The evolution of talent retention practices during M&A

Findings from the 2020 M&A Retention Survey

Willis Towers Watson

Financial retention programs remain a critical element in a holistic talent retention strategy during times of uncertainty, such as during M&A or a business restructuring. A constant challenge during normal times, retaining talent is even more difficult in these times of change. Retention programs provide the ever-important foundation of time; time to build a relationship with the talent critical to driving business value. The 2020 refresh of our M&A Retention Study provides valuable insights into the continued evolution of the practices used by serial acquirers.

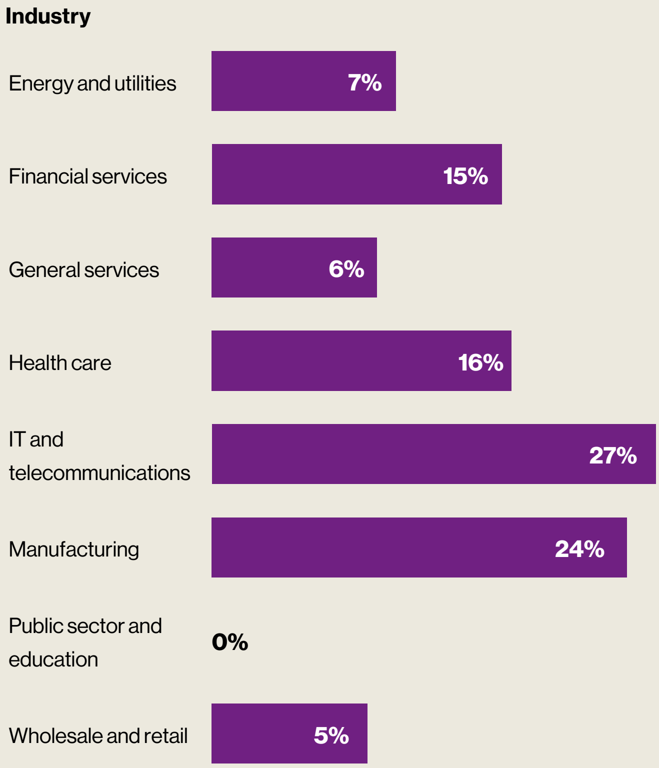
Key findings

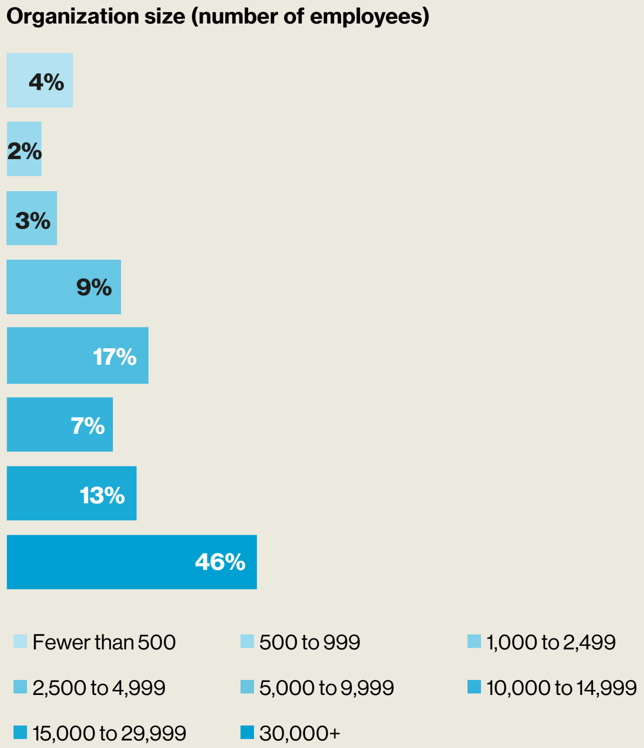
- The most common retention tool remains a straightforward pay-to-stay approach, used by 84% of survey respondents, typically in the form of a time-based cash bonus, denominated as a percentage of base salary.
- Consistent with our findings in 2014 (but higher than in 2017), the median retention budget is 1% to 2% of total purchase price. **However, over one-quarter of acquirers do not set a retention budget**.
- A surprising new finding in 2020: Respondents are optimistic about retention outcomes and effectiveness of retention agreements, but **a third of acquirers do not track retention rates**.
- Even among survey respondents, use of retention awards was not universal; 16% of respondents who had recently completed deals did not use retention agreements.

