

Mitigating the Human Capital Risks of

Spin-Offs



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Spin-offs — corporate transactions through which business units separate from their parent company to become independent entities — are increasingly popular as companies reexamine their business strategies and search for additional ways to boost shareholder returns. Two Towers Watson experts look at the challenges associated with spin-offs and the steps organizations can take to minimize the risks and maximize the chances of success for these types of transactions.

Q What's driving interest in spin-offs?

A Brizel: Business leaders are taking a hard look at how their businesses are structured, and how and where their resources are deployed. They're searching for new ways to respond to the economic downturn and shareholder demands. When they have business units that aren't closely aligned with the company's core business or the organization's strategy, or have persistently low growth rates, they may choose to spin them off.

Sometimes, the spin-offs are high-performing businesses that can be nicely positioned for growth as new, independent entities. Or they're businesses that are focused on more mature markets or have different growth rates than the parent company. Sometimes, they're businesses that are no longer in sync with the company's strategy or product/service mix. Shareholder activism, limited financial resources and the economic climate all can foster these transactions.

McMenamin: Spin-offs are often the result of a determination that various businesses can achieve their full potential more efficiently by making them stand-alone, independent companies. Creating smaller, more focused organizations can increase the value for

shareholders and other investors. The divesting company can refocus its business while benefiting from the sale of the unit. The spun-off organization then faces its own challenges as a new entity.

Q Do spin-offs differ from mergers and acquisitions in terms of human capital needs?

A Brizel: Yes, they do, because spin-offs are *not* mergers in reverse. They're complex, risky transactions. While spin-offs, mergers and acquisitions have some HR considerations in common, spin-offs present their own unique HR challenges.

McMenamin: In a spin-off, the magnitude of change can be enormous. For example, businesses that had been part of a public company could be privately held after being spun off. Also, the new organization will likely be smaller than the original one, with limited corporate and HR infrastructure, and the mix of employees could be dramatically different in the new entity. Business units that had a large presence in particular countries could see those operations shrink

dramatically and suddenly have very different support needs. And as the organization moves from being a supporting player in a large business to being a stand-alone entity, its business goals could change radically.

Q **What's the most immediate human capital challenge when conducting a spin-off?**

A **Brizel:** Getting ready for Day One as the new entity. Leaders must meet myriad requirements in order to have the right people and processes in place on the first day. It takes a lot of time, planning and consideration to put those things in place. At the same time, the business unit must be stabilized and able to retain and engage the talent in the organization. Having the leadership team for the new organization in place on Day One is crucial.

McMenamin: You need to develop your game plan and establish priorities immediately. What absolutely must get done for business to start on Day One? What's important, but can wait? Often there's a tightly compressed timeline for these divestitures, so it's essential to be clear about priorities and stick to them.

Brizel: I encourage business leaders to ask themselves, "What can stay the same?" and then follow with, "What has to change?" For the latter, they need to understand why things must change and be deliberate in their decisions. Then they need to include the changes in their timelines.

Another significant challenge in a spin-off is preparing people for the future. Change management plays a big part in preparing employees for their roles in the new entity, and communication is most effective when leaders explain the reasons for decisions. Through change management efforts, leaders begin to paint a picture of the future for employees, which is critical to retaining and engaging them.

Q **What priorities typically must be addressed in preparation for a spin-off?**

A **Brizel:** A top priority is ensuring you have the right people in the right roles. You have to identify who you want to retain and create programs to recruit those you need to bring in. It can be challenging to attract people to a new entity that doesn't yet have a track record. And retention can be tricky, because competitors might view the transition as an opportunity for them to pursue talented and critical employees who feel insecure about their roles in the new order.

McMenamin: The latter point is exactly why communication is essential from the outset. Employees will go through a lot of change — perhaps even more than in a merger integration process. They want to know what it means to them that the company will be independent. How will it affect them that the new entity will be private versus public or small versus large? How will their talents and skills align with the reshaped corporate goals? Will their compensation and benefit packages change? Basically, they'll want information quickly, so as to assess the impact of the change on their deal with the company. The question on every employee's mind will be, "What's in it for me?" It's very important for leaders to start addressing those questions early on.

Developing a strategy to measure employee engagement is also critical in ensuring a smooth transition. Employee behavior directly influences customer behavior, and customer behavior directly affects revenue growth and profitability overall. So the importance of measuring engagement levels through surveys and other means, and factoring the insights into the new entity's business objectives, can't be overemphasized. Towers Watson's research underscores the importance of understanding how change affects people. We've also studied how people's behavior in the face of change can affect organizational performance and the speed or efficiency with which an organization achieves its transaction goals. The behavioral element shouldn't be overlooked.

Brizel: Another priority that might seem obvious — but that can be overlooked when leaders are focused outward — is setting up the HR function. HR will have its plate full. It will need to keep day-to-day operations running, build a new team, and help everyone in the organization understand and prepare for the transition — often with limited resources.

