A deeper dive into due diligence: Unlocking the value of human capital

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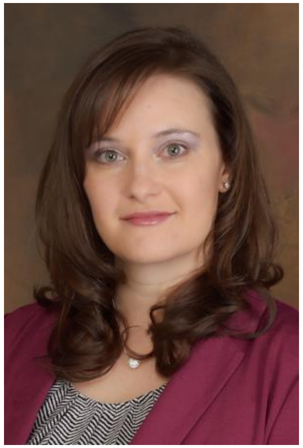
Today’s presenter



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Objectives

By the end of this session, you will be able to:

- Identify tips for successful due diligence
- Understand what is included in HR due diligence
- Identify the critical HR factors for adding value to an organization
- Develop a potential roadmap for HR due diligence

What is the point of conducting due diligence?

To evaluate the risks and identify operational opportunities

Robust due diligence =

Lower risk

Higher value

More secure investment

Refresher tips for successful due diligence

Organization is critical: Use a virtual data room whenever possible

- Make sure it's structured in an intuitive manner.
- Make sure your security settings are established.

Preparation is key

- Seller: Have your house in order to facilitate timely due diligence.
- Buyer: Make sure you know what you're asking for and when it needs to be requested.

Refresher tips for successful due diligence

Conduct a phased approach

- Phase 1: Preliminary due diligence – typically focused solely on financials and fit to determine go/no-go decision.
- Phase 2: Document review – more extensive due diligence to identify operational risk as well as financial risk.
- Phase 3: Operational review – typically includes onsite visit and interviews with key stakeholders.

Engage HR in the beginning of the transaction

It’s not the business itself that provides exceptional customer service or generates great new ideas or generates revenue. **It’s the people.**

HR due diligence basics: Recommended documents

What should be included?

- Employment agreements
- Consulting agreements
- Compensation plans (bonus, incentive, stock plans)
- Employee benefit plans
- Insurance contracts
- Job descriptions
- Disciplinary documentation for the last 12 months

HR due diligence basics: Recommended documents

- Ongoing or past lawsuits based on harassment, discrimination or safety
- Employee turnover rate/open positions
- Retention agreements
- Full employee data file with job title, start date, status, salary, last increase, bonus target, most recent payout, and eligibility for other compensation
- Organizational chart
- Separation agreements

"Mergers and acquisitions fail when HR decides to work only with the other company's HR to match up processes and policies. They don't get to know the businesses, the synergies or the culture. That's how you can really destroy a great acquisition – when you lose the intrinsic value of the acquired company. It falls to HR to preserve that intrinsic value."

– Troy Cromwell
Group President, Global Strategic Services
Verizon Business

https://www.shrm.org/resourcesandtools/hr-topics/behavioral-competencies/leadership-and-navigation/pages/berelevant.aspx

Illustrative purposes only
How much are these companies worth?

Company A	Company for Sale	Company B
5-7X	Valuation	5-7X
15 years old	Company age	15 Years Old
Injection molding	Product	Injection molding
$40M	Sales	$40M
$4M	EBITDA	$4M
Moderate	Market growth	Moderate
Undeveloped	Management team	Extensive and developed
None	Human capital plan	Thorough cascaded plan
Outdated	Policies and procedures	Finely tuned
Exists by default	Culture	Cultivated and owned by all
Punishment for errors	Safety	Engrained in operations
High turnover	Turnover	Minimal voluntary turnover
None	Leadership development	Structured program
Reactive, event-triggered	Training	Structured annual training plan

Company-specific risk factors:

Human capital directly impacts all of these!

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Assessing the management team

How involved was the president/ CEO in day-to-day decision making?

a. Practically every decision is made by them.
b. Majority of all operational decisions are made by them.
c. They only approve major decisions.
d. They are kept informed of major decisions and/or consulted by the leadership team.

Assessing the management team: Does the value lie with them or the president/CEO?