About the survey

Our 2020 M&A Retention Survey looked at retention periods and program design structures, the typical budget set aside for these payments within deals and the key deal objectives that drive such decisions. The survey results also reveal steps acquirers can take toward best practice.

The survey was conducted in August 2020, and the results reflect 166 organizations across 18 countries and eight industry sectors – representing a combined total of 800 completed transactions in the last two years. Most of the survey participants are large, publicly-listed serial acquirers that purchased smaller, privately held companies; about half of the transactions covered had a purchase price of less than $250 million, and many of these deals focused on the acquisition of key skills and talent.





Key features of retention programs used by serial acquirers

The most common financial retention tool remains a straightforward pay-to-stay approach, used by 84% of survey respondents. This is typically in the form of a **time-based** (as opposed to performance-based) **cash bonus** (as opposed to shares or options), denominated as a **percentage of base salary** (as opposed to a fixed amount).

It's typically paid 100% at the end of the retention period, which is reported as somewhat longer in 2020 than it was in 2017. In addition to cash retention bonuses, many companies also use a variety of financial and nonfinancial retention tools.

Cash is king

84-87%

use cash bonuses

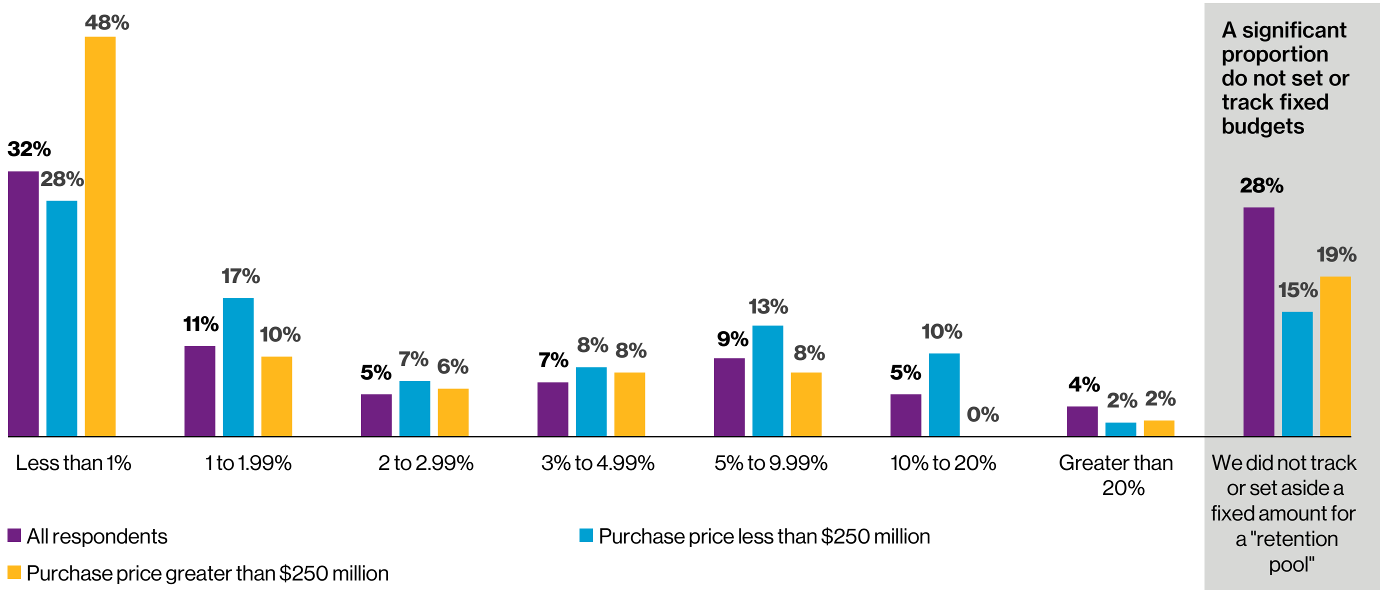
Budget and individual awards

Consistent with our findings in 2014 (but higher than in 2017), the median retention budget is 1% to 2% of total purchase price (*Figure 1*). The percentage tends to be lower for larger deals, and a significant number of respondents do not track or set aside a fixed amount to serve as a "retention pool".

> **A significant number of respondents do not track or set aside a fixed amount to serve as a "retention pool".**

Figure 1: **The median retention pool is 1% to 2% of total purchase price**

What was the retention pool as a percentage of the total purchase price?



