

M&A Practice

Talent retention and selection in M&A

Retaining critical talent and ensuring the right people are in key roles are essential to a successful merger.

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An organization is only as good as its people, as the adage goes. At no time is that more true than during a merger integration. A deal can create an opportunity to upgrade talent across the organization; in some cases, gaining access to highly skilled employees is the primary reason for an acquisition. Conversely, mismanaging talent issues can seriously affect the success of even a relatively straightforward transaction.

Organizations undergoing a merger need to tackle two core challenges around talent: how to retain people critical to the combined company's performance and how to manage the employee selection and appointment process in a way that causes the least disruption and anxiety. Thorough preparation and management of both processes is paramount to achieving a merger's goals. This article presents our insights into talent issues that arise during M&A and how to handle them to foster a smooth transition.

Understand your merger archetype

Managing talent in a merger integration should not follow a one-size-fits-all approach. Rather, the type of deal you pursue needs to guide how you go about employee retention and selection.

In the case of two organizations of similar size coming together in an approximate merger of equals, both the acquirer and the target company need to pay close attention to retaining key talent. This type of deal often happens during industry consolidations or when a company is trying to reinvent itself by acquiring a competitor with complementary products and customer relationships. While leadership teams tend to protect their own core cadres and corporate cultures, the focus here needs to be on keeping the people best suited to driving the combined company's performance. Accordingly, a fair and transparent selection process is needed to avoid (real or perceived) biases or favoritism on the part of either legacy company.

When a larger, often better-performing company acquires a smaller or lower-performing firm that operates within its core business, employee selection tends to favor the acquirer's incumbent talent. In such cases, the acquirer's retention focus may be quite narrow, aimed at the best performers or employees deemed critical for maintaining business continuity.

In an acquisition involving the entry into a new business or market, the buyer's talent retention focus will likely be quite different. Typically, retaining the target firm's employees is essential to the deal's value, and there is usually limited overlap between the target's workforce and that of the acquiring company, aside from support functions.

Tailor your talent retention strategy

During the anxiety-filled period of merger negotiation and integration, talent deemed critical to the combined company's future needs to receive special attention. Since talent flight can undermine performance, value creation, and both the near- and long-term success of the deal, organizations should develop talent retention plans as soon as possible—often before the acquisition is finalized.

The key steps in a talent retention program are determining its scope and approach, defining retention levers, and implementing and monitoring the results.

Determine retention scope and approach

In most merger scenarios, the vast majority of employees do not receive retention packages—typically, less than 2 percent of staff should receive such incentives. However, those few critical employees need to be identified quickly. They could have highly specialized and hard-to-access skills or knowledge vital to running the combined business (such as expertise in the legacy IT systems). They may be important for ensuring stability during the integration phase or they may be high performers essential to building the next phase of the combined organization.

Talent-retention programs typically target critical employees with a mix of financial and nonfinancial incentives. While financial measures tend to be the first lever organizations turn to, this approach can be both expensive and often less effective than companies anticipate.

For example, when a global medical device company acquired a small but fast-growing healthcare solutions firm, the target's product innovation capabilities were a core reason for the deal. The acquirer's CEO knew he had to move quickly to engage and retain the R&D team, so the head of the integration group promptly flew across the country to meet with the staff, reassure them about their roles in the future organization, and express the company's enthusiasm for their product innovation plans. The integration leader also committed to ring-fencing the R&D team to allay their concerns that the multinational's "bureaucracy" would stifle their activities. All the core innovation staff ended up remaining with the new company, with limited financial retention investment required.

It can be challenging to identify the most valuable individuals or know which ones represent a flight risk. Often, top leaders create lists of employees they feel are important to retain—a top-down approach that, being fast and simple, is well suited to mergers with short time frames and high potential for significant loss of talent. However, unless an organization had recently undertaken a talent-to-value exercise, top corporate leaders may lack a comprehensive understanding of the critical talent and roles in the company. As a result, the company may end up offering retention bonuses to too many people, some of whom do not hold essential roles, potentially causing integration cost overruns. Conversely, complex hierarchies or unconscious biases may shield top executives' views of who

really matters in the legacy company, leading to omissions in retention efforts that end up costing the combined company valuable capabilities.

