KPMG

The human side of due diligence

Assessing a deal's people-related risks and opportunities

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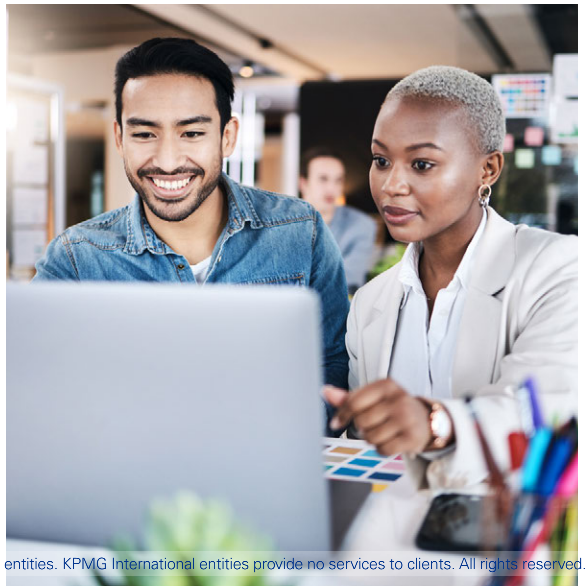

Uncovering the human element in dealmaking

Technology alone isn't transforming organizations. Humans play a vital role too. Shifting demographics and changing social expectations from today's workers are reshaping the corporate landscape. To attract, engage and retain employees, companies are introducing innovative employment policies and work practices.

In turn, organizations are demanding their people change. As companies integrate artificial intelligence (AI), machine learning and automation technologies, employees are learning to work in new ways — with human colleagues as well as virtual ones. They also need to develop new skill sets and follow new career paths.

All of this is redefining organizational structures and leadership models. Workplace cultures are evolving. It is also introducing new dynamics for dealmakers. As the rate and pace of transformations differ across geographies, within industries and between companies, the employee journey, including required capabilities and engagement strategies, needs to be fully understood to help minimize potential long-term risks to the deal's success.

This calls on investors to broaden their scope of due diligence. Looking beyond financial and operational due diligence, we propose a closer look at the human side of a deal.

Human Resources due diligence examines people-related liabilities and risks as well as the drivers that can unlock future value creation opportunities. By considering the human elements at play, we believe dealmakers can capture a more complete picture of a deal's value as well as its future viability.

Key takeaways

- Organizations are shaping their businesses to attract, retain and develop the right talent, this is creating disparate dynamics that dealmakers need to consider before a deal closes.
- Assessing the human side of a business during the due diligence process can offer buyers and sellers a truer picture of the value of a target — and the levers to create value in the future.
- A comprehensive due diligence process that considers people-focused value drivers can help dealmakers uncover vital information that may mitigate risks, drive performance and EBITDA margins and create long-term value for the business and investors.

Unlocking deal value with people

The human factor is critical to a deal's success. Leaders and employees bring the skills, knowledge and relationships that are essential to maintaining business operations, fostering innovation and driving growth. Depending on the deal thesis, these can be the very things some buyers are looking to gain.

Understanding a business' workforce and structures — the policies, programs, contracts, cultures, leadership styles — can offer dealmakers important insights about a target investment. It can also help investors more deeply understand a business: its scalability potential, its reputation as an employer and its ability to innovate. Diving deeper into a business' human resources can also offer additional insights into the potential liabilities or incompatibilities that could risk value potential, increase acquisition costs, lead to the loss of key talent, or disrupt business continuity.

This level of analysis goes beyond the review of employee contracts and benefits. As important as these are, dealmakers need to perform a fuller assessment of a company's workforce composition, its people and culture. Headcount, tenure, attrition rates and capability gaps can shed light on the reality of a target's growth plan.

Considering a target's leadership and key talent can help investors identify who drives and runs the business, who holds the critical relationships and who makes key decisions. With this information, dealmakers can proactively develop strategies to drive retention and engagement. It can also help ensure business leaders are driving the employee journey.

In one case involving an energy and natural resources client, KPMG in UK discovered that four key leaders had clauses in their contracts that could trigger substantial payouts if the company was acquired. This could impact costs associated with the deal. More significantly, these leaders could depart the company upon the deal's close and take with them the knowledge and experience that could impact long-term value of the deal. Uncovering this risk early on allowed the client to develop strategies to retain these key individuals post-acquisition, avoiding loss of talent and a potential large-sum payout. Similar retention strategies can result from gauging employee sentiment and motivations.

Culture, too, needs closer investigation to uncover and address potential clashes that could impede a smooth integration. Compensation and benefits as well as pension analysis are also essential elements to investigate. By uncovering any possible discrepancies early, investors can evaluate any investments needed to harmonize plans post-deal close.

Despite the critical insights HR due diligence can offer, it is often underestimated — or ignored completely. Inadequate focus on assessing an organization's culture and people can leave dealmakers at risk of absorbing hidden costs, unforeseen expenses, liabilities and other complications. Further down the line, employees from the acquired company may compromise the success of the business integration and overall company performance.

Three phases of HR due diligence

HR due diligence is a critical part of the overall assessment of a business' financial performance. To understand a deal's key risks and post-deal considerations, there are three areas of human resources, that when analyzed during the due diligence process, can help dealmakers enhance value, mitigate risks, identify opportunities and enhance long-term value across the deal life cycle.

Risk + Opportunity = Value

Risk

Change in control triggers, distributions and other post-close requirements for key management and the broad-based employee population. This includes assessing any transaction-related payments that may be material to the deal that could impact value or create an attrition risk of key leaders and talent.

Opportunity

The ability to understand the current market and existing organizational structure provides perspectives on the ability to attract and retain talent. This includes market benchmarks in terms of compensation, culture, brand reputation and employee value proposition. It also requires the buyer to consider strategies that will likely have employees saying, "Even without this deal I'd have chosen to work for this organization."

Value

Analyze employee value propositions and other workforce strategies that may impact deal valuations. These could include headcount growth, culture-based programs, compensation and benefits packages, equity-based and variable pay that drives retention, and longer-term HR operation structures that may create synergy opportunities, such as migrating to automated or AI systems, or benefits providers.

People-related value drivers

There are many dimensions to the human side of a business. HR due diligence, then, must be a multi-faceted approach. At KPMG, HR due diligence is a detailed process. Depending on the type of transaction (e.g., a carve out, full acquisition) and the businesses involved, we identify the specific elements to investigate for each deal. We also call on KPMG professionals from other practice areas to augment and enhance our analysis (e.g., pension or labor law specialists).

By focusing on key people-focused value drivers, we help dealmakers uncover vital information, that when considered with financial, operational and other due diligence, can help mitigate risks, drive performance and EBITDA margins, and create long-term value for the business and its investors.

Here's a closer look at the people-focused value drivers KPMG professionals assess during HR due diligence, along with some essential questions to guide your thinking.

Workforce overview

Understanding the workforce composition, including demographics, distribution by geography and function, length of service and more, is essential to planning integration and addressing potential gaps.

Ask yourself:

- What does the overall workforce look like (i.e., in headcount, tenure, attrition rates, DEI metrics)?
- Are there critical capability gaps that need to be addressed?
- What are the potential challenges post deal?

Leadership and key talent

Dealmakers need to understand a target's pivotal figures, the roles they play and their skills and capabilities to operate in the future business.

Ask yourself:

- Who are the leaders driving the business?
- Will the deal trigger any attrition losses that could impact the transaction?
- What is the cost to retain these people?

Reward strategy

Assessing a target's total rewards structure, including employee benefits, long- and short-term incentives, can help dealmakers understand any potential areas of exposure or opportunity.

Ask yourself:

- How competitive is the target's total rewards structure?
- What are the potential costs to harmonize compensation and benefits structures post-deal close?
- Where can I adapt the compensation structure to align to new business objectives?

Labor relations

Labor relations, such as unions, work councils, employee disputes, can present real risks for investors. By assessing this area, dealmakers can avoid labor-related disruptions and comply with local regulations.

Ask yourself:

- Are there existing labor agreements or union contracts that could impact the deal?
- What are any potential liabilities or legacy terms?
- Are there any ongoing disputes or grievances that need to be resolved?

HR operations

A strong, consistent HR structure and capability is crucial for maintaining employee satisfaction and operating a larger business. Identifying and addressing any gaps or inefficiencies in HR operations allows investors to plan for a more seamless integration.

Ask yourself:

- Who is leading the people strategy?
- What strategies are used to attract and retain talent?
- How compatible are the HR systems and processes?

Culture

Culture compatibility is a major success factor for dealmakers looking to merge a new organization. This makes it paramount for dealmakers to assess cultural fit or potential clashes with the target company.

Ask yourself:

- What are the core values and culture norms of the target company?
- What cultural differences could pose a challenge during integration?
- How can I enhance the employee value proposition to make an employee say: "even without this deal I would have chosen to work for them"?

ESG

Investors focused on reaching set environmental, social and governance (ESG) goals will want to closely consider a target's people practices from an ESG perspective.

Ask yourself:

- What is the 'social' strategy under the human capital aspect of ESG?
- Is the ESG strategy aligned to current and future generations of employees?
- Are there any significant risks or opportunities related to ESG that need to be addressed?

Case study

KPMG in UK client, a major player in the frozen foods industry, was interested in a deal that would strategically expand its UK based portfolio into Croatia, Bosnia and Serbia — new geographies where the client had minimal previous presence. The deal would also open the company up to new categories and channels, and it would integrate a diverse set of businesses into their existing operations and culture, while achieving cost synergies within the first two years. Such complexity required a meticulous HR due diligence process to ensure success.

Given the client's limited knowledge of the new geographies, the client team included professionals from the KPMG member firms in UK, Croatia, Bosnia and Serbia. This allowed the client to gain deeper understandings of the local labor relations, cultures and nuances that could prove critical to the success of the deal.

The team assessed and analyzed the organization structure and reporting lines to understand the scale of change that may be required post close. In addition, the compensation and benefits strategy was considered to identify potential investment needed to bring employee compensation to market rates across geographies. Another key area to review was the relationships with unions, works councils and employee representatives, and any collective agreements that were in place that could restrict post-deal changes.

Continuing their work with the client, the teams brought the insights and knowledge from the pre-deal HR due diligence to support the integration planning, change and communication activities to create an employee experience journey that minimized disruption, managed reporting line changes and adjusted roles — all with a lens to any potential long-term impacts.

The proactive efforts supported a seamless transition. The client and its newly acquired business are continuing to drive growth with minimal disruption to business operations. During this time, the business also launched new products. Labor relations considerations were also addressed, making for a smooth interaction across the client's new global workforce.

A critical piece of the due diligence puzzle

Before buying or selling a business, dealmakers will want a clear picture of the value of the business. To do so, they'll need to widen the aperture of their analysis to include the people side of the business. From workforce composition to HR operations, people policies and programs as well as leadership and rewards packages — deep investigation into each of these areas can help buyers project costs upon deal close, while understanding the potential drivers that will grow and create value for the business in the future. For sellers, more comprehensive due diligence can help gain a truer picture of the business' value to set an optimal price for the deal.

Assessing a business' human side can help enhance due diligence for any deal. It is especially relevant to deals where the acquisition of talent and knowledge is at its core, and in situations that will bring together business from different geographies or with different organizational cultures.

Analyzing the full scope of people risks and opportunities in a deal requires cutting edge expertise in human resources, rewards and compensation and cultural integration, all the while bringing a deeper understanding of the deal cycle. It also requires access to specialists in pensions, labor law as well a deep sector knowledge to help convert any findings into meaningful insights within weeks, not months, so dealmakers can make decisions with conviction at deal speed.

Transformation never stops

At KPMG we believe that business transformation is too good an opportunity to miss. In our view, combining the right tech and leading processes with people whose insight is as broad as it is deep are essential ingredients to a successful transformation.

KPMG professionals have worked at the heart of global businesses for many decades, helping clients realize the full potential of their strategy, people and technology. We work together to achieve real-world outcomes. Because when strategy, people and technology are in harmony, great things happen.

Making a world of difference

KPMG people can make the difference on your transaction and transformation journeys. Together, we can help you to level up your performance, grow your business, orient your organization around the customer and new business models, enhance functions for a new era, manage enterprise risk and regulation for a safer future, pursue opportunities to better realize or preserve value, and create an environment for managing ongoing change.

The power of plus: A value-focused approach to due diligence

KPMG Diligence+ brings together global methodology and sector-specific value drivers to deliver holistic insights to enable dealmakers to make rapid, confident decisions to grow their business. This approach seeks to transcend traditional financial due diligence to assess an expanded universe of risks and rewards. Leveraging proprietary data analytics and insights, along with deep sector and functional experiences KPMG professionals work to identify the levers that can create value across a business.

KPMG firms' support extends beyond a deal's close, by orchestrating dedicated teams of professionals across the globe to deliver measurable performance improvements that can create quantifiable value across a business.

Learn how KPMG firms can help power your next deal at kpmg.com/diligence

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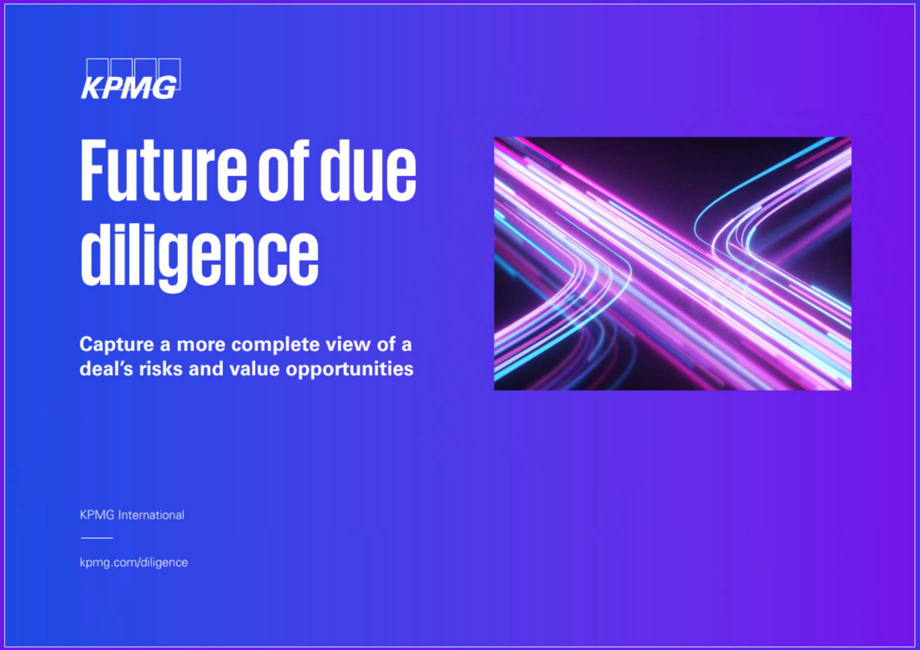

