Talent flight: Overlooked risks during M&A

How to retain talent during acquisition and integration to preserve deal value

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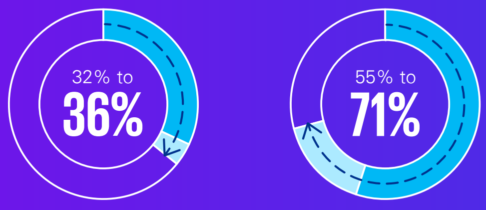
Introduction

Most acquirers seem to understand the importance of a target's employees, praising them in memos and press releases during the merger and acquisition (M&A) process. But many dealmakers focus keenly on retaining top executives, overlooking the technical and functional talent who keep the business humming. This can result in the loss of hard-to-replace people at each step of the acquisition, from announcement and closing through integration.

Our recent study confirms our experience that acquired workers are about twice as likely to depart than those with similar profiles hired directly. Researching 19 tech companies whose acquisitions were announced in 2020, we found that average annual employee attrition for the two years before the announcement ranged from **32 to 36 percent**.[1] In the following two years, it roughly doubled to between **55 and 71 percent**. (Layoffs did not materially affect attrition rates at these firms.) Unfortunately, the most capable people are even more likely to leave—they tend to have better opportunities.[2]

Employee attrition:



Before a transaction

After a transaction

The challenge can be especially acute when the target and acquirer have misaligned organizational cultures.[3] People who love working for an informal, fast-moving startup, for example, may look for the door when they're acquired by what they believe is a bureaucratic behemoth. The departure of key leaders can also cause a cultural shift, since their replacements may have far different attitudes and approaches.

The most sophisticated acquirers significantly reduce those hazards with a holistic approach to talent retention. They tailor their approaches to specific employee groups and circumstances, for example, aligning their efforts closely with other integration priorities to meet near-term integration targets and create long-term value. In some cases, such as the example above, this may even include limiting the integration of an acquisition as a part of a holistic approach to talent retention.

[1] KPMG used Capital IQ to filter M&A transactions in the technology industry announced in 2020. Considering targets with 500 to 2,500 employees and a deal value of $100 million to $1 billion, KPMG used data from Revelio Labs to understand the dynamics of employee turnover, headcount growth, and tenure in the two years before the announcement and the two years after.

[2] "Mismatch: Why Workers Don't Stay After an Acquisition," Knowledge at Wharton, Dec. 2, 2019

[3] "The Effect of Cultural Similarity on Mergers and Acquisitions: Evidence from Corporate Social Responsibility," Frederick L. Bereskin et alia, July 23, 2017

A sophisticated retention strategy evolves and adapts as a deal unfolds

Effective talent planning typically focuses on both near-term transitional and long-term strategic goals. While we urge acquirers to conduct retention planning throughout every transaction, their employee focus and retention efforts typically vary in each of the three deal phases: pre-signing, sign to close, and post-close integration.

Retention planning efforts should cover three milestones: easing immediate flight risks upon announcement; securing talent, skills, experience, and internal know-how after the close for a defined period, typically six months to two years; and rolling out a compelling long-term employee value proposition during the integration.

Employee engagement and communications—talking and listening—are essential to inform and equip talent to thrive in the new organization, and to avoid the confusion, frustration, and uncertainty that can drive attrition.

Stage 1: Pre-signing

Before signing, planning should generally focus on the target's most critical talent—which could extend well beyond the senior team. Identifying talent beyond the C-suite can be difficult in this phase because the team may have limited or no access to business unit or functional leaders. That said, deal teams can often identify critical roles, groups or divisions based on the deal thesis, plan for their placements in the new organization, and begin to assess employees' potential areas of concern with the target leadership team. Based on preliminary information and insights, the team can begin retention plan design.