A more comprehensive but time-consuming alternative is a bottom-up approach, which gathers input from multiple management tiers and combines it with other information, such as employee interviews, surveys, or social network analysis. While this provides leaders with a more detailed understanding of the talent they should try to retain—including people at lower levels of the organization—it is not always feasible given pre-close limitations on who can be engaged for input and what information the target company will provide.

A solution that balances the above two approaches is for the legacy heads of each function and the HR business partners of both organizations to nominate the 2 percent "critical talent" in each area—individuals in mission-critical roles, high performers, or those with strong future potential. The HR team can then vet the list with the CEO, the chief human resources officer (CHRO), and the integration leader to determine the need for retention incentives based on the impact and probability of each individual's departure. (For more on identifying critical talent, see "Matching talent to value" and "Finding hidden leaders" on McKinsey.com.)

Define incentives

Talent-retention programs typically target critical employees the company believes it may lose with

a mix of financial and nonfinancial incentives. While financial measures tend to be the first lever organizations turn to, this approach can be both expensive and often less effective than companies anticipate. Financial incentives are best used for addressing short-term needs, such as inducing a finance manager targeted for layoff to stay for a few months after merger close to help with the transition from legacy financial processes to new ones adopted by the combined company. Generally, however, organizations should lead with “soft” incentives such as praise, attention from leaders, and opportunities to take on more responsibility, all of which have proved to be more powerful at keeping talent motivated. A McKinsey survey of more than 1,400 integration executives, for example, reported that “praise and commendation from an immediate manager” was the most effective retention lever, scoring above performance-based cash bonuses and increases in base pay.

In general, incentives should be offered in waves rather than at one time, as not all essential employees will be immediately known to management. Additionally, leaders may find that some highly valued talent does not need special incentives to stay after the deal is announced.

Implement and monitor retention

Once companies have identified their critical talent and determined suitable incentive plans, they should waste no time in implementing the retention program. With financial incentives, it is usually best to conduct the program discreetly so as not to alienate those not offered incentives to stay. There is much less sensitivity around the many nonfinancial retention levers, such as opportunities to participate in training programs or invitations to lead projects, as these are common incentives or rewards for high-performing individuals. With both retention approaches, perceived fairness is critical. In particular, functional heads and HR staff need to be prepared to answer questions about the methodology and thoroughness of the process that determines which individuals receive financial bonuses.

Tracking the impact of the talent retention program is important, both as it applies to the overall workforce and employees identified as critical. Companies can use metrics such as unwanted

attrition, turnover costs and employee satisfaction, and should be proactive in adapting the retention program in response to the findings. For instance, engagement surveys can deliver early alerts of declining staff morale, providing time to reengage select employees or employee groups before they decide to move on.

Selecting the right talent

Identifying the candidates for key positions in the combined company is a priority that HR leaders should start addressing even before the deal closes. From determining the selection criteria to communicating, implementing, and tracking outcomes, the decisions made at this stage will bear heavily on the integration’s success. This is particularly important in deals involving the merger of similarly sized firms as such situations require more finesse than other M&A integrations.

At a time when companies are competing for talent in a global arena, offering a positive employee experience—by enabling staff to create personalized, authentic workplaces that ignite their passion and give them purpose—is a key driver of retention, especially among millennials. Our research shows organizations that focus on employee experience as a core element of talent management have a 65 percent chance of achieving superior total returns to shareholders.

Designing, managing, and delivering a positive experience is especially important during the post-merger talent selection process—not only for employees offered positions but also for those not selected or who choose to leave. How the HR and integration teams treat the latter groups can have far-reaching effects on workplace morale and the company’s reputation as an employer of choice.

There are four core elements to ensuring that the selection process leaves a positive impression on all involved: designing a fair and transparent methodology, ensuring the process is well coordinated, managing stakeholder expectations, and effectively onboarding employees starting new positions. Most of these tasks are best handled by a central talent selection office.

