Global payroll: Managing mergers & acquisitions

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Executive Summary

Payroll plays a major role in helping manage the execution of mergers and acquisitions (M&A), but the issues it faces are not always understood elsewhere in the organization, particularly in international deals. This Briefing Paper provides insights into how payroll functions within different multinationals prepare for and manage the impact of M&As, from their high-level strategy to the kinds of checklists they deploy.

Webster Buchanan Research spoke to global payroll managers with M&A experience at seven multinationals to gauge their experiences. They ranged in size from a smaller start-up where payroll has broad-ranging responsibilities, to large global corporations where payroll's responsibilities are more conventionally defined – and ranged in character from serial acquirers to organizations that have gone through one-off mergers. The respondents – predominantly drawn from Webster Buchanan's Global Payroll Research Network[1] - recommend global payroll managers take a number of steps to ease the path for future M&A activity including:

- **Make senior managers aware of the issues that M&As trigger for payroll, and get payroll a seat at the table** As a downstream function, payroll's role in M&As is largely reactive, and as a result its interests can be overlooked. The earlier payroll can be involved in the M&A process – subject to confidentiality and regulatory constraints – the better. It is payroll's responsibility to bring these issues to its acquisition team's attention – ideally, before a specific deal is under consideration
- **Develop a methodology for managing an M&A** Advance preparations – including collaboration with other functions and creating a checklist for payroll activities – can help smooth the M&A process. A sample set of milestones is provided in Part 1.4
- **Research ways to tap into payroll professionals with M&A experience.** Having access to specialist M&A resources during a transition can help head off problems. If you expect your company to be a serial acquirer consider setting up a dedicated, experienced team
- **Tap into the expertise of the acquired company's team, including any outsourced service providers**. Even if you do not plan to retain acquired team members, their help will be critical during the transition
- **Partner with vendors**. Strategies for easing the transition from a vendor perspective are covered in Part 2.2
- **Be prepared to challenge integration timescales**. Integration timelines can be challenging and in practice will sometimes need to be extended – for example, by keeping onboard the acquired in-house team longer than originally planned.

[1] Webster Buchanan's Global Payroll Research Network is a confidential community for senior international HR and payroll managers. Visit www.websterb.com for details

Part One: Assessing payroll's role in the M&A process

1.1 The challenges of international M&As

The drivers of M&A vary widely, from long-planned takeovers designed to propel companies into new markets and geographies, through opportunistic deals that take advantage of short-term market conditions, to tactical deals that bring in products, technologies or expertise. As a result, the requirements that fall on payroll will also vary from deal to deal – requiring it to react, often at short notice, in different ways to different situations.

One problem payroll faces, however, is that it's typically a junior partner in the M&A cycle, with information often passed on late and decisions made without assessing the impact on payroll operations. Payroll is never going to be at the forefront of what are highly sensitive and often tightly regulated M&A procedures – but as a downstream partner, the impact of decisions made in the M&A cycle can be severe.

Take for example a deal that moves the acquiring company into new countries. The payroll risks include:

- **Failing to make country-specific payments**. Payroll teams may need to grapple with complex statutory payments – the calculation of holiday accruals, for example, can be particularly complicated in some countries – as well as paying benefits that are customary rather than legal requirements (a particular issue in Latin American countries such as Brazil)[2]
- **Non-compliance**. If organizations move too quickly in a new country, there is a greater risk of non-compliance with set-up requirements, such as registration of a new entity with statutory authorities, tax and social security bodies
- **Inability to run payroll**. In extreme cases, the acquiring payroll function may be unable to set up its systems in time to process payroll for acquired employees. One respondent had to estimate salaries on the basis of previous payrolls, with the expectation that differences in allowances and deductions would be corrected in future payroll runs. This of course has cash implications (since overpayments may need to be recovered over time); may lead to potential losses if employees leave while still owing money; causes reputational damage for the acquiring organization; and generates long-term work for payroll in handling employee queries and managing amendments

[2] See "Tackling Payroll Complexity in Latin America", published by Webster Buchanan Research, March 2015 www.websterb.com

- **Inability to make payments**. Similarly if bank accounts are not set up quickly and correctly, it may not be possible to make payments in some countries. This is a particular risk in countries that require payments to be made from specific in-country banks, and tales of payroll managers boarding planes with suitcases full of cash are not just apocryphal. Organizations that have existing regional or global relationships with third party payment providers, either direct or through their payroll provider, may find they are able to set up payment procedures more quickly

1.2 Pre-emptive planning

One of the most effective ways for payroll to mitigate these kinds of risks is to ensure that its voice is heard at an earlier stage in the M&A cycle, and respondents have adopted a variety of approaches to help make business leaders aware of the issues they face. One respondent has put together a briefing document explaining the actions payroll needs to take during an M&A. Another M&A payroll leader at an acquisitive company holds regular meetings with the company's integration team. While confidential details of upcoming transactions will not be disclosed to payroll prior to a deal being agreed – including of course the identity of any target company, its size, the number of employees and their location – these meetings enable payroll to pre-empt potential difficulties, such as the company's position on the taxability of severance payments or issues relating to contingent workers.

