Global payroll: Managing mergers & acquisitions

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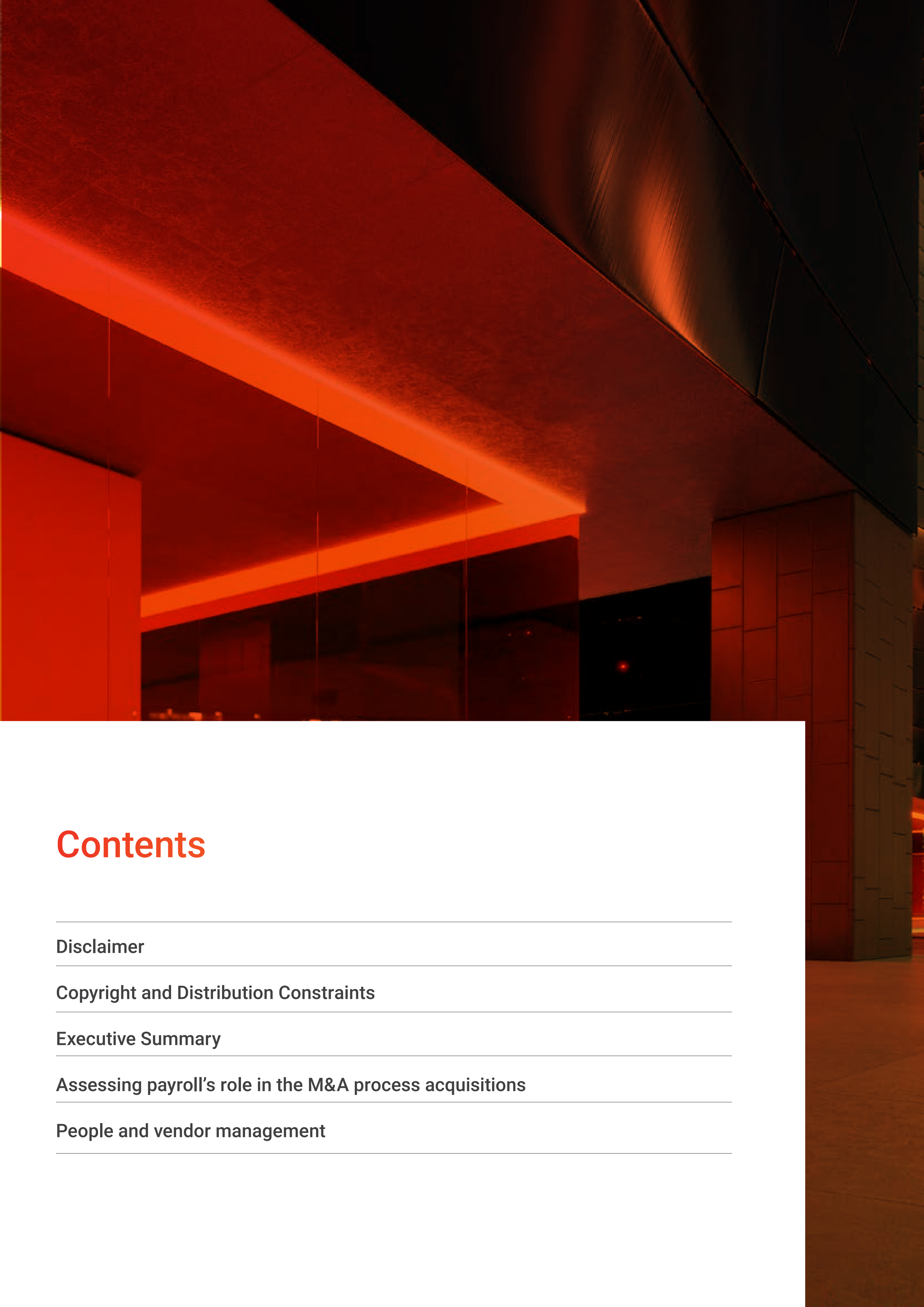

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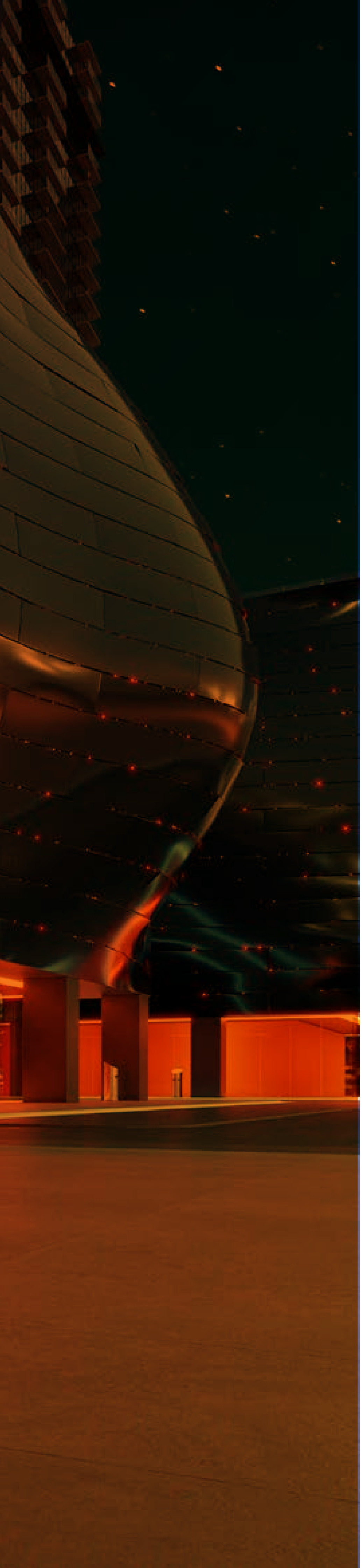

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Executive Summary

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 organisation, particularly in international deals. Here, we look at how payroll teams or departments within different multinationals prepare for and manage the impact of M&As, from high-level strategy to the kinds of checklists they deploy.