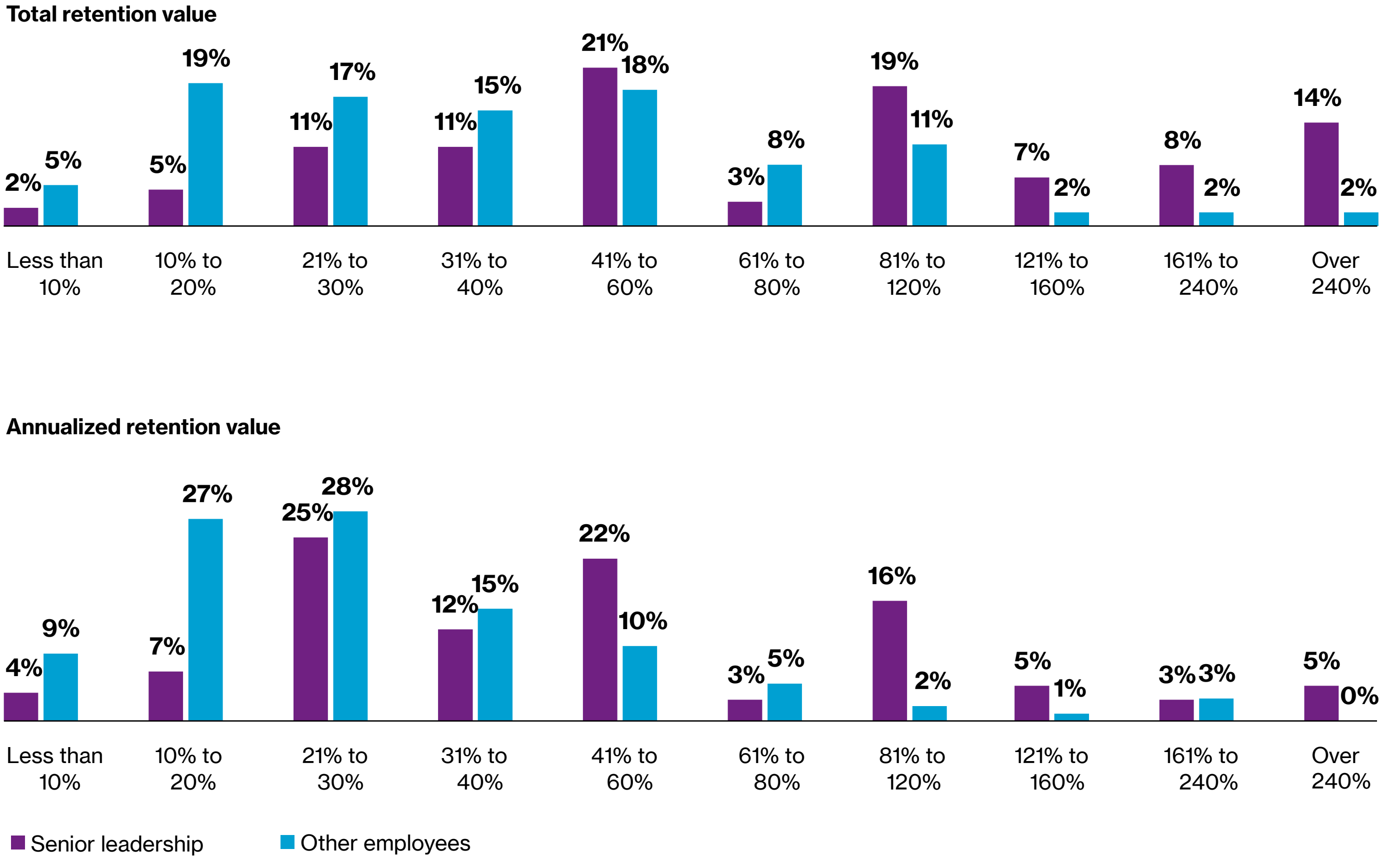
Note: Excludes responses (19%) without purchase price information

The median award is 60% of salary for senior leaders and 30% to 40% for others, both which show a continued increasing trend from prior surveys. However, practices range widely, with a significant number of companies paying senior leaders an award of two or more times their base salary (*Figure 2*).

Median total retention value is **~60% of base pay** for senior leaders and **31% to 40% of base pay** for other employees.