Deal teams can take several steps to set retention priorities and design retention initiatives. They can explore existing data to estimate employees' flight risk, for example, without violating their privacy. They can also review marketplace compensation and benefits, internal pay equity relationships, career advancement and training opportunities, and other important factors. To clarify retention priorities, they can review employee performance metrics, succession planning, and open positions. Detailed summaries of market demand for specific roles and skill sets, including job posting and wage trends, can help teams design retention programs that work.

Stage 2: sign to close

Between announcement of the transaction and close, the deal team can craft retention plans and begin comparisons and integration hypotheses across compensation, benefits, work-from-elsewhere policies, and other elements of the employee value proposition. In some instances between sign and close, the team can incorporate in-depth management, Human Resources (HR) input, and existing employee listening data, such as engagement survey results, to integrate critical talent smoothly and effectively.

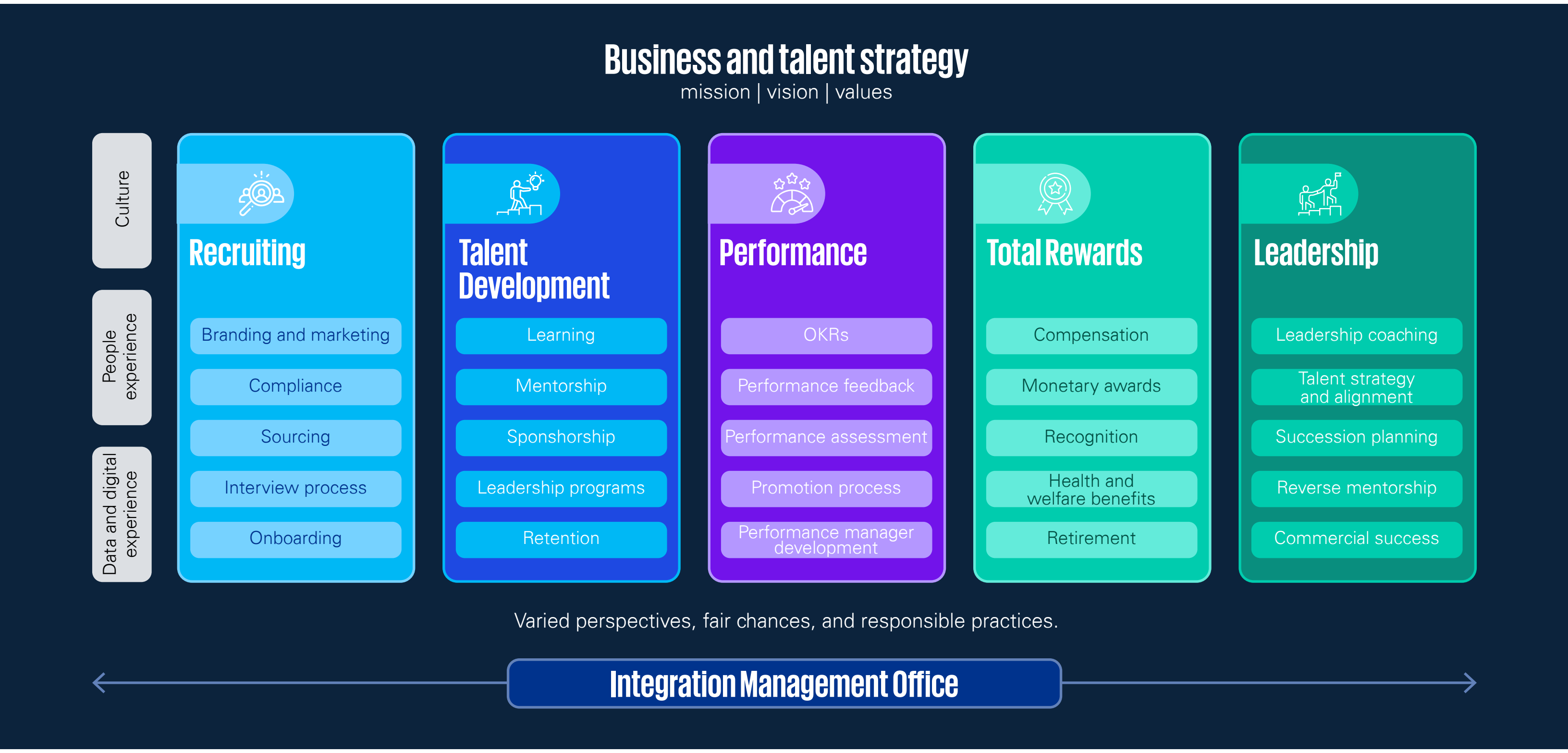
An initial talent retention program—based on a clear employee selection methodology aligned to strategic objectives—can feature cash awards for specific populations of high performers, value creators and preservers, and flight risks, along with a better employee experience that includes clarity on roles, career paths, culture, and reporting relationships. Executive roadshows or listening tours can also help senior leaders engage more deeply with employees and model desired behaviors.

