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M&A: Plugging the Brain Drain

A FOCUS ON HUMAN RESOURCES CAN PREVENT THE LOSS OF INTELLECTUAL PROPERTY DURING MERGERS AND ACQUISITIONS.

Susan Grant and Carol Cherkis

Susan Grant is president of Winguth, Grant & Company, a retained executive search firm in San Francisco, CA. She can be reached at (800) 795-3550 or sgrant@winguthgrant.com

Carol Cherkis, PhD, is the life science consultant at NewCap Partners. She can be reached at (650) 631-0428 or cherkis@newcap.com.

The rapid pace of M&A activity in the biomedical industry is likely to continue—along with an accompanying shortage of qualified people to fill the industry's needs. When merger negotiations focus on physical assets, real estate, and product portfolios and give short shrift to people issues, critical intangible assets such as intellectual capital can get lost in the shuffle.

Often, the loss of those assets goes unnoticed until long after the transaction books are closed. When a company is "on the block" or undergoing a major transition, insufficient human resources (HR) and business planning can cause its reputation to suffer as it faces scrutiny from peers and competitors.

That means companies must consider human resources as well as business issues when planning for mergers or acquisitions, and both sellers and buyers need to do their homework. This article discusses some of the consequences of poor planning and outlines a three-phase strategy for conducting mergers and acquisitions while minimizing the loss of intellectual capital.

Pitfalls of Poor Planning

Failing to consider HR issues in business consolidations can cause employees to jump ship as they fear losing their jobs or being lost in a larger, hierarchical organization. Improper planning can also

invite competitors to raid the company.

In 1998, when word got out that Bayer was buying Chiron Diagnostics, many long-term Chiron employees wasted no time in updating their resumes and going to work for local start-ups eager for their experience and talent. Therefore, Bayer failed to acquire the depth of talent it expected.

And for young biotech companies, poor HR planning can raise fears among alliance partners that the company's value has decreased. Problems with intangible assets, such as staff and reputation, can also damage a company's status and ability to bring products to market.

When Celera recently announced its plans to change from a genomics/bioinformatics company to a full-fledged pharmaceutical company, investors and the media questioned the future of its Paracel unit, which consequently became devalued. If the company had sold Paracel before publicly discussing the change in strategy, it would have retained its value as well as boosted the morale and career options for Paracel's employees. To avoid such consequences, merging companies must implement a three-phase strategy consisting of planning, restructuring, and integration.

Plan Ahead

Preparation has the greatest positive impact on M&A success. Management must spend considerable time and energy on planning, which not only smooths the integration, it also sends a strong signal, both inside and outside the company, that the proposed merger/acquisition is a major corporate priority.

Identify key strengths. The first step is to clarify the company's key strengths and align human resources accordingly. The board or top managers should analyze the company's business and technical strengths and weaknesses, enabling them to see which areas need to be fixed and what value the company brings to a new union. (See "Get Ready.") Hiring an M&A firm can facilitate that type of objective analysis.

Before initiating alliances, executives at one privately held company made the difficult decision to drop its founding technology, a me-too molecular diagnostics product line, and focus all its efforts on its fast-growing sterilant/disinfection business. Subsequent realignment of its small R&D staff resulted in the rapid development of new formulations that led to several joint venture opportunities.

To increase company value, leaders must—with HR's help—also evaluate managerial, business, and technical talent within the company and determine which workers will be difficult to replace. It makes no sense to lose genomics, proteomics, bioinformatics, and regulatory/clinical experts whose positions can be filled only through an extensive search.

As the biotech industry matures and more drugs move through clinical trials, the demand for synthetic organic chemists, biologics batch processors, quality assurance specialists, and manufacturing supervisors will heat up, possibly leading to the sort of hiring frenzy that handicapped the high technology world in the late 1990s. Integrating new employees into company operations takes time and attention, distracting top management from other tasks.

Cut the excess. Next, the HR merger team must determine which workers are in oversupply. Managers must prune and streamline to make the bottom line more attractive. For example, chemists or biologists who lack knowledge of the latest techniques may need to be let go. Managers may also need to lay off sales and marketing personnel associated with discontinued product lines.

Another difficult but important task is to remove non-performers who are in critical positions and to rehire early to integrate the newcomers as productive team members. "Dead wood" must be removed because it damages valuation and hampers operations. That means companies should hire a search firm early in the process to give staff replacements time to understand the company and make significant contributions.

When a privately held company with less than $20 million in revenues prepared for acquisition, the CEO understood the importance of having a highly credible chief financial officer (CFO) in place. The controller, whose skills were not strong enough to warrant a promotion, handled accounting, and the CEO, who had served as a CFO for a couple of public companies, acted as the financial interface with the investment community.