Figure 2: **There is a wide range of practices in setting retention values; for around 20% of deals, total retention values can be two times base pay or more**

What is the average total retention award size for senior leadership and other employees, expressed as a percentage of annual base salary?



For example, an employee who receives 60% of salary in total retention value over two years has an annualized retention value of 30% of salary.

Regional Spotlight

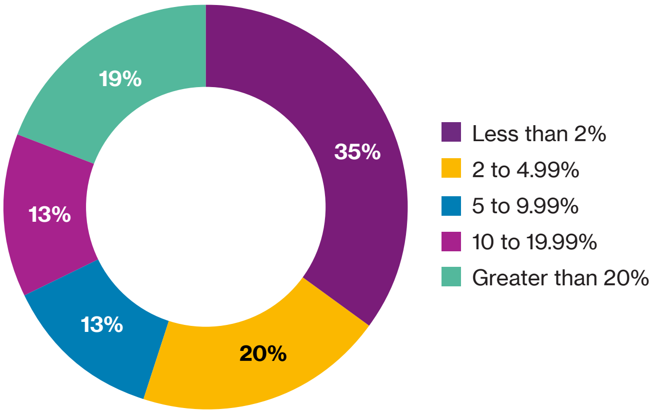
The median retention value is significantly higher in Japan as well as in the IT and telecom industry: **80-120%**

Retention program coverage

Retention agreements cover less than 5% (at the median) of the employees in a target organization, though a significant number of companies cover as many as 20% of the employees in a target organization (*Figure 3*).

Figure 3: **Retention agreements cover less than 5% of the total population in a majority of deals**

What percentage of the total salaried population at the acquired entity were selected to sign retention agreements?



Acquirers continue to realize that acquisitions can lead to regrettable losses of their own talent. In 36% of deals, the retention pool was used for retention agreements or special one-time payments to the acquirer's employees[1].

Regional Spotlight

European acquirers tend to be more inclusive when identifying employees for retention.

35% of retention agreements in Europe cover more than 20% of the total population in deals, compared to 19% globally.

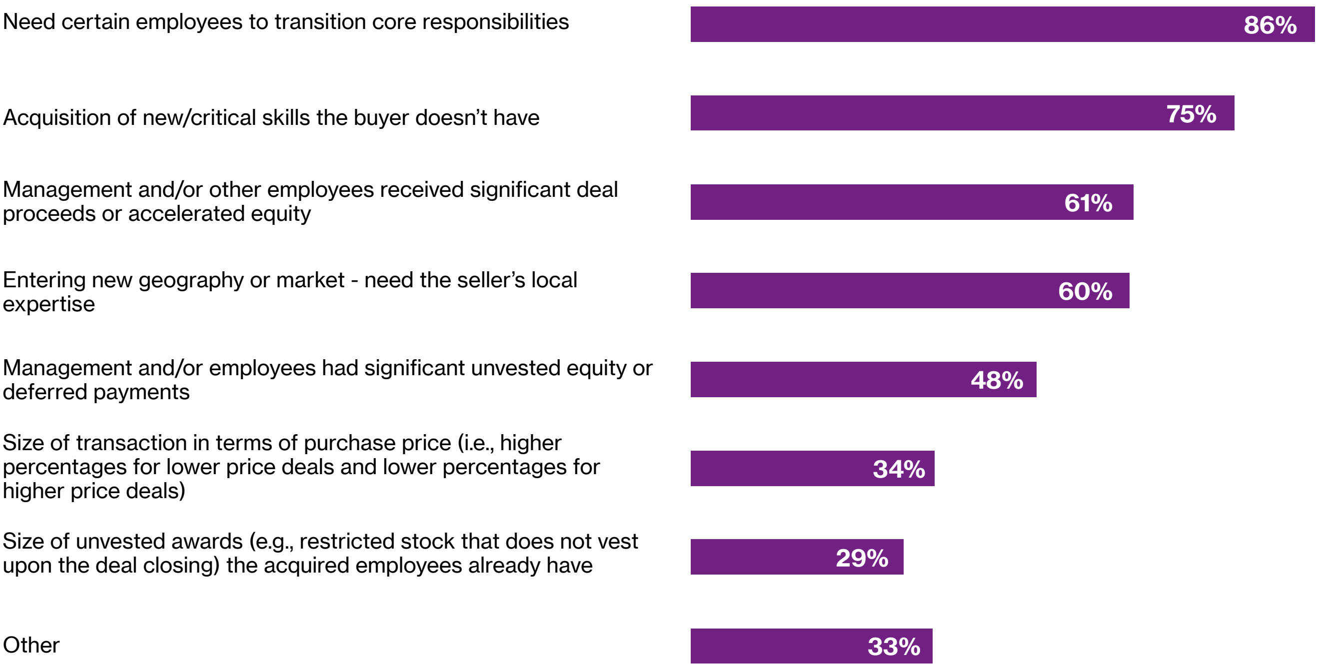
[1]2019 Survey of M&A Acquirer Special Incentive Plans

