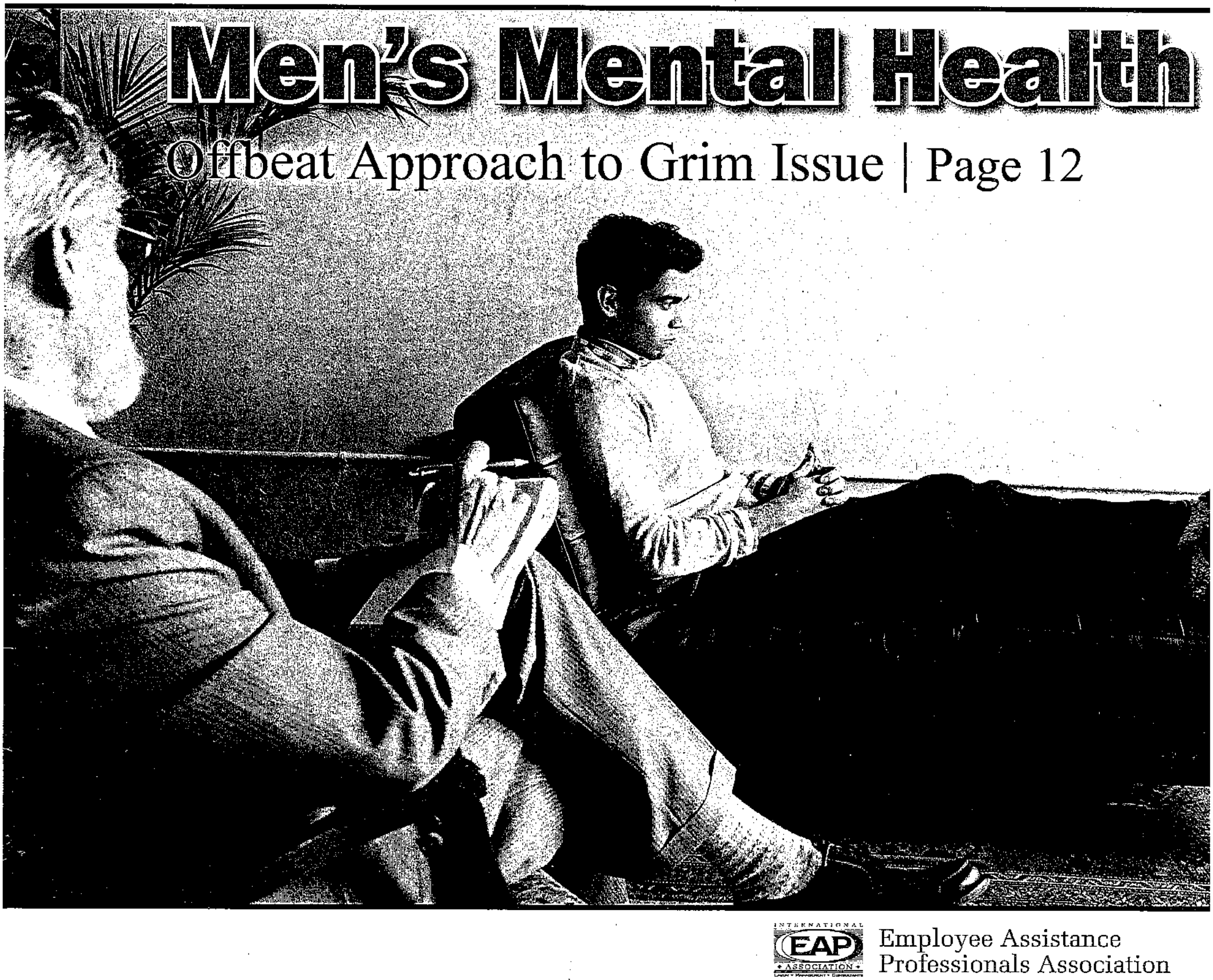
2nd Quarter 2014 | VOL. 44 NO. 2 The magazine of the Employee Assistance Professionals Association

The Journal of Employee Assistance



Men's Mental Health

Offbeat Approach to Grim Issue | Page 12

Employee Assistance Professionals Association

PLUS:



Mergers & Acquisitions Part II

Two Perspectives on M & A

By Stanford W. Granberry, Ph.D., Richard L. Bozzelli, CPA & John Burke, MA

Acquisitions are complex endeavors that test even experts experienced in the subject matter. The authors' previous article, *"Mergers & Acquisitions: A Neglected Area of EAP Literature*" (2013) provided foundational information concerning the multiple intricacies of the M & A process. This article focuses largely on the perspectives of the seller and the buyer, with some key background information presented first.

Overview and Perspective on EAP M & A

The 1980s and 1990s were boom periods for starting stand-alone EAP companies. The typical ownership model was closely held, for-profit, and included a sole or minimal number of owners. Currently, the founders from the boom periods are getting older and this is creating a "graying effect". The authors predict that over the next few years many EAP owners will actively seek to be acquired as an exit strategy to fund their retirement.