A search culminated in the hiring of a CFO with multi-location, public com-

Get Ready

Business	Human Resources
Clean up the books/prepare for audit	Evaluate current talent, determine who stays/goes
Do tax and estate planning (private companies)	Plan retention tactics
Maximize company value (increase sales/decrease costs)	Plan communication of who's in/out, implement
Add outside directors	Fill gaps in management
Raise the company's public profile	Understand company's own culture
Position the company for the right comparisons	Set up a plan to determine cultural differences of potential buyers
Document the competition	Determine how to handle those differences, implement
Scrutinize the company as buyers would	Determine/fix compensation/benefits misalignments between companies
Understand the buyers' needs	Put relocation plan into place
Be patient during negotiations to maximize price	
Be prepared for the unexpected	

pany experience who was able to help define and implement strategies and tactics for aggressive growth worldwide. Having another financially astute executive as a strong right hand for the CEO made the company more attractive to investors and acquirers.

Communicate with employees. Throughout the acquisition process, companies must keep employees informed of how the merger will affect them so they can prepare accordingly. Companies should counsel staff about changes and gain their help in the transition process. The initiative needs to come from the top in a global message delivered by the heads of various departments.

Agilent is one company whose managers are good communicators—even in tough times. During layoffs at its Healthcare Solutions Group and in several subsequent downsizings, the company's top-quality management practices, well honed planning disciplines, and empathetic culture served it well. According to *Fortune* (February 4, 2002), Agilent remains among the "best companies to work for."

Structure for Success

The planning exercise's value can be realized only if the companies involved structure the transaction to optimize personnel outcomes in support of business objectives.

Handle with care. Managers must be up front about "who's in and who's out" and must clarify how they will take care of those people. The biotech industry is inbred; everyone knows, or knows of, everyone else. When a company handles employee issues well, it gains a good reputation and finds it easier to attract and retain good people later.

Mary Ann Rafferty, vice-president of HR for Onyx Pharmaceuticals in Richmond, California, reiterates that communication with all employees—those staying and those leaving—is critical. When her company recently restructured, top management spent considerable time planning the communications. They made it clear that decisions would be based on an analysis of people's skills versus the needs of the business for the next 24 months.

The CEO was physically present for the announcement. Executives expressed empathy toward the people staying as well as toward those leaving. Rafferty says, "We told people we knew that, as stretched as they were, some things wouldn't get done. We said we appreciated the effort they were making and we understood that, although it's hard on those leaving, it's also hard on those remaining."

Re-align the staff structure. If a merger or sale is imminent, it is important to hold on to key technical people, especially regulatory personnel who are critical if a company is involved in clinical trials. Talking to each person and painting a picture of his or her role in the new entity, regardless of the buyer, is a must. Management must work closely with HR to develop an attractive retention bonus package.

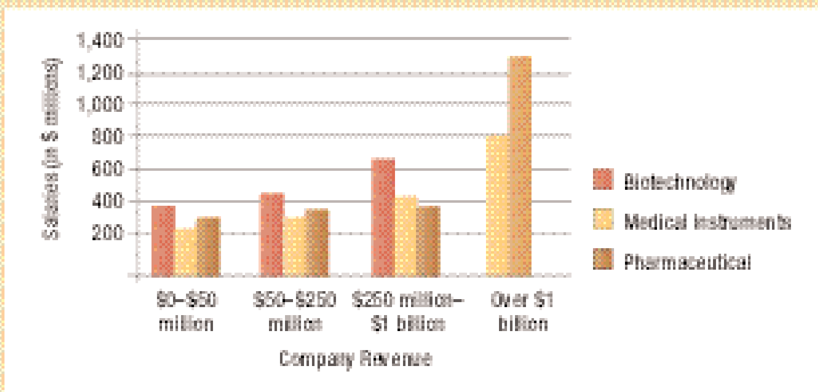
Rafferty also indicated that when Onyx closed a division, it granted retention money to employees at all levels at pre-announced milestones. For senior-level team members, it gave a bonus of 20–30 percent at the mid-project mark, then another 10-15 percent at the project's completion. Retention bonuses were given all the way down to the research assistant level and onsite outplacement was also available. Onyx wanted the retained employees to see how well the company cared for those who were leaving.

Know the buyer. During the courtship phase, flexibility is vital because each potential buyer has different needs—in business and human capital—and therefore will be attracted to different strengths within the company.

For the purchase of an immunodiagnostics reagents company, for example, three potential buyers each have a different acquisition rationale, place a unique value on the acquisition, and plan differing integration scenarios. The analysis becomes much more complex as additional factors such as customer lists, target markets, and plans for future products and intellectual property are considered. (See "Buyer Scenarios.")