Setting the retention pool

The primary drivers of the retention budget are the need for employees to transition responsibilities and the acquisition of new critical skills the buyer doesn't have (*Figure 4*). This demonstrates a crucial linkage of HR M&A programs and activities to the business drivers of the deal.

Figure 4: **Need for employees to transition core responsibilities is the most cited factor considered in setting retention pools**

Which factors were influential in setting the retention pool?



Regional Spotlight

Unvested equity has a greater impact in Europe

European acquirers are nearly twice as likely to use retention budget to compensate for loss of equity.

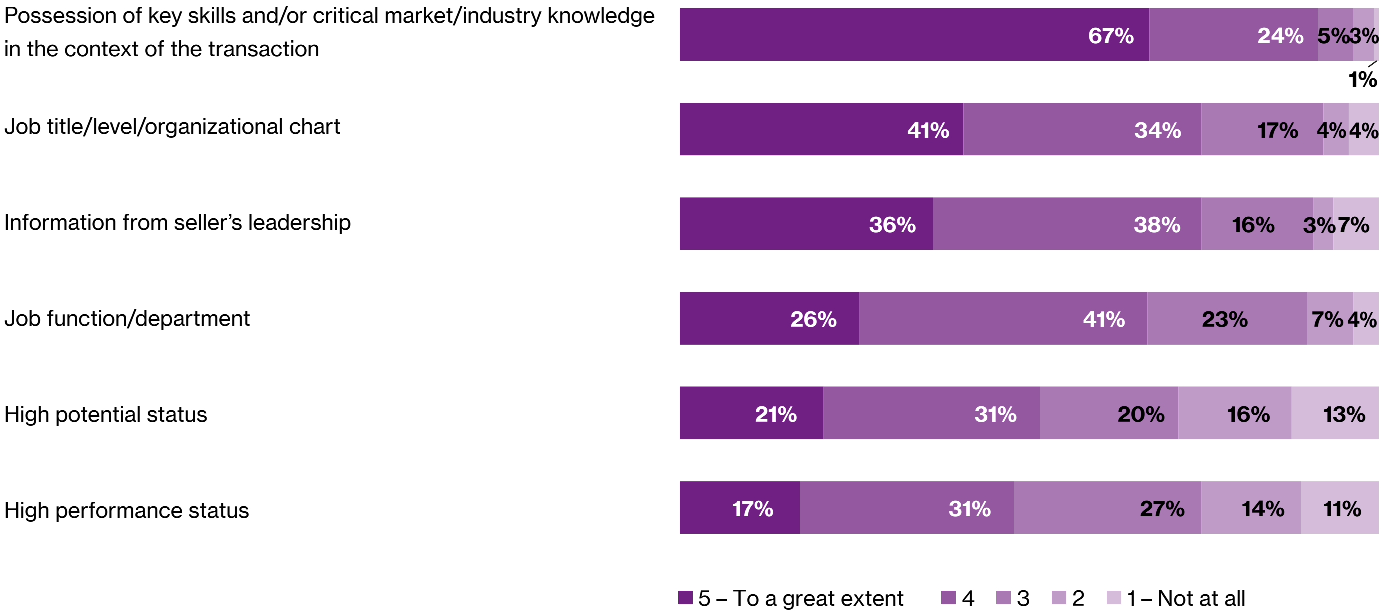
Note: Percentage indicates "yes"

Selection of talent for retention

Similarly, the primary factor in selecting individuals is possession of key skills and/or critical market/industry knowledge. In other words, the extent to which the acquisition is for the purpose of acquiring employees, as opposed to technology or other assets, drives the retention budget and employee selection (*Figure 5*).

Figure 5: **Possession of key skills and/or knowledge is by far the most cited reason for eligibility in retention agreements**

To what extent did you consider each of the following factors in determining employee eligibility for retention agreements?



