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M&A and Carve Outs (Part 2)

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Don't forget – there are people involved

Sometimes you can get so focused on the nuts and bolts of a carve-out that you can overlook the very human element of the deal: your HR.

Claudia Poernig, Managing Director of DLA Piper's International Corporate Reorganization practice, has seen it happen many times.

"In my experience, I find this is very challenging and it can take a lot of time. Clients need some sort of interim period to focus on this, or they're not ready for prime time."

In her years of experience leading M&A and carve-outs around the world, Claudia has seen recurring HR challenges, all of which might be affected if not dealt with effectively.

Risk one: how will you transfer employees?

The business unit set for carve-out has employees working in it, and how they transfer to the new entity will depend very much on where they are based and the nature of the carve-out deal. You may be facing a TUPE[1] regulations, or you may end up terminating all staff and re-hiring them in the new entity. Neither is straightforward, and there is risk every way you look.

Remember: you need employees ready, or your first day of operations will be a quiet one. And you need to be able to pay them, or they won't stick around to help you grow.

"I see a lot of problems with HR," says Claudia. "When I want to separate a business into a new entity, I have to make sure the new entity is ready to employ on day X. In a given country it may need to be registered as an employer, it needs bank accounts, it needs a payroll system - you need to be ready for prime time.

"I think a lot of times people underestimate what needs to happen

[1] Transfer of Undertakings (Protection of Employment)

when it comes to employees, especially in highly regulated countries. Somewhere like China, for example, establishing and running payroll might be very difficult for you to sort out from HQ, so you'll have to outsource it. Then you need to find a trusted provider who can do that for you and who can help you set it up."

Risk two: dealing with organized workforces

Those leaders of workforces with strong unions or Works Councils are unlikely to forget these very important players, but you do need to make sure you communicate your carve-out intentions to them sooner rather than later - in some countries, they may even be able to veto the deal.

"Communicate with your works council very early on because otherwise you might not have a chance to implement on time," says Claudia.

"The deal might not trigger any changes for the workforce - it could even be beneficial for employees - but when a Works Council hears 'we're going to sell a business unit', their job is to be suspicious. In some cases, they may even have a say, or need to approve the deal. So communication is very important."

At the end of the day, if you're wondering if you should notify the Works Council about something, you usually should - just in case.

Risk three: what about the benefits packages?

One thing is guaranteed in HR: mess with a benefits package, and there will be hell to pay. You'll need to examine the benefits package both current and intended to ensure there's no degradation of entitlement - and if there is, you need to have your messaging right.

Claudia gives the example of pensions: "The pension might be with the overall holding company, not the new entity or buyer, so you want to make sure that vested employees keep their benefits when transferred and you make clear which entity needs to fund the pension going forward. There's a lot of calculations involved, and accruals - the numbers game. Make sure you work with a pension specialist who can oversee that transfer of benefits."

Then there's the holidays, the bonuses, the health cover… Ensure your talent attraction and retention is considered an integral part of the carve-out deal.

How to establish whether your M&A compliance partner is the right one

We have spent many years working with multinational companies on mergers and acquisitions, and we've noticed there is a pattern to how things go.

Company wants growth. Company buys a carved-out division of a foreign company. Company finds a compliance partner to do the deal admin. Company takes over the division, entering multiple new markets. Company soon realises compliance isn't the same everywhere. Company faces a long road to compliance, and potentially even fines and operational bans in a new territory.

It can be heart-breaking to realise that all your hard work, planning, and strategy on the acquisition will amount to naught because you assumed your global HR and accounting functions would be able to tackle statutory accounting in Taiwan, or run the right payroll in France.

We found that although outbound FDI from the US is forecast to fall this year[2], US-based multinationals still see investment outside the US market as central to their corporate growth plans. The developed economies of Northern and Western Europe, as well as Canada, remain the most favoured destinations for investment over the next two years. Emerging markets in South America also remain a destination choice for one-third of companies surveyed.

So, to save the heartache and help streamline your M&A deal, make sure you ask any prospective compliance partner the following five questions before signing a contract.

1. What presence do you have on the ground in these countries?

Yes, you could get that experience operating from a shared service centre somewhere offshore - but what do you do about those countries that require statutory filings to be handed over in person? In-country operations were important enough for you to buy the new entity, and your service provider should recognise the importance of matching that commitment with in-country personnel.

2. What statutory accounting experience do you have in these markets?

Government regulation can be hard to anticipate, and even harder to interpret. Knowing the history of where an Act has come from can help you to gauge the appropriate response for a multinational entity to take for any developments. Wherever you are, the regulatory environment is constantly changing both locally and globally. In many parts of the world – particularly in Latin America – the only way one can react quickly is to be local.

3. What's the transition timeline for us to be up and running smoothly?

It is easy to overlook, especially if you have a Transition Services

[2] Data from TMF Group research in partnership with Forbes Insights.

Agreement (TSA) in place with the seller in the transaction. But, Randy Worzala, Head of Sales – Americas at TMF Group explains, “Acquisitions and/or carve-outs happen quickly, and whatever the buyer expects to receive by way of the TSA from the seller – the reality is you’ll be lucky if you get half of it. Much like the buyer in the transaction, the seller is equally focused on closing the transaction. Post-close, whatever happens is the buyer’s responsibility. Often that translates to the seller having a different level of motivation than the buyer to ensure TSA obligations are adhered to.” Partnering with a provider that can mitigate that risk with a ready-made capability in your acquired countries can greatly accelerate your speed to market.

“The TSA clock starts ticking as soon as the paperwork is signed, and extending the coverage will cost you a lot. You want your new compliance partner to be ready as soon as possible, and if they need to recruit their own teams or service providers, the transition timeline can run on and on and on.”