SALARY INEQUITIES

CEO salaries are fairly equal across industry sectors except for companies that earn more than $1 billion annually—then Big Pharma gets the big bucks.



Source: Clark Bardes Consulting

Integrate With Caution

Although the planning and structuring aspects of the merger/acquisition process are difficult, it is the integration phase—the combining of people, systems, and cultures—that tests the mettle of the new entity's leadership. The quicker, more thorough, and less disruptive the integration, the better.

It's important to evaluate the staff from the post-merger company's perspective. The buyer is in charge. Sellers that fail to plan or implement plans during the courtship lose the opportunity to make personnel changes.

Culture clashes. Cultural issues, both domestic and international, are critical to

Buyer Scenarios

Potential Buyer	Acquisition Rationale	Acquisition Value	Likely Integration Plan
Large-sized reagents firm with similar immunotechnology	Increase market share, decrease costs of overall business	Low	Integrate the two businesses
Medium-sized reagents firm with different immunotechnology	Extension of existing business by addition of new product line	Medium	Keep units intact
Instrument firm with limited reagent products	Addition of new product line that complements an existing business	High	Keep units intact

the venture's success. The merging companies must conduct cultural due diligence and address the following issues:

- corporate structure
- culture and climate
- company values
- predominant management style
- top management's business and personal agenda
- decision making processes
- employee demographics
- communication style and methods
- industrial relations climate.

According to a recent Conference Board study, corporate culture conflicts and CEO personality clashes are key reasons for M&A failures. "Cultural issues are equal to financial factors in making a deal successful," says Lawrence Schein, author of the study. "M&As are conflict-prone situations that bring the risk that even seemingly small cultural differences can take on enormous significance. The study suggests that CEOs and other top executives could benefit from mentoring on cultural issues."

Management styles. A personality clash between Sir Richard Sykes and Jan Leschley, the CEOs of Glaxo Wellcome and SmithKline Beecham, respectively, was partly responsible for the failed merger attempt of the two British companies in 1998. Problems concerning the roles that each executive would play and how the new company would be run resulted in cancellation of the merger. The companies finally succeeded in merging in 2000 when Sykes and Leschley both agreed to retire.

Dissimilar management styles are another major source of conflict, particularly when large, traditional pharma companies acquire relatively small biotechs with breakthrough technologies. Successful integrations result when the buyer is able to put the seller's technology to good use in the large organization without stifling the innovative spirit of the smaller company.

Merck's purchase of Rosetta Inpharmatics in July 2001 is such an example. With Rosetta's top-notch scientists and leading-edge genomic research and data analysis capabilities, Merck now has a tremendous drug discovery advantage over its competitors who rely on purchased databases and alliances with other toolbox companies. And, by remaining in the state of Washington, Rosetta has just enough interaction with its East Coast parent to provide needed expertise, but not so much that it will lose its innovative culture.

There may be many cultures within merged companies, but they must work together toward shared goals. Clarity of leadership is critical early in the process, especially from the CEOs. The chief executive officer articulates the vision; if he or she fails to do so, no one will.

Compensation programs. Managers must establish and communicate priorities, restructure the new organization, and establish compensation programs quickly so that people know their roles and customers experience a seamless consolidation. Customers will switch alliances if their needs are not met because of a break down in business processes. Similarly, many employees may walk out the door.

Compensation inequities between two companies, including availability of stock options, must be resolved quickly. Even differences in holiday and vacation policies can cause friction in the ranks. Because salaries in small startups will typically be lower for similar titles in larger companies, merging companies can deal with "sticker shock" by strengthening employee stock options. When the organization grows, it will be able to deliver high value to executives without incurring high cash output. (See "Salary Inequities.") However, in light of the current questions about expensing stock options, it is critical to consult with legal and financial experts on the matter.

Relocation issues. Frequently, people are unwilling to leave the "biotech centers"—Boston, San Francisco, and San Diego. A strong relocation program, including housing assistance, can help the acquiring company avoid problems. When moving a new person to a high-cost-of-living area, it may be necessary to give him or her a cost-of-living differential, a temporary allowance during the search for affordable housing, or even a forgivable loan to cover high real estate closing costs. The company can directly pay for the move or give a lump sum payment to the employee.

The importance of handling people well—in other words, good HR planning—during all phases of the merger/acquisition process cannot be overemphasized. As the healthcare industry's shake-out continues, leaders on both sides of transactions can benefit from the three-phase strategy. Many merger failures that are blamed on bad business strategies are, in fact, the result of poor HR practices—and thus, poor implementation of what may otherwise be a good business strategy. ∎