*Please note the percentage might exceed 100% due to rounding.

Regional Spotlight

In Japan, **high performance status** and **job title** are the most commonly cited reasons for retention eligibility.

Regional Spotlight

In Europe, **job title is less important** in determining retention agreement eligibility than it is globally.

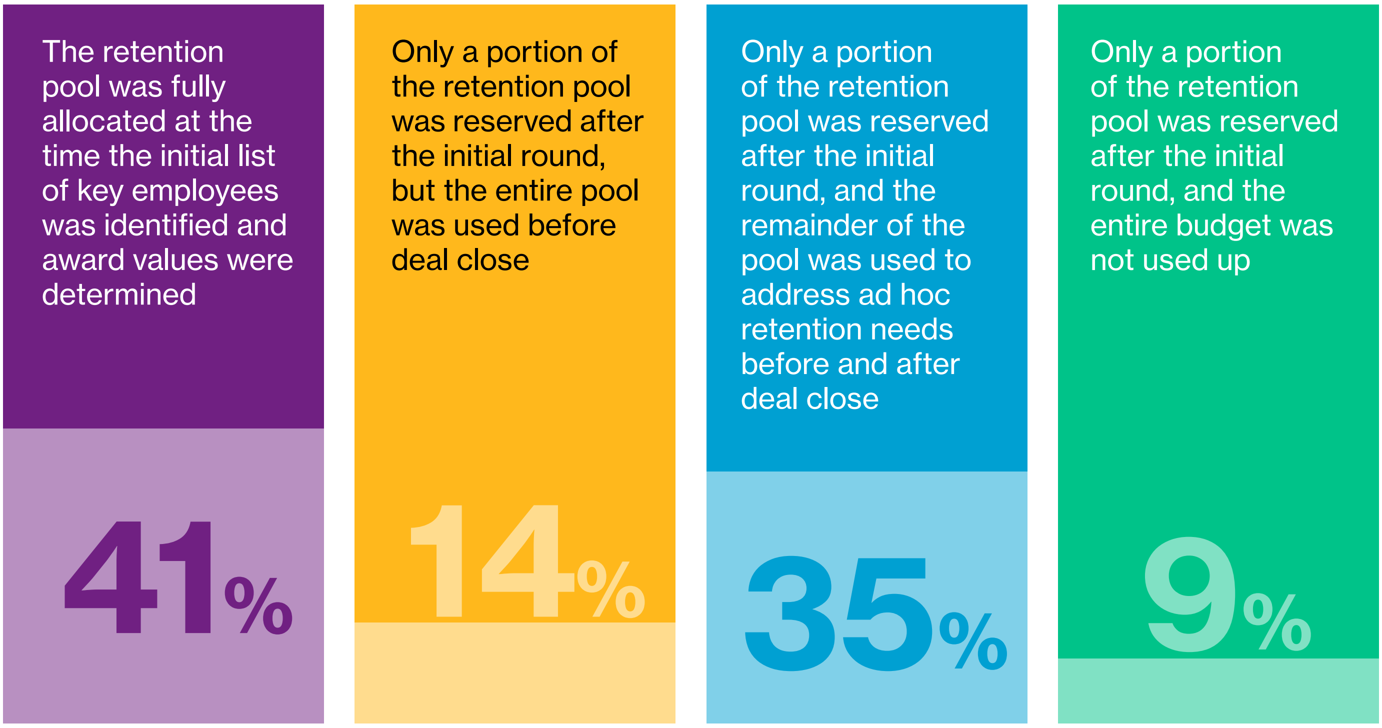
Strategic allocation of the retention pool

Most likely driven by learnings from past deal experience where the retention budget is exhausted too early, most buyers reserve a portion of the pool to address critical talent needs that are identified after the initial round of selection (*Figure 6*).

Less than half of surveyed organizations use up the entire pool for the initial list of key employees. This allows for a faster response and action plan, when time is of the essence to avoid regrettable losses.

Figure 6: **Less than half of surveyed organizations use up the entire retention pool for the initial list of key employees**

At what point was the retention pool allocated?



Retention periods, payment criteria, and form of award

The retention period is typically one to three years post-close, depending on factors such as seniority and criticality. Of note is that one-third of the survey respondents use a three-year period, and another one-third use a two-year period – both longer than the typical period seen in the last survey of one year or less.