1. How much is operational knowledge distributed among company leaders?
2. How are decisions made?
3. Do leaders have autonomy to run the business?
4. Are they capable of running the business in the president's absence?
5. Is there a clear succession plan in place?
6. Are the managers developed?
7. What are the strengths and weaknesses of the existing management team?
8. Are there any members who could potentially carry risk?

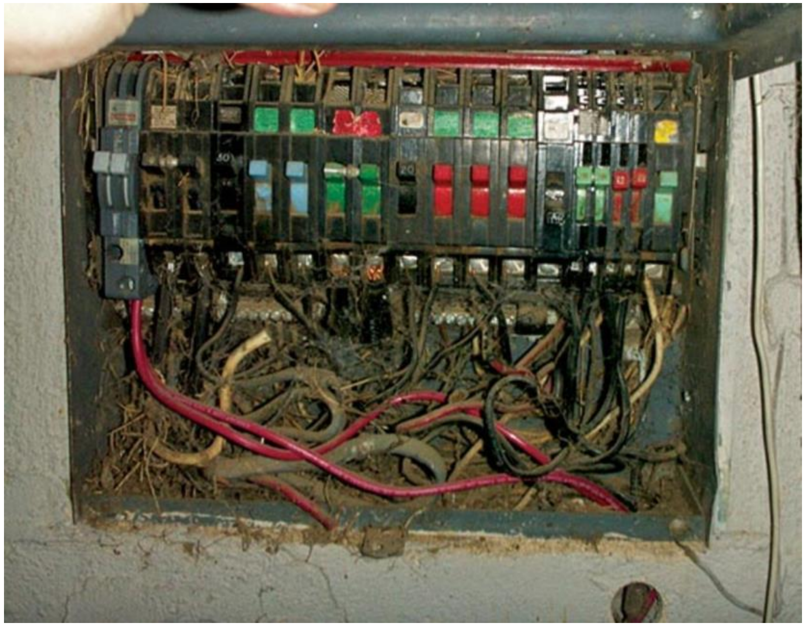
How to evaluate management team risk

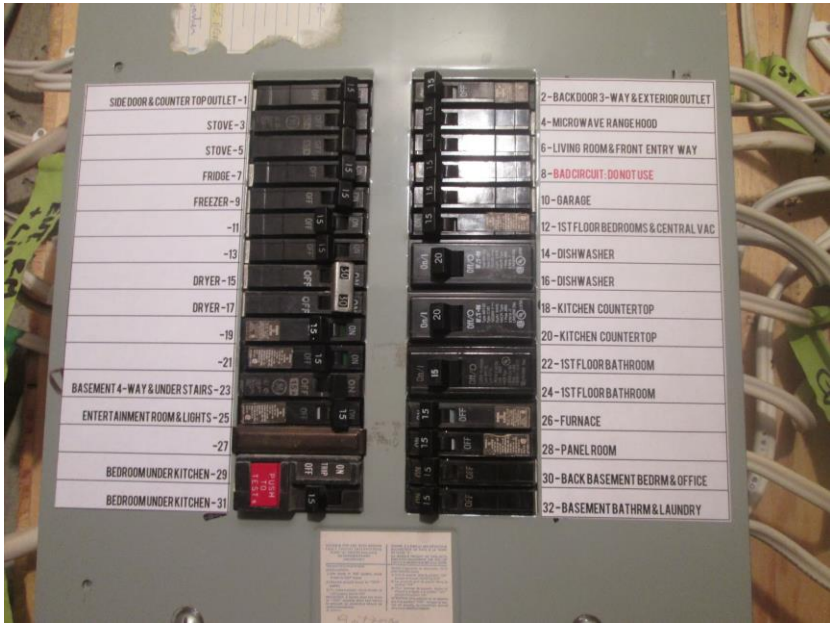
Key questions	Lower value (higher risk)	Higher value (lower risk)
How much is operational knowledge distributed among company leaders?	Day-to-day operations are managed by a single leader or few leaders.	Actively engaged managers understand the performance of the organization as a whole beyond their respective discipline.
How are decisions made within the organization?	Decision-making resides within a single leader or a few (likely the CEO or COO).	Managers are empowered to make decisions impacting their teams.