In a study commissioned by TMF Group, in 2015, Western Buchanan Research spoke to global payroll managers with M&A experience at seven multinationals to gauge their experiences.

> It's worth noting that, in this context, the term 'M&A' encompasses all activities where there is a change of ownership, including mergers, acquisitions, corporate divestiture, divestment strategy, spin-offs, and carve-outs.

The companies spoken to in the study ranged in size from a smaller startup, where HR and payroll managers have broad-ranging responsibilities, to large global corporations where payroll's responsibilities are more conventionally defined – and ranged in character from serial acquirers to organisations that have gone through one-off mergers. The respondents recommend global payroll managers take a number of steps to ease the path for future divestiture 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 corporate divestment process – subject to confidentiality and regulatory constraints – the better. It is payroll's responsibility to bring potential issues to its acquisition team's attention – ideally before a specific deal is under consideration. These might include the shape of future processes, the toolsets to be used, and the size, skills and location of the future HR and payroll operation.

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 divestiture process.

Research ways to tap into HR and 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 later in this article.

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.

Assessing payroll's role in the M&A process

The challenges of international M&As

The drivers of a corporate spin off 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 the payroll team 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. HR and payroll are never going to be at the forefront of what are highly sensitive and often tightly regulated divestiture procedures – but as downstream partners, 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 risks to global payroll include:

- **Failing to make country-specific payments.** Global 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, for example).
- **Non-compliance.** If organisations move too quickly in a new country, there is a greater risk of non-compliance with setup 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 based on 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 organisation; and generates long-term work for payroll in handling employee queries and managing amendments.
- **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. Organisations 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.

Pre-emptive planning

One of the most effective ways for global payroll teams to mitigate these kinds of risks is to ensure that its voice is heard at an earlier stage in the divestment cycle, and respondents have adopted a variety of approaches to help make business leaders aware of the issues they face.

One respondent put together a briefing document explaining the actions payroll needs to take during a spin off. Another M&A payroll leader at an acquisitive company held 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 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 the compensation and benefits teams to provide (and sometimes analyse) net pay data relating to:

- **total compensation cost** for an acquired team, taking into account salary, benefits, 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.

Many companies going through a corporate divestment are very keen to maintain like-for-like compensation and benefits for their own employees – and these potentially significant post-deal costs need to be considered, especially when creating a smaller spin-off company. In addition, while legalities such as collective agreements and transfer of undertakings rules are not strictly the responsibility of HR and payroll, in some companies payroll teams have the deepest understanding and experience of their implications for a post-merger integration.

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 standardised, 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 centre) 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 standardised, 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 HR and 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 HR and 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 divestiture take the company into new regions or countries where the acquiring payroll organisation – 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 organisation where payroll and other support functions are excluded from the deal.

Transition project management

Once the decision has been taken to proceed with an acquisition or merger, in larger organisations a project management office (PMO) will take responsibility for coordinating 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 setup, 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, which 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 managed 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, such as 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 USA, P60s and P11Ds in the UK, and equity reporting).

While checklists and playbooks are an important tool to help structure the transition, respondents cautioned 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 a spin off 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 organisation, it can be difficult to understand why an accrual has been made and whether it has been recorded correctly.

Change management and communications

Since the employee experience in corporate divestitures is so important, communications to transferred employees around items such as changes in pay dates or pay slip 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 said, "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 have been instances when we've not stuck to our guns when it comes to putting it into practice."

Challenging assumptions about timelines

Many of the mistakes made during the immediate aftermath of a divestment 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 setup – and in manually keying in 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 dataflows from the acquired company: if not, any manual insertions should be documented on watchlists 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.

People and vendor management

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 organisations also put in place retention bonuses to lock in acquired employees.

In the most successful change programmes, 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
- reorganising 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 backup
- handing more tasks over to an outsourcing partner.

In most cases, 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 the Asia-Pacific region by merging its existing small payroll presence into an acquired company's service centre, at the same time moving on to 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 organisation.

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

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-centralised to highly-devolved models. In turn, this affects vendor strategies: some organisations 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, we recommend taking a pragmatic rather than purist approach: the priority is operational ability over design elegance.
- **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 pay slip 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 organisation 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 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 favour 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 (for example, 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 organisation is particularly valued, it may be possible to plug it into a global payroll provider's network.

We recommend several steps for both retaining and terminating an acquired vendor.

If staying with an incumbent vendor:

- review the contract and Statement of Work (SOW) 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 recognised industry standards such as ISO/IEC 27001 and 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 a divestiture: 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. We recommend 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.

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