Retention agreements are typically time-based. Using performance criteria in paying retention bonuses is not common, leaving performance measures to be used for other incentive programs. If they are used in retention agreements, they are typically in the form of earn-outs for owners of the acquired company.

Most awards are paid as cash bonuses and use of equity awards is still a minority practice. When equity is used, it's more commonly for senior leadership and used in lieu or in combination with cash awards.

Most awards are paid as cash bonuses and use of equity awards is still a minority practice.

Most serial acquirers are cautiously optimistic about the effectiveness of employee retention programs

Most surveyed companies expect more than 80% of leaders and employees covered by retention programs to remain until the end of the retention period; about half also expect them to remain one year after the retention period. The consensus among serial acquirers is that employee retention programs are designed to buy time for integration until high-touch retention activities can be properly deployed. This aligns with the cited reasons that covered why employees leave before they receive the full retention payment – and it is rarely about pay, benefits or the size of the retention award. Instead, the most attributed factors are cultural misalignment, disagreement with the company's new direction, and dissatisfaction with the new role or manager.

Considering the significant investments companies make in employee retention programs, it is surprising that more than one-third of those surveyed do not track retention rates as a success measure for these programs (*Figure 7*).

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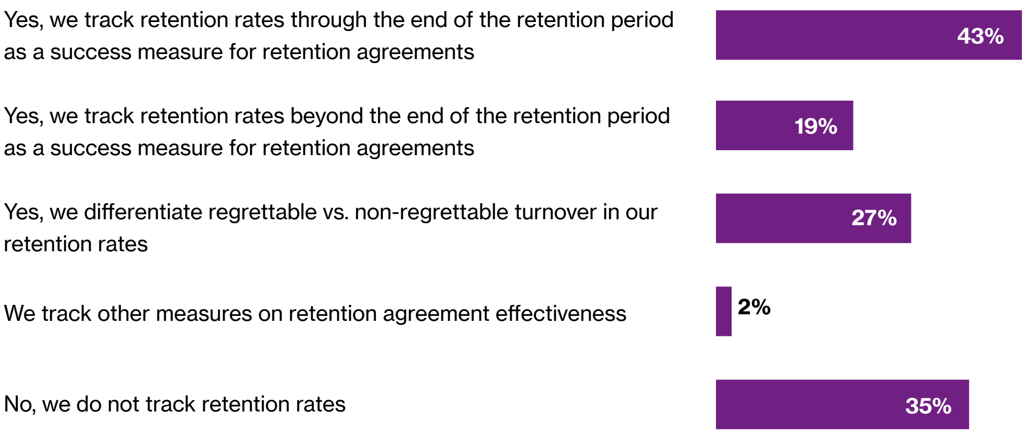
> **More than one-third do not track retention rates as a success measure.**

In fact, even among deals where retention budgets are at least 5% of total purchase price, one in five acquirers does not monitor the turnover of key leaders and employees who receive a retention award. This is particularly challenging after the first year, as the acquired business transitions from integration to business as usual. Differentiating between regrettable and non-regrettable turnover (i.e., those who are no longer critical post-integration) when assessing talent retention outcomes is even more of a challenge.

Figure 7: **More than a third of organizations do not track retention rates**

Does your organization track retention rates as a success measure for retention agreements?



Regional Spotlight

In the United States, nearly **50%** of respondents do not track retention rates.

Don’t forget about other financial and nonfinancial retention tactics

Other financial tactics that survey respondents use are division-specific incentives (often in the form of earn-outs) and increases in base pay. Less frequently used is enhanced severance, which can convince anxious employees to give the new parent a try and costs nothing if the employees, generally the ones selected to be retained, are not terminated.

Financial incentives can be very powerful, but we have learned from experience that it is only a portion of what employees look for from their companies. Serial acquirers understand the need for a comprehensive talent retention strategy that includes nonfinancial tactics, such as personal outreach by leaders and a compelling narrative on enhanced career opportunities after the transaction.

The lessons for future deal makers

Retention incentives are a key tool for deal makers, as they help buyers to secure key talent for at least a defined period following the close of an M&A deal. Experienced buyers use this additional time to focus on key priorities, whether transitioning key skills or engaging acquired talent in the future of the combined business post-transaction.

It's not too late to participate!

A detailed report of findings is available to survey participants only. We continue to accept survey submissions on a rolling basis. If you are interested in receiving the full global report (or one of the available region/country or industry cuts) but did not participate in the survey, please contact your consultants at Willis Towers Watson or:

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