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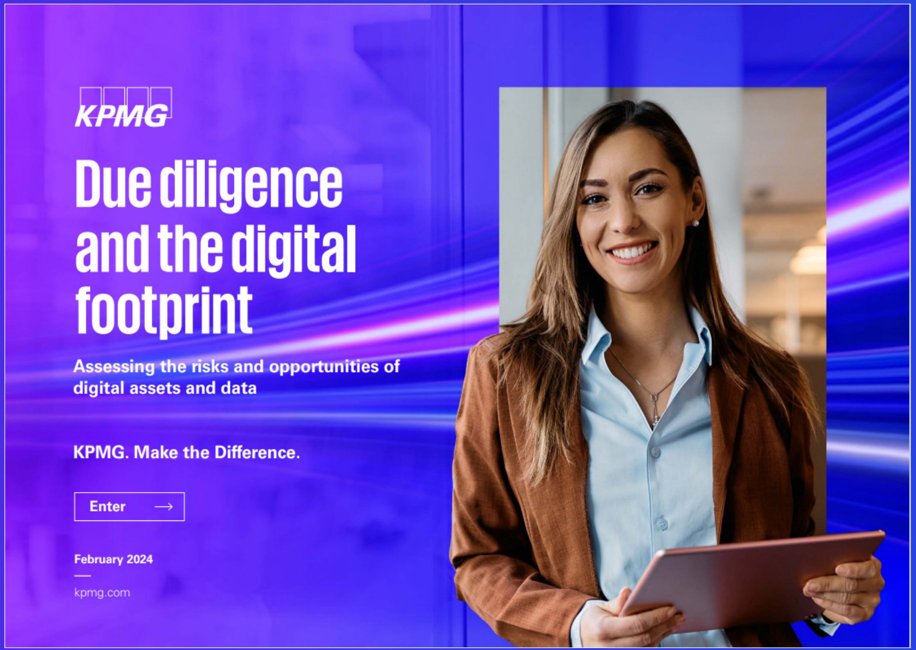


Authors

Amy Bishop
Director, Deal Advisory
KPMG in the UK
T: +44 203 0783487
E: amy.bishop@kpmg.co.uk

Amy Bishop leads HR due diligence in the UK, leveraging her HR professional experience and sector insights to provide insight and guidance on the human side of a deal.

Julia Jöns
Senior Manager, People & Change
KPMG in Germany
T: +49 211 475 7190
E: juliajoens@kpmg.com

Julia Jöns brings together her extensive experience from HR transformations, compensation and benefits as well as deal projects to analyze HR and other support functions during transactions and provide recommendations.

Lovisa Vacek
Manager, Deal Advisory
KPMG in Germany
T: +49 30 2068 4968
E: lvacek@kpmg.com

Lovisa Vacek brings her extensive experience in HR topics, strategy development and change management to support HR due diligence in transactions.

Sheila Mistry
Partner
National Lead – People in Deals
Advisory, Consulting
T: +61 2 9273 5015
E: smistry7@kpmg.com.au

Sheila heads the People in Deals Advisory practice in Australia. She combines her expertise in Employee Experience, Human Centered Design, and Organization Design to assist clients in navigating the complex changes associated with M&A activities through a unique approach that blends people, process, and culture.

Contacts

Craig Mennie
Global Head of Transaction Services
KPMG International
T: +61 2 9335 8671
E: cmennie@kpmg.com.au

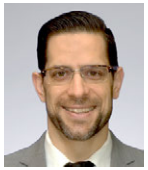
Tim Bryan
Head of Transaction Services
KPMG Australia
T: +61 2 9335 8954
E: timbryan@kpmg.com.au

John Cho
National Leader, Deal Advisory
KPMG in Canada
T: +1 416 777 3994
E: johncho@kpmg.ca

Elaine Yu
Head of Transaction Services
KPMG China
T: +86 21 2212 3543
E: elaine.yu@kpmg.com

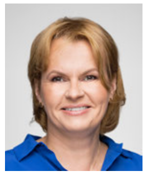
Vincent Delmas
Head of Transaction Services
KPMG in France
T: +33 1 5568 7502
E: vdelmas@kpmg.fr

Christoph Kaiser
EMA Head of Transaction Services
KPMG in Germany
T: +49 173 5764860
E: ckaiser@kpmg.com



Paul Ford
Head of Transaction Services
KPMG in Japan
T: +81 3 3548 5394
E: paul.ford@jp.kpmg.com

Rafał Owczarek
Partner, Deal Advisory
Head of Transaction Services
KPMG in Poland
E: rowczarek@kpmg.pl



Iwona Sprycha
Head of HR Advisory & Change Management
KPMG in Poland
E: isprycha@kpmg.pl

Nicola Longfield
Transaction Services Lead
KPMG in the UK
T: +44 207 311 4383
E: nicola.longfield@kpmg.co.uk

Timothy Johnson
Americas Lead, Deal Advisory
KPMG in the US
T: +1 312 665 1048
E: tejohnson@kpmg.com

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