Does the management team matter?

Evaluating policies and procedures

Which would you feel good about purchasing?





Is there a standard way of operating within the organization?

1. Are there standard operating procedures for the day-to-day activities?
2. Do they have documented HR policies and procedures?
3. Are these HR policies and procedures actually practiced or are they just on paper?
4. How frequently are the HR policies and procedures reviewed and updated to reflect changes?
5. Are there basic policies and procedures around safety, workplace violence prevention, harassment prevention, evacuation procedures, time off, meal times, company holidays, disciplinary processes, attendance, work hours, etc.?

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How to assess policies & procedures

Key questions	Lower value (higher risk)	Higher value (lower risk)
Are foundational HR practices and policies in place (e.g., employee handbook, employee files, job descriptions, time-off procedures, anti-harassment, etc.)?	There are limited or outdated HR policies and procedures that are not easily identified or located by employees. Some practices and policies may be in conflict with federal and state employment regulations.	Standardized HR policies, procedures and practices are in place. All HR procedures and policies reflect best practices. Someone stays abreast of state/federal employment laws. There is an annual review that includes any needed updates.

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Evaluating the human capital plan

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Do they have a strategic human capital plan?

1. Is there a clearly understood strategic direction?
2. Are there clear goals that have been cascaded through all levels of the organization?
3. Have there been projections done related to workforce needs as the organization continues to grow?
4. Is there a clear plan in place for how the employees will be supported in order to achieve organizational goals?
5. Has HR been used to develop systems and practices to support the organization's growth?
6. Is data collected and monitored to inform progress toward goals?
7. Have critical roles and high-performers been identified?

How to assess risk related to human capital planning

Key questions	Lower value (higher risk)	Higher value (lower risk)
Is staffing evaluated and planned for in advance?	Staffing levels are evaluated as positions are vacated and filled on an as-needed basis with no direct connection to budgeting.	Staffing is reviewed regularly (e.g. annually, prior to a major event). Workforce changes are budgeted in support of key strategies.
Have high-performers been identified? Are there efforts in place to maintain them?	There is no documentation or shared knowledge of critical players, but they can be identified quickly by CEO/COO/Owner. There are anecdotal references about key employees being loyal to the organization with no strategies to maintain them.	There is a clear list of key employees required to continue the organization's success. Motivation, risk factors and retention strategies have been identified to retain critical talent.

Leadership development

Are leaders a valued asset driving the future of the organization or simply a pair of hands?

1. Has there been any investment in developing the leaders of the organization?
2. Are there clear lines of advancement through the organization for high-performers?
3. What steps have been taken to identify, develop and promote high-performers?
4. How are leaders supported to grow and develop their leadership skills?
5. How are leaders engaged in day-to-day operations and improvement efforts?
6. Is development a portion of the organizational budget?
7. Do the leaders drive their own development, or are opportunities dictated to them?

How to assess leadership development

Key questions	Lower value (higher risk)	Higher value (lower risk)
How are leaders supported to grow and develop their leadership skills?	Future development is not a topic of discussion, but rather how the leader is completing responsibilities and tasks on a regular basis. No clear development goals.	Career goals have been identified and serve as a topic during regular performance conversations, with necessary resources allocated to support these goals.
Are leaders provided with clear growth opportunities?	Growth opportunities are not a focus. Mindset may be that if a leader wants to grow, then additional responsibilities may be added without the resources to succeed.	There is a clear succession plan that has been communicated with specific areas of development and resources to prepare the next level of leaders for future roles.

Turnover

How much turnover is experienced, and how is it managed?

1. What is the average turnover over the last 12 months?
2. What is the average voluntary turnover (resignations) in the last 12 months?
3. How many high-performers resigned in the last 2 months?
4. Of the turnover in the last 12 months, how many resigned in the first 30 days … 60 days … 90 days … year?
5. What is the average tenure of the employees?
6. How do current employees describe the work environment to new hires?
7. How are positions filled? How many open positions are there?
8. Do they conduct exit interviews? If so, what themes or patterns have been identified from those interviews? Have there been any actions based on that feedback?