Stand-alone EAP companies remain competitive in the marketplace. However, due in part to M & A activity, the total number of local, regional and stand-alone EAPs is diminishing. The precise number of stand-alone EAPs is unknown, but it's estimated at several hundred in the US market.

Historically, national EAPs were the primary acquisition targets, but as the number of remaining national EAP's decreased, acquisition shifted to include local and regional companies. Nonetheless, local, regional, national and international EAP companies all remain attractive acquisition targets by health plans (HP), specialty health care service providers, private equity groups, private investors and other entities.

Business enterprises have an ongoing need to grow larger through both organic and accretion strategies in a competitive environment. This is a business necessity that cannot be easily dismissed. Currently, industry consolidation has resulted in a decline in the number of EAPs.

According to OPEN MINDS (2013) "about 60% of the United States EAP market across all product lines, defined in terms of covered lives is controlled by five companies":

- Magellan Health Services, Inc., 15.5%;
- ComPsych Corp., 14.2%;
- Aetna Behavioral Health, 14.1%;
- OptumHealth, 9.3%; and
- Ceridian, 6.5%.

Acquisitions & Entrepreneurs

➢ **Strategic vs. financial acquisition:** In order to understand the drive to acquire companies it is important to distinguish between two different acquisition goals:

1. Acquiring strategic assets, such as human capital, geography or infrastructure that is cost prohibitive to build internally, or
2. Emphasizing a stable revenue base (cash flow) and profitability that will accelerate value.

➢ **The vital role of entrepreneurs:** It is important to not underestimate the vital role of entrepreneurs in our economy. They are the essence of an unencumbered free market system that punishes *ad libitum* conduct and rewards innovation and robust customer service. Successful entrepreneurs create jobs, prosperity and opportunity. Consequently, their success accelerates the velocity of money moving through our economy, which seeds the growth of new job opportunities.

Successful EAP entrepreneurs are members of a diverse group who share some common characteristics. By nature entrepreneurs are confident, which increases their tolerance of risk. They possess a behavioral hardiness that affords enhanced stress tolerance. And, perhaps most importantly, they understand that their livelihoods depend upon satisfied customers. Without entrepreneurs, M & A activity would languish. And absent EAP entrepreneurs, our profession would languish even more.

The Seller's Perspective

➢ **Deciding to sell and pursuing the "deal":** Selling a company creates a wide range of emotions; especially when the seller views their company as a prominent aspect of their professional identity and their role in leading the company. This personal reaction is ill afforded.

Planning and executing a divestment strategy is complex, emotional, tedious, and time-consuming and yet it's essential for a favorable outcome. The owner(s) should receive appropriate compensation for their years of labor if they have built a financially viable company. Moreover, the owner(s) want to ensure continuity of their company's reputation after the acquisition. In addition, owner(s) desire a "soft landing" for employee retention, roles and compensation. Unfortunately, this rarely occurs in the sale of a company.

Exercising positive skepticism is essential to defining and executing the "deal". Here is a practice conundrum: "*Which is greater: An immovable object or an unstoppable force?*" The answer is: "the ability to do both eclipses the ability to do either." In order to optimize the acquisition outcome, the seller must adopt the same skeptical and unemotional logic used to solve the riddle. Be willing to challenge the premises and then refine it early in the process.

Trust is a key factor throughout the acquisition process. There is a strong relationship between trust and predictability. We tend to trust people to the extent that we can predict their behavior. Hence, in a business setting, consistency of what employees are told should readily match what happens. But absent predictability, trust erodes quickly and is difficult to restore whether it occurs between employees or the employee and the company leaders.

Owners, in turn, face the reality that they are no longer in charge, decisions will be made with or without them and their current way of doing business will change. It is assumed that the acquired company was purchased for its strategic value, and its business and position in the marketplace. It is also assumed that the buyer will bring added value, new capabilities and greater growth opportunity to the acquired company. This being the case, the transaction should bring about excitement and a level of energy that creates a stronger and more competitive merged enterprise.

The first three months following the transaction are critical to the success of the acquisition. It is during this time that the former owner(s) and retained staff will experience moderate to high stress about the changes. Openness and frequent communication between management and staff of the acquired company is essential to mitigate inaccurate information about what will and will not happen. Elimination of redundant positions will trigger a variety of emotions among the surviving staff. In addition, managers of the acquired company will likely be required to adapt to new ways of thinking and operating.

The Buyer's Perspective

➢ **Acquisitions have three distinct phases**: (1) Pre- (2) Mid and (3) Post-Acquisition. Retention of senior management is a key aspect during each of these phases. Almost all M & A transactions have a component of human capital. The ability to recognize and retain senior talent during and following the acquisition is essential to ensure the transaction's projected performance remains on track for optimal future outcomes.

Achieving the strategic goals of a deal hinge on having the right people with the right skills in the right roles. Even companies with extensive M & A experience struggle with the complex nature of this process. The future success of the combined company, post-acquisition, is significantly tied to its' human capital; thus making talent retention a top priority.