This kind of collaborative approach can work both ways. During the due diligence carried out prior to completion of a deal, payroll can assist with the M&A team's financial analysis, working with Compensation and Benefits teams to provide (and sometimes analyze) net pay data relating to:

- **Total compensation cost** for an acquired team, taking into account salary, bonuses and commissions
- **Severance costs** if employees will be let go during the transition, including bonuses and commissions on a pro-rated basis
- **Accruals**
- **Correct treatment and liabilities towards contingent workers**, including those employed on the acquired company's behalf by a third party employment agency. While these types of employees are more usually paid through accounts payable, countries may have specific rules around the status of contingent workers and their rights – including the requirement to pay certain types of contractors through payroll

Likewise, while legalities such as collective agreements and transfer of undertakings rules are not strictly the responsibility of payroll, in some companies payroll teams have the deepest understanding and experience of their implications for a post-merger integration.

1.3 Assessing the deal fundamentals

Once payroll is informed of a deal, there are a number of fundamental questions to address:

- Will the acquired company be run as a **standalone** operation, or be fully or partially **integrated**?
    - If it's to be fully integrated, how and when will employee terms and conditions be standardized, given the sensitivity of aligning compensation policies?
    - If it's to be partially integrated (for example, by merging functions such as Finance, HR and payroll in a shared services center) what are the expectations in relation to acquired payroll staff?
    - If it's to remain as a standalone entity, will employee terms and conditions still be standardized, and if so, how quickly?
- What is the **nature of the workforce** being acquired? Do employees have complicated stock plans and benefits packages? Does the acquiring company have the experience to deal with them – or can employees be moved across to existing schemes?
- What are the **talent management** considerations that impact payroll? People management is a key consideration in every M&A, but in some acquisitions key employees (or employee groups) may be a critical driver of the deal. For payroll, this is likely to influence complexity (for example, if the company offers retention bonuses to secure high-value staff) and also resourcing, particularly if support functions are expected to provide a "white glove" service to new employees
- What is the **nature of the employment environment** at the acquired company? Is it an "at-will" environment more common in parts of the US, where newly-acquired employees can be more easily let go, or are there works councils and collective agreements?
- Are there **transfers of undertakings** involved? Under European Union employment law, for example, general principles state that most responsibilities to employees pass to the acquiring company, putting a greater onus on it to provide equivalent or better compensation and benefits
- What are the **timescales** for execution?
- Does the M&A take the company into **new regions or countries** where the acquiring payroll organization – or its vendor – has limited experience and incomplete knowledge of local requirements? In these cases, one option may be to retain the acquired company's existing payroll teams and service provider, either on a long-term basis or in the short-term to continue processing payroll while the acquirer carries out its own parallel runs. It's important to keep in mind that this approach isn't always possible – for example, if the acquired entity is being spun

off from a larger organization where payroll and other support functions are excluded from the deal. These options are explored further in Part Two

1.4 Transition project management

Once the decision has been taken to proceed with an acquisition or merger, in larger organizations a project management office (PMO) will take responsibility for co-ordinating workstreams and lists of tasks, as well as pulling together representatives from the due diligence and integration teams, HR, payroll, finance, tax and legal. Payroll's role typically becomes more operational at this point, although it may continue to provide some advisory services.

Payroll's initial goal is to understand the in-house payroll set-up, the relationship with any outsourced service provider and key components of payroll such as benefits and allowances. To an extent, this process mirrors the kind of 'status quo' analysis that companies typically carry out as they first build their international payroll strategy.

Several respondents with experience of multiple M&As have developed methodologies and checklists to help manage this information gathering and transition cycle. As well as generic checklists, these documents may include country or regional specifics such as special bonuses, lunch vouchers and special allowances. In turn, payroll's operational responsibilities may be documented as part of a larger M&A playbook that includes details of how to make final payments, how to transfer data, how to terminate employees in the system and how to merge employee Terms and Conditions. A section on payroll tax, for example, might outline payroll's responsibility for checking:

- Where the company is registered
- Whether corporate names and addresses need changing
- Whether short term visitors' agreements are required
- The compliance requirements of different tax jurisdictions

One respondent manages transitions through a set of key milestones. These include items such as:

- Has all information been received to run the first payroll?
- Have final tax filings been completed?
- Have predecessor payroll service provider accounts been closed?
- Have employment/unemployment agency accounts been closed?
- Has power of attorney been granted?
- Have payroll records been transferred?
- Have calculations been communicated for existing revenue streams e.g. sales bonus plans?