Establish a fair and transparent process

“Will I have a job in the new organization?” During a merger, that is the primary concern of most employees, so step one in the talent selection process should be providing information. Defining how staffing choices will be made—including selection criteria, legal parameters, and timelines—and communicating this to the organization will help allay anxiety, as will an explicit commitment to fairness and transparency.

Naturally, the approach to selecting high-level executives (such as those reporting directly to the CEO) will differ from the one used for most of the workforce. While the executive selection process is often opaque to the broader organization, the outcomes send a message to all employees about the values and culture they will experience in the combined organization. For example, if the CEO only selects individuals from the acquiring company for the new management team, this may be interpreted as a signal that the acquirer’s employees will be favored for lower-level positions as well, creating the risk of critical talent leaving the acquired company.

Typically, at least the top two levels of leadership below the CEO are chosen before the deal closes, usually by the combined company’s chief executive, and the appointments are often subject to board approval. In selecting direct reports, the CEO should first focus on roles essential to maintaining business continuity along with those needed to fulfill the growth or transformation ambitions that motivated the acquisition. For example, if the CEO

is moving from a sales-led geographic structure to a more matrixed brand structure, selecting a chief marketing officer should be a top priority, and if no sufficiently strong candidate is present at either organization, the company should quickly launch an external search. Furthermore, the new leadership team ideally should be introduced to the organization as a group rather than through appointment announcements over time, as a one-time transition in management will help lower uncertainty and distraction among employees.

For the rest of the staff, the selection principles and process should be communicated as soon as possible to reassure employees that the methodology will be consistent and equitable. The principles are typically developed by the CHRO, endorsed by the CEO, and shared with the employee base as the talent selection process kicks off. They may range from strategic, outcome-oriented goals (such as supporting and protecting the core businesses and enabling the vision for the combined company) to specific guidelines (for example, if a position in the new organization consists at least in half of new responsibilities, all eligible employees from both companies can apply for it).

What matters most is that the principles resonate with the organization and increase confidence in the process. They should address questions such as: What does the talent selection aim to achieve? Will employees from both companies receive equal consideration for positions? Who decides who will be offered positions in the merged company?

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And, will downgrades, grandfathering, relocation, trial periods, and other individual factors be part of the decisions?

The selection process also needs to establish “guardrails”: legal parameters by which decisions must abide, such as regulatory approvals, the WARN Act¹ (for US businesses) and works council² stipulations (for European businesses mostly) that apply to HR practices and may vary by role, geography, and timeframe (for example, pre-close, day one, and post-close). Such guardrails are typically shared only among HR employees responsible for defining and executing the selection process and with managers involved in conducting interviews or choosing talent for the new company. The parameters should be defined and disseminated as soon as possible after the deal is announced and reviewed regularly by the general counsel overseeing the integration.

Finally, management needs to define and communicate the criteria, process, and timeline for selections. These are often constrained by how quickly a company needs to make staffing decisions, how involved direct managers are in the process, and the availability and quality of talent assessment data. Typically, the criteria cover the following kinds of questions:

- How do you define the talent pool eligible for each role in the new organization (for example, can potential candidates come from both legacy companies)? If someone is not selected for a CEO-2 role (reporting to a CEO’s direct report), can the individual be eligible for a CEO-3 role? Could he or she be offered positions in other parts of the company?
- What guides the selection when multiple incumbent employees apply for a role?
- What data (such as performance ratings or R&D patent applications) and other inputs

(resumes, for example) are considered and how do you calibrate their relative importance given different practices in the legacy organizations and potential functional or individual biases?

- For which roles will you conduct interviews or seek additional internal or external applicants, and how will you source external talent if needed?

In terms of schedule and time frame, the following questions should be answered:

- Are you prioritizing talent selection by seniority and level of responsibility, or handling multiple employee tiers at once?
- When will candidates be notified, when will new roles begin, and what will be the exit dates for those leaving?
- Will the dates vary by office location or country?
- What do HR business partners, managers, and other decision makers need to do, and by when, in order for candidates to be notified of selection outcomes by a certain date?