Stage 3: post close integration

After Day 1, an effective acquirer usually refines the overall employee value proposition to support long-term retention of its own people and those of the target. We believe retention planning should bring the two companies together without negative disruption—securing skills, experience, and institutional know-how for at least six months while the buyer and target employees assess each other (Exhibit 1).

Exhibit 1. Roll out the compelling long-term employee value proposition

An effective EVP includes a wide range of initiatives that align with business and talent strategies



Total rewards is a key area to drive retention

A truly holistic retention program appeals to talent while supporting corporate performance and organizational sustainability. We recommend a "total rewards" offering tailored to market challenges. That can include eligibility for new programs, new and enhanced benefits, and a share of ownership, including time-based equity.

The deal team can use internal and external analyses to identify perceived gaps and refresh pay structures, including compensation levels and mix. Retention bonuses are typically the most compelling short-term incentives. New or modified short- and long-term incentive plans can include eligibility, award opportunities, metrics, payout, and vesting strategies to align with business objectives and talent challenges.

Following a transaction, many organizations may not be able to afford to increase compensation or incentive plan eligibility to realize deal values. In these cases, internal pay equity becomes even more important: while few employees may get more compensation, most at least believe the programs are consistent, fair, and equitable. This can help maintain morale and minimize litigation risk. Research by Bankrate in March 2022 showed that more than four in ten millennial employees—those under age 42—now share salary information with colleagues.[4] Experience shows that many people disengage and begin job searches after learning that a colleague earns more in a comparable role.

[4] "Younger workers aren't keeping their salaries a secret anymore — here's why it could be a good idea," Bankrate, April 27, 2022

Effective retention programs include more than the financial incentives

And while all employees need paychecks, most are engaged and motivated by recognition, culture, career paths, training, and development. Today, appealing employee value propositions are likely to include regular coaching or other touchpoints with management, and support for personal wellbeing. People at every level will look for new training and development offerings, offered within the company or by external providers.

In the wake of the pandemic, hybrid workplace options matter more than ever; nine in ten workers in remote-capable jobs prefer some degree of long-term remote flexibility.[5] The Wall Street Journal reported that about 17 percent of paid job postings on LinkedIn in the U.S. in July 2022 offered remote work—and attracted more than half of applications.[6]

The emerging importance of cultural data

Culture is almost always a key to integration success, but its intangible nature makes it difficult to account for during due diligence and integration. KPMG research shows that when M&A deals fail to meet targets, the most likely reason by far is a lack of buy-in among execution teams across the organization.[7]

Culture includes working norms, how teams collaborate and make decisions, what meetings senior leaders attend, whom they praise and promote, and how open and honest they are. Information gaps after an announcement, for example, will be closed by rumors, often with corrosive effects. Leaders who claim to want "out-of-the-box thinking" but reject challenges to the status quo are likely to see innovation decline and departures rise.