McMenamin: Many of the services HR had been receiving through its corporate partners will disappear. HR leaders will need to marshal their ideas and answer questions such as: "How do we structure ourselves and what we do?" "What can we stop doing?" "What do we want to look like in the short, medium and long term?"

Brizel: All of this will come with a steep learning curve for some. The depth and breadth of HR leaders' responsibilities could increase exponentially. They might have been responsible for implementing total rewards in the old company, but now they must also manage strategy. Or they might have been well versed in recruitment or retirement benefits in the U.S., but now have global responsibilities and more limited resources.

Q How do spin-offs affect total rewards?

A McMenamini: Assessing total rewards to ensure they closely align with the new business priorities is crucial to a successful transition. The first step is to identify key employees and critical talent; next is to understand what those workers value in their current environments, and then devise a strategy to deliver similar value.

As you build the new organization, you'll need to assess and compare your total rewards practices with those of competitors, some of which could be new. You might need to define new benchmarks. You'll want to understand what it means to be a successful, well-rewarded employee in the new context.

The form your divestiture takes will influence the rewards you'll be able to provide. For example, if the spun-off entity is shifting from being a public company to being privately held, you'll need to decide how (or whether) you'll replace stock options or equity, and how you'll communicate the changes to employees without weakening engagement.

Companies with global operations will need to pay close attention to rewards. In some cases, the divestiture will mean that only a handful of employees will remain in a country where there has been a large employee population. It will take some analysis to ensure the remaining employees' compensation and benefit packages remain appropriate and equitable.

Q What should companies do to prepare employees for changes related to divestiture?

A Brizel: After the spin-off is announced, the only thing employees will understand is that things will change. A strong change management plan is the best way to help them through this period of uncertainty and keep them engaged. Managers should be given the resources to help guide employees while remaining focused on business issues. You want employees to turn the corner from focusing on the past to being excited about the future.

You should link your change management plan to transaction milestones. Create targeted communications for various workforce segments, to help people understand the impact of the spin-off on them personally. At some point, fatigue will set in, and people will stop reading e-mails or paying attention to issues that need to be addressed. Some people might retire before the transaction is finalized, or some might need to exercise their stock options or take some other step. If they don't have a clear sense of your expectations — or someone to keep them on track — it will be chaotic at the end.

Q What characteristics mark successful spin-offs?

A Brizel: At the top of the list is ensuring that HR understands the rationale behind the spin-off decision and some of the associated risks. HR can't develop human capital plans without a solid understanding of the business reasons for the divestiture, as well as the business goals and operating environment of the new entity. For example, something that might have been a glimmer of an idea in someone's mind when the entity was part of a bigger organization could become a pivotal strategy in the new organization and operating environment. And that could change who should be considered critical talent.

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Equally important in cross-border transactions is thinking globally from the outset. Though it's easy to immerse yourself in the details of the transaction when you're sitting at headquarters, it's vital to look at the broader picture. For example, though the deal may be taking place in the U.S., the things that could go wrong in other countries can be considerably more challenging than what happens inside the U.S. Missteps elsewhere could be painful and costly.

McMenamin: Negotiating effective transition services is also very important. Often, the parent company will offer to provide payroll, HR systems and other services to the new entity for a defined period of time during and just after the transition. While this can be enormously helpful, the agreement should be specific about the services that will be provided, their costs and the people who'll deliver the services. Remember, it's likely the person who will be responsible for delivering the transition services may be supporting two entities after Day One. Clearly understanding and documenting transition support for payroll, HRIS and HR service delivery is another key to ensuring a successful transition.

In addition, one of the most fundamental components of a successful spin-off is a strong project management office, or PMO. The PMO oversees the entire HR transition, including all the separate work streams, and links HR milestones and decision points with the business project leaders. The PMO sets and enforces deadlines that must be met for a successful Day One.

Brizel: Finally, there's a lot of value to be gained by incorporating measurement throughout the process. Take a close look at your costs, and put measurement tools in place for tracking areas of concern. Something

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that cost you “x” when you were part of a larger organization might cost you three or four times as much when there are only two or three employees in a particular location. Data will help you make a business case for needed changes.

McMenamin: We've covered a lot of ground here. To sum up, our experience has taught us a few important success factors: Make sure you align your HR objectives with the strategic objective and structure of the deal. Make sure your processes and plans line up with the larger goals of the organization. Establish guiding principles to help leaders set priorities, identify decision makers early on and ensure milestones are clearly defined. Be sure to document and measure your progress.

The bottom line? Spin-offs always go faster than you expect. Establishing a strong PMO, creating work streams and identifying decision makers to address critical HR issues as early as possible are crucial for success. A thoughtful, comprehensive approach — with a sharp focus on human capital — can make all the difference in your results.

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