Establish a central office to coordinate selection

Deciding which employees should stay, go, or move to different roles is often a complex process involving many decision makers and urgent time pressures. If managed poorly, it can cause the new company to lose critical talent and capabilities, miss synergy targets, face business disruptions, and even risk lawsuits and reputational damage. What’s more, during the hectic integration period, the HR team often lacks the capacity to adequately support talent selection, especially as the department is likely undergoing its own functional integration. Creating a talent selection office (TSO)—a temporary, centralized command group—can improve the employee experience, produce better selection outcomes, and reduce potential legal risks.

¹ The Worker Adjustment and Retraining Notification Act (WARN Act) of 1988 is a US law that protects employees, their families, and communities by requiring that most employers with 100 or more employees provide 60 calendar-day advance notification of plant closings and mass layoffs.

² A works council is an organization representing employees that functions as a local and company-level complement to trade unions.

The TSO needs to become the “one source of truth,” tracking decisions in real time and making sure systems are updated promptly and accurately.

A TSO is particularly valuable during large employee reorganizations driven by ambitious synergy targets and undertaken within short time frames. It can also play a vital role in ensuring exits happen quickly when one or both of the merging companies operate in multiple geographies or industries with complex labor laws or strong union relationships. For example, when one US-based company acquired a European firm of similar size with a significant number of employee overlaps across numerous regions and functions, it established a temporary TSO and placed a member of the target company in charge. Not only did the central TSO enable the combined organization to reach its synergy targets roughly six months ahead of schedule, but the choice of lead helped reassure the target company's employees that the selection process would be fair to them.

As the command center, the TSO is responsible for guiding leaders involved in the selection process in how they manage organizational anxiety around potential head-count reductions. This includes instructing managers and job candidates on the interview and selection steps and timelines and coordinating with the communications team of the central integration management office (IMO), where appropriate, on responses to questions about the process. The TSO also ensures that the employee choices align with the new organization's strategy, desired culture, and synergy objectives related to employees, and that the selection and retention processes adhere to the established principles and other guidelines.

Communicate with stakeholders

Typically, the TSO is also responsible for the third element of the selection process: managing stakeholder expectations. This can range from defining who will be consulted in talent selection decisions to helping managers conducting interviews understand how much time is required and when they need to commit. The TSO needs to become the “one source of truth,” tracking decisions in real time and making sure systems are updated promptly and accurately.

Doing this effectively requires regular communication among several stakeholder groups, including the IMO (to coordinate the timeline with other integration activities), employees involved (both those who interview or select candidates and the candidates themselves), the communications team (to align messaging related to talent, such as the announcement of a new leadership team), and finance and IT (to coordinate updates to HR management and payroll systems). The TSO also needs to be in close touch with the company's HR partners to coordinate the execution of the selection process, as when new external employees are brought onboard.

Onboard employees into new jobs

Once talent selection is completed and announced, the talent team often thinks its job is done. However, the selected employees still need to be properly onboarded. Given the intense pace and workload before, during, and right after a merger, this crucial step is often neglected, leaving employees who

start new jobs insufficiently prepared for the realities of the merged organization.

To avoid a decline in workforce performance and employee experience, the TSO should work with HR staff and line managers to define the onboarding requirements, at least for critical roles and talent. It should also solicit feedback from employees on their experience of the integration process and report that to the IMO.

With companies increasingly seeing talent as a vital competitive advantage, delivering a positive retention and selection experience is an element essential to the success of any merger or acquisition. That requires starting retention efforts early, identifying and safeguarding employees critical to business continuity, and moving quickly on talent selection to quell rumors, remove uncertainty, and allow the organization to get back to focusing on the business. Making sure the selection process is transparent and fair will help retain the best talent and shore up employee morale, while proper onboarding will give the new workforce the tools to succeed in the new organization.

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