4. What language capabilities do you have in-house?

Translators are a dime a dozen, so this doesn’t really matter, right? Wrong. Native nuances can be missed by translators, but more than that, it’s only when you’ve been trained in the country and in the language that you truly understand those local compliance needs. Make sure nothing is lost in translation.

5. What technology do you use to ensure global oversight of all work?

In-country coverage isn’t enough when you’re operating in multiple markets; you need to have an easy way to have a view of all operations at all times. Does your service provider have locally compliant financial reporting and payroll systems already in place in each of your countries? Or will your in-house teams spend much of their time, and a significant amount of the integration budget on implementing a global Enterprise Resources Planning (ERP) and Human Resource Information System (HRIS), while introducing significant risk to the Go-Live schedule?

Before you sign any contracts, make sure you question your prospective compliance partner on all of these points. It could save your time and money – and it could save your business.

Cross-border M&A integration – what if it goes wrong?

It’s not an exaggeration to say that when it comes to cross-border M&A implementation, one misstep can lead to significant financial, reputational and regulatory impacts. Make incorrect assumptions about the timing of setting up your entity or setting up your employees to be paid, or about how long it will take to register with authorities, and you may not be ready in time. Remember, you’ve agreed a handover deadline with the company you’re acquiring from, and it's detailed in the TSA – and these agreements can include a heavy financial burden for missing deadlines.

There are non-financial impacts, too. If you don't set up payroll or bank accounts properly, you might miss your first payroll to new employees - people who will be struggling to adapt to change and won't be too happy with their new management if they have to miss a payment on their mortgage. You might also miss payments to vendors who you rely on to be able to service your own clients.

And it does not just about understand how a business needs to operate in the new country; you need to know how a business from your home country needs to operate in your new country. There's a major difference - double taxation treaties, Foreign Account Tax Compliance Act (FATCA), BEPS compliance, and more. These things could impact you not just as a one-off, but for years after.

All of this can cause lasting financial and reputational damage.

Four ways to avoid these kind of errors

Getting it right can boil down to answering these four essential questions.

1. Are you acquiring the whole entity, or just part of the assets?

There are really two scenarios for an acquisition: you acquire a full business with physical entities and employees, or you acquire a division - that's a stock purchase or an asset purchase. In the first scenario, you will likely also take over any pre-existing contracts with suppliers, employee contracts, and so on; the latter is an acquisition of the assets of the company, rather than all the bells and whistles.

Stock purchase brings complexity

You'll need to understand how the business is operating in the country or countries you're moving into: are they compliant? Have they done all their necessary tax filings over the whole operational life? What about the other reporting and regulatory requirements in that country? Often the answer to the compliance question is "no", and you'll need to take the necessary steps to bring the business to compliance, and keep it there.

Asset purchase brings multiple registrations

You've acquired a division of a larger company; it's likely that company had a single back office function servicing all its divisions. You'll need to set up teams for accounting, payroll and compliance. You'll also need to understand local compliance and how to operate locally. If you're acquiring employees, what will happen when transfer them to your company? Do you need any new licenses or to register anywhere? This brings me to the next point.

2. How can you complete the deal compliantly?

Remember that every country's regulation is unique, even in countries just on the other side of your border. Timing is of the essence with a carve-out or acquisition, and you must remain aware of how long it takes to get things done locally. For example, you may have agreed a date for the transfer, but may not have considered that, say, in Argentina it can take six months or more just to create an entity - and that's before you start thinking about registering as a taxpayer, getting your bank accounts set up so you can pay staff, and so on. In places like Brazil, Mexico, Colombia - even parts of the United States - you need to not only register as an employer at a national level, but also register at a state or county level. These things can impact your timing, so make sure you're asking the right questions to get set up correctly.

3. Have you considered the cultural impact?

The culture question is an important thing that often gets overlooked. From an employee or an outside vendor's perspective, any type of M&A is a sensitive one. Everyone's worried what their future will be going to look like. You need to understand the local cultures - even simple things, like how what someone says and what they mean can differ. Make sure you're working with someone who can help you with the cultural nuances, who have been through it all before. Someone who knows what a "normal" benefits package looks like, e.g. if a new employee in Colombia needs a medical examination. or if you are legally required to provide meal tickets to employees. If you're acquiring a business that has a heavily unionised workforce, or a very strong Works Council (these are particularly important in Germany and Benelux), make sure you know when and how to work with them - remembering that they may need to be involved before you sign the deal.

4. Do you have the resource to get this done right, and on time?

Whether you work through internal resource or outsourced vendors, inheriting an entire company will bring an increased workload. Your great couple of HR, legal, or finance managers in the US or Canada will now need to look after hundreds or thousands of people across the globe. And in each of those countries, the culture and regulatory needs will be different. Can you get the transfer of assets done in a way that is in line with data protection regulation in both countries?

Where the purchase covers multiple countries, you may also be inheriting multiple vendors across all those countries. Let's say each country has separate providers for payroll, accounting and regulatory compliance. If you've bought a company operating in five countries, that's 15 providers you now must manage; in 10 countries, it's 30, and so on. Do you have the necessary internal resource to manage all those suppliers, or will it be better to streamline to one single provider across all countries of operation?

Do your homework, make sure you're set up right and working with partners who can help you navigate ever changing local requirements so that great growth opportunity can be made a reality.

TMF GROUP
Global reach
Local knowledge

TMF Group helps its clients operate internationally and 'belong' wherever they are in the world. They do this by making sure their clients are properly set up to do business in any country and compliant with local and international regulations.

TMF Group firmly believe that the only way to be truly 'global' is to put local first, which is what their team of 7,000 in-country experts do for businesses of all sizes, every day.