



Improving Financial Modeling Through Extensive Human Capital Due Diligence

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About Insperity®

Insperity serves more than **100,000 businesses** with more than **2 million employees** nationwide.

Founded: April 1986

Headquarters: Houston, Texas

Locations: 73 U.S. offices

2018 Revenue: \$3.8 billion

Corporate Employees: 3,211



Objectives

- Identifying pitfalls of “traditional” financial models related to human capital
- Assessing cultural compatibility
- Understanding the financial impacts of culture differences
- Leading through integration

Today's Presenter



Michelle Mikesell

Managing Director, HR Services, Workforce
Administration, Traditional Employment
Solutions
Insperity®

Synergy



$$1 + 1 = ???$$

Same industry, same product = great merger opportunity?

Company Information



To say Starbucks purchases and roasts high-quality whole bean coffees is very hardy tells the whole story.

Our Heritage

Every day, we go to work hoping to do two things: share great coffee with our friends and help make the world a little better. It was true when the first Starbucks opened in 1971, and it's just as true today.

RELATIONSHIPS
HIGH QUALITY
WORLD IMPACT

A screenshot of the Dunkin' Donuts website. The top navigation bar includes links for COFFEE, MENU, RESTAURANTS, SHOP ONLINE, DD CARD, and DD PERKS. The main content area features a large image of two Dunkin' Donuts coffee cups with the text "LET'S HEAR IT FOR CONSISTENