly over 6-12 months, depending on their level. In another case, integration teams received bonuses drawn from a pool that supplied funds only as milestone targets were met.

A long integration period will cause greater difficulty in retaining talented employees. In these situations, certain people may require additional incentives, along with clear assurances of their future roles. In any event, <u>it is critically important to keep all employees fully informed</u>, including the acquiring company employees whose positions may overlap those of people in the acquired company.

When all has been done to encourage the retention of key people, attention must shift to terminations. The best long-term strategy usually includes a generous severance plan: the short-term cost may be high, but good plans will have a positive influence on the morale of all remaining employees. For example, in a merger of two manufacturers, only some of the unwanted executives in the acquired company had golden parachutes. To encourage other employees to walk away, the acquiring company offered them congruent severance packages. The executives who were asked to stay received performance-based cash and equity incentives that exceeded their walk-away money. Thanks to this approach, the remaining employees are more engaged with the future of the new organisation.

Market research shows that attractive incentives will help maintain performance and retain key people, but the payments may add significantly to the total cost of a merger – possibly enough to obliterate the short term value of the union. The challenge for the merged company is to remain focused on what its talented employees must do to achieve long term success.

Simon Hare

HaRe Group