How to evaluate turnover

Key questions	Lower value (higher risk)	Higher value (lower risk)
How much turnover is experienced?	There is a high level of unanticipated turnover and/or consistent/expected high turnover with no proactive plan to address.	There is a low level of unanticipated or voluntary turnover.
What is the recruiting process?	Positions are filled as they are vacated with no standard process or clear outline of an ideal candidate based on organizational fit and technical skill. Top leadership hires all employees as opposed to direct managers and time-to-fill isn't planned for.	There is a standardized process with defined criteria for ideal candidates, trained interviewers using consistent and compliant questions, and time-to-fill is proactively budgeted for and included in workforce planning models.

Training

How has the organization invested in the employees?

1. How are new employees trained?
2. Do employees receive regular training?
3. Is training monitored and tracked consistently?
4. Does the organization have funds set aside for employee development in the annual budget?
5. What training have employees received in the last 12 months?
6. Have employees had the necessary training to ensure compliance with federal, state and local discrimination/harassment requirements?
7. How are employees trained on organizational policies? new programs/policies/practices?

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How to evaluate employee development

Key questions	Lower value (higher risk)	Higher value (lower risk)
How are new employees trained?	They start and then learn as they go.	They are oriented through a structured onboarding program focused on organizational, department and job function.
Do employees receive regular training?	Informal training methods are used with training provided on an ad-hoc basis. No mandatory training is in place.	Training requirements are outlined for each position (new hire training, annual training, ongoing development, etc.).

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Evaluating workplace safety

How does the organization ensure a safe and secure work environment?

1. Are there clearly communicated safety practices and policies in place?
2. How are events managed (recorded, investigated, communicated, mitigated, etc.)?
3. What is the safety record from the past 12 months?
4. Do they have any recurring safety issues that have not been addressed?
5. Are there any employees who have multiple safety infractions or accidents?
6. How are new hires trained about safety practices?
7. What is the process for addressing safety issues? Is it punitive or focused on identifying root causes?
8. Are employees provided with all the necessary safety equipment?
9. Are they proactively or reactively planning for ergonomics and safety?

How to assess risk related to safety

Key questions	Lower value (higher risk)	Higher value (lower risk)
Are there clearly communicated safety practices and policies in place?	There is a generic feeling that the organization is “safe.” There are no specific practices in place for monitoring.	Safety is a clear focus of the organization. The organization strives to comply with state/local safety regulations. Standardized procedures are documented, communicated and consistently practiced.
How are events managed? (recorded, communicated, mitigated, etc.)	Events are managed as they occur with no standard process for preventing, monitoring, communicating or following up. There may be action taken, but it is not consistently followed and may not be as robust as necessary to prevent future liability.	Established safety processes exist for preventing, as well as handling, events as they occur. Includes steps such as filing event record, notification of required parties, establishing any necessary follow-up, and integrating changes to prevent similar future errors.

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What about cultural due diligence?

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“What about culture…everyone knows culture is important, too, right?”

Culture is a by-product of how an organization chooses to operate.

Is an investment worth $40,000 or $100,000?

Human capital factors that impact overall value

	Lower value (higher risk)	**Higher value** (lower risk)
Management team	Undeveloped and underutilized	Extensive and developed
Policies and procedures	Inconsistent, undocumented practices	Finely tuned; established
Human capital plan	No defined plan	Thorough cascaded plan
Leadership development	No defined development	Structured program
Turnover	High voluntary turnover	Minimal voluntary turnover
Training	Reactive; event-triggered	Standard annual training plan
Safety	Reactive; punished for errors	Proactive; engrained throughout operations

Critical considerations for buying or selling any organization

- Strong management team
- Solid foundation of standard policies and procedures
- Strategic human capital plan in place
- Clear leadership development resources
- Proactively managed turnover
- Structured training program
- Clearly engrained safety efforts

Questions?

Thank you for joining us!

For more information, or to speak with an Insperity® business performance consultant, visit insperity.com/acg or email us at alliance@insperity.com