- If there's a system/database with predecessor information, has information been transferred across for future reference?
- Prior to close, has payroll consulted on tax treatment for any closing or post-close payments to employees
- At close, has payroll created a year-end plan, which it is confident can be executed prior to year end (including items such as W-2s in the US, P60s and P11Ds in the UK and equity reporting)

While checklists and playbooks are an important tool to help structure the transition, respondents caution that it's impossible to document every scenario, and some level of prior M&A experience can be invaluable. For example, combining employee populations in a country may push the company over a legal threshold and trigger provisions for pension schemes or collective bargaining. Likewise, payroll may need to take a call on the technicalities of an individual's wage basis for tax in a stock deal. Ideally, the payroll team will combine experience of M&A process and change management with country-specific knowledge and technical expertise – which in practice may mean tapping into a pool of experts, including external advisors in areas such as tax.

It's also important to check all documentation relating to the acquired payroll function, and to create documentation for any critical activities if it doesn't already exist. One example where documentation is essential is in explaining accruals made for work carried out prior to an acquisition: if this isn't sufficiently detailed and the acquired payroll team is no longer with the organization, it can be difficult to understand why an accrual has been made and whether it has been recorded correctly.

1.5 Change management and communications

Since the employee experience in M&As is so important, communications to transferred employees around items such as changes in pay dates or payslip formats needs to be early and clear. This communication may be part of a broader initiative from HR, but payroll has a responsibility to ensure that pay-related issues are covered.

As one M&A veteran says: "You need to think about integration in a very detailed and structured way; we've been guilty in the past of being too laissez faire and that's when things have not gone according to plan. And once we've got the plan we should stick to it. There've been instances when we've not stuck to our guns when it comes to putting it into practice."

1.6 Challenging assumptions about timelines

Many of the mistakes made during the immediate aftermath of an M&A can be traced back to timing – particularly when payroll is hard-pressed to source a new provider or set up new payrolls in-house.

Respondents warned of specific dangers in rushing through last minute changes – especially late changes in employee set-up – and in manually keying or calculating payments where deadlines have been missed. In some cases this can be averted by mapping systems and interface changes early on to automate data flows from the acquired company: if not, any manual insertions should be documented on watch lists and double checked for accuracy.

Extra time may also be required to administer new arrangements for acquired employees – such as employee registration in new benefits or pension schemes, or the transfer of fuel cards and lunch vouchers to the new employer. Employee enrolment for these benefits is ultimately the responsibility of Compensation and Benefits teams, but payroll is often the first point of contact for employees, and it cannot start making deductions until they are enrolled.

For these reasons, several respondents recommended that payroll should be prepared to push back on timing where necessary, arguing that there is often a surprising amount of flexibility. If payroll is struggling to integrate, for example, one option may be to retain an acquired in-house team longer than initially planned. While this may increase costs, it may also head off more serious longer-term problems.

Part Two: People and vendor management

2.1 Working with an incumbent payroll team

One of the most important lessons outlined by respondents is the need to collaborate widely to retain as much of the knowledge and experience in the acquired company as possible through the transition. This starts with establishing a good working relationship with the acquired company's payroll team. Much of this is common sense change management – reaching out to the team as early as possible, arranging visits to key countries wherever practical, and clearly stating what will be required of employees during the transition. Some organizations also put in place retention bonuses to lock in acquired employees.

In the most successful change programs, international payroll managers are able to keep key staff through the transition even when individuals know they have no long-term role post-acquisition – for some employees, the experience of working through an M&A while they plan their next career move is good experience for their CV and provides an incentive to assist.

But it's possible that not every team member will stay, and some level of forward planning is necessary to help allay potential difficulties. This includes:

- Establishing whether there are available resources elsewhere in the acquiring company that could be brought in to assist if needed
- Reorganizing global payroll country teams to pool resources across employee populations that share similar characteristics, enabling experiences to be better shared and providing some level of back-up
- Handing more tasks over to an outsourcing partner

In most cases, our respondents did not typically hire payroll team members from the companies they acquired for the long-term, but there were exceptions. One contributor explained how it was able to ramp up its expertise in Asia-Pac by merging its existing small payroll presence into an acquired company's service center, at the same time moving onto the new partner's payroll processing platform. Another created a virtual shared services set-up by keeping acquired in-country resources as local points of presence in its global payroll organization.

What was more common was for acquirers to take advantage of the change initiative to drive through other organizational changes. In smaller acquired entities, where the person responsible for payroll is also likely to be handling HR administration, company secretarial duties and even authorizing payments, some respondents took the opportunity to impose separation of duties.

2.2 M&A and global payroll vendor strategy

It's equally important in the transition to maintain a relationship with incumbent vendors contracted to the acquired company, since their assistance will be required in closing payments, making severance calculations and handing over data.