According to Towers Watson's 2012 Global Workforce Study, employees of both the acquired and acquiring companies are more likely to leave their positions within two years after a transaction than employees not involved in an M&A. The study also found that nearly three-quarters of successful retention organizations identify talent in the due diligence or negotiation stages.

Ensuring effective post-acquisition talent retention requires a meticulous assessment of human capital during the initial due diligence of the M&A process. This requires a nuanced strategy that balances financial and emotional rewards to help employees understand their personal gain in the new company's success.

This is easier said than done! Early identification of talent is not simple. Even during due diligence, access to relevant employee information may be limited, thereby increasing the likelihood of subjective decisions. Early decisions require an unbiased assessment of an employee's role, function, skills and ability to contribute to the transaction process.

Retaining key staff includes both financial and emotional components. Although compensation is important it may not be sufficient to ensure retention. For some individuals emotional and interpersonal interests can equal or even exceed the compensation expectations. Nonetheless, retention bonuses remain a primary method of retention.

Key Practices for Retaining Human Capital during the Post-Acquisition Phase:

(1) *Develop and communicate a clear retention strategy that recognizes the employee's importance to the success of the deal and proper execution of the business strategy.* For managers, the starting point involves determining the number, mix, skills and cost of employees needed to meet the deal's strategic objectives.

(2) *Identify the retention candidates early.* Managers should leverage all information available to make informed decisions that balance employee retention against cost and risk factors.

(3) *Do not rely solely on money.* A high degree of engagement and valuing the retained employees' capabilities is important. Consider actions beyond monetary ones to promote long-term strategic goals, such as personal outreach by leaders and managers.

(4) *Be faithful to the retention strategy.* While there should be some flexibility if issues arise, decisions can be made more quickly and readily with an agreed-upon framework and clear guiding principle.

Completing the Deal

Completing an acquisition requires many sequential steps carried out in a collaborative manner. Within these categories, there are multiple sub-steps taken to ensure the deal is brought to resolution. The major categories are:

- Introductions;
- Due Diligence Review;
- Letter of Intent;
- Second, more rigorous Due Diligence Review; and
- Asset Purchase Agreement ("APA") or Share Purchase Agreement ("SPA").

Assuming that the acquiring entity has identified a target, a Non-disclosure/Confidentiality Agreement ("NDA/CA") is executed between the parties. This agreement basically allows the seller to open up the books/information of the company to the buyer and ensures that the buyer treats the information gathered during the review phase as confidential information.

Generally, the NDA/CA allows for the following information to be disclosed: type of transaction requested by the seller (sale, recapitalization or partial sale, etc.); 3-5 years financial results of the business; review of owner's benefits; summary of top customers; and other information pertinent to the operation of the business.

After both parties have executed the NDA/CA, and the overview information has been exchanged, a Letter of Intent ("LOI") is prepared and submitted to the seller. The LOI will contain the general provisions that will be included in the APA or SPA. This facilitates a quick transition to the formalized preparation of the APA or SPA.

After executing the LOI, a more rigorous Due Diligence review is performed. It normally is a minimum 30-day period review of the business, including a detailed analysis of the accounting history and practices, operating practices, customer references, management references and market reviews.

Once the buyer has the confidence of the seller's business operations, the formalized APA/SPA will be prepared and a closing date will be established. This is the final step in the acquisition process. Upon completion of the legal process, the acquisition funds are wired to the seller and the acquisition is complete.

Conclusion

The authors believe the EAP industry will continue to witness a convergence of divestment-acquisition activity among local and regional companies, especially in the case of closely held tenured owner(s). Furthermore the authors believe consolidation and competitive industry factors will continue to be a significant market dynamic driving investment and roll-up strategies. ❖

Stan Granberry is the Executive Director of the National Behavioral Consortium and the primary investigator of an EARF-funded study, "The National Behavioral Consortium Industry Profile of External EAP Vendors." He may be reached at stan_granberry@yahoo.com. John Burke is a strategy and business development consultant to the EAP and behavioral health industries. He may be contacted at jburke@coastalnet.com. Richard Bozzelli is Co-Founder and Managing Director at Capstone Capital, Inc. He may be reached at richardbozzelli@capstonecapital.org.

References

Granberry, S.W., Burke, J., & Bozzelli, R. (2013) Mergers & Acquisitions: A Neglected Area of the Literature. *Journal of Employee Assistance*, Volume 43 Number 2

Attridge, M., Cahill, T., Granberry, S.W., Herlihy, P. The National Behavioral Consortium Industry Profile of 82 External EAP Vendors (2013) *Journal of Workplace Behavioral Health*

Towers Watson, (2012) Global Workforce Study, Engagement at Risk: Driving Strong Performance in a Volatile Global Environment.

Wohlsen, M. "Amazon's Secret Formula Could Keep It From Ruling the World", *WIRED Magazine*, January 15, 2013 (Wired Magazine, interview with Jeff Bezos, 2013) 11.15.13