In short, crucial talent may take flight to find a place where they feel comfortable, supported, and appreciated. Recent developments in big data can help organizations take scientific approaches to measuring culture that can be incorporated throughout the deal lifecycle. From analyzing linguistic style similarities between internal emails to anonymous reviews on public forums, companies can better distinguish between cultural fit and cultural adaptability—the latter could be a much better indicator of performance and result in more successful retention efforts.[8]

Applying marketing concepts, such as assigning net promoter scores (NPS) to common attributes of culture between companies, could also enable benchmarking. While we often associate NPS with customer purchase and referral behaviors, similar principles apply in employees' decisions about where and with whom to work (and potentially refer others).

[5] Jim Harter, Ben Wigert and Sangeeta Agrawal, "Coordinating Hybrid Work Schedules—Five Important Findings," Gallup Workplace, Nov. 7, 2022

[6] "Enough, Bosses Say: This Fall, It Really Is Time to Get Back to the Office," Wall Street Journal, Sept. 3, 2022

[7] "Transforming transformation: How to beat the odds and succeed with ambitious, sustainable change," KPMG, 2020

[8] For more on this topic, please see "The New Analytics of Culture: What email, Slack, and Glassdoor reveal about your organization," Matthew Corritore, Amir Goldberg, and Sameer B. Srivastava, Harvard Business Review, Jan.-Feb. 2020)

Conclusion

On occasion, an acquisition is made only to obtain some narrowly defined asset, such as intellectual property or access to new customers. But most mergers and acquisitions are complex unions of people, processes, ways of working, and even world views and philosophies.

Successful acquirers recognize these complexities while searching for targets, assesses them in the diligence phase, and manages them carefully after the deal announcement and through integration. This focus on retention should be part of an overarching, cross-functional integration program to manage dependencies, document the unified organizational design, track against the execution roadmap, and other broad integration management activities.

And while some employees show up just for a paycheck, the most talented want much more from their jobs. Engaging and inspiring them—a key to the success of nearly every deal—requires deep, up-to-date insights and sophisticated approaches tailored to a changing workforce.

How KPMG can help

Strategic employee retention during M&A activity—especially in a tight labor market—requires deep expertise across multiple disciplines to support not only the compensation-related aspects but also the broader employee value proposition that drives retention planning. The KPMG People Strategy team provides wide-ranging support that leverages progressive data and analytics to identify key talent risks, competitive retention programs, and enhanced long-term employee-oriented programs.

Throughout the process, our HR strategists work closely with management to close any identified retention risks and set up the company for long-term employee engagement and success.

We have hands-on experience within and outside of the M&A space to craft effective retention programs in any business lifecycle.

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Kristine is a Principal in the People Strategy practice in Chicago at KPMG. She works with clients to utilize data and analytics to understand workforce, talent, and human capital matters including talent supply and demand, hiring and retention, transformative changes to workforce, and employee engagement. She has significant experience in utilizing large data sets of economic and labor indicators to drive insights that support talent sourcing and hiring improvements.

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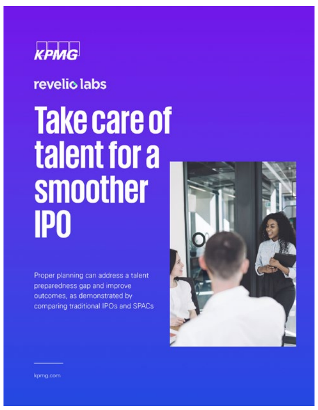

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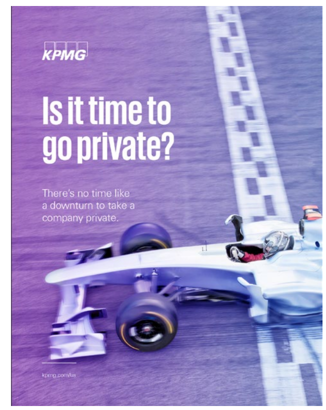

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