The decision about whether to retain an in-country vendor isn't always simple – particularly as incumbent vendors will often be national rather than multi-country providers, and may not be a close fit with the acquiring company's global payroll strategy. These decisions need to take account of a number of factors including:

- **Global Payroll Strategy.** Approaches to multi-country payroll vary from company to company, from highly-centralized to highly-devolved models. In turn this impacts vendor strategies: some organizations strive to work with one vendor (or a small group of vendors) globally, and may therefore be less inclined to retain single country providers. For all of these decisions, Webster Buchanan recommends taking a pragmatic rather than purist approach: the priority is operational ability over design elegance[3]
- **Controls and compliance requirements.** In countries with complex compliance requirements, as well as smaller or more remote countries, there may be benefits in retaining a vendor with strong local knowledge and experience
- **Global payroll vendor governance**. The decision on retaining an in-country provider may be influenced by the acquiring company's vendor management strategy – specifically whether the vendor will be managed locally from within the country, centrally through head office, or through shared service centers or regional hubs. In some cases, language or timezone issues may make it harder for the acquiring company to effectively manage an in-country provider
- **The cost equation,** including cost per payslip and all extras
- **Systems set-up,** and whether incumbent vendors are able to integrate with the acquired company's central HR systems and provide data back to the organization in the format required
- **Range of services provided by the vendor.** Payroll services will sometimes be bundled in with other support services such as accounting or HR, and any decision to terminate payroll may be set aside by the practical requirements of other support functions
- **Quality of service.** Establish from the in-house team what level of service has been provided by the vendor, both in terms of conventional

3 See "Multi-country Payroll: tackling the challenges of small country populations", published by Webster Buchanan Research in January 2015. See www.websterb.com for details

metrics such as accuracy and timeliness, but also with regard to 'softer' measures such as its responsiveness to change

- **Contractual issues.** Contract issues can swing arguments both in favor and against retaining an in-country provider. On the one hand, if a country team has recently committed to a multi-year outsourcing agreement with no easy termination clauses, this may influence the retention decision. On the other, retaining an incumbent provider may require committing to a new multi-year contract and also incur one-off fees (e.g. for integration to HR and financial systems). Since this commitment may have to be based on limited information gleaned in challenging circumstances from the incumbent team, one option is to seek a short-term interim contract while further assessment is carried out
- **More creative approaches.** Many global payroll providers work with partners. Where a local provider in an acquired organization is particularly valued, it may be possible to plug it into a global payroll vendor's network

Webster Buchanan recommends several steps for both retaining and terminating an acquired vendor:

If staying with an incumbent vendor:

- Review the contract and Statement of Work that outlines the services provided by the vendor, and take feedback wherever possible from the incumbent team about the quality of service. If a contract needs to be transferred to the acquiring company, take the opportunity to negotiate changes in the agreement, including where possible tightening up Service Level Agreements to bring them into line with company standards
- Assess the ability of the vendor to handle both growth in employee numbers and potential growth in complexity
- At an appropriate time, carry out due diligence on the vendor, covering financials, size of customer base, market reputation etc. It's likely that no formal appraisal will have been carried out since the initial contract was agreed
- Check the vendor meets minimum controls and security standards. If there are no company guidelines on this, take advice on recognized industry standards such as SSAE 16/ISAE 3402

If terminating a vendor:

- Review notice periods and early release clauses, take legal advice as required, and prepare the vendor for the change
- Agree any exceptional costs upfront with the vendor to manage the transition
- Ask the vendor to make closing payments to terminated employees. If this is not possible and you have to manage these payments as an exception or manual payments, check and monitor them closely
- Keep the door open for possibly working with the vendor again, particularly if the in-house team's experience has been positive

Managing an exit from outsourced providers can be challenging with or without an M&A: while some vendors follow a methodology and handle the loss of business professionally, others may be less cooperative. This can be seen at a practical level in the form of extra charges being levied (for example, for data download), or more generally in being slow to respond and communicate. Webster Buchanan recommends examining supplier contracts carefully to see what provisions, if any, were made for an exit strategy.

In both scenarios:

- Audit the data coming over from the incumbent provider to ensure it meets data quality standards
- Check on historical treatments for tax and other deductions and if they do not match up with current expectations, correct them

End Notes

About the Authors

Webster Buchanan Research is an independent market research and consulting company specializing in international HR and multi-country payroll, operating from regional centers in London, San Francisco, and Singapore. Webster Buchanan has been carrying out research in multi-country payroll since 2002, when the sector was in its infancy: since then, we have worked with numerous senior HR, payroll, and finance professionals from around the world through our consulting, market research and events businesses. Our clients range from some of the world's largest multinationals to small companies operating in fewer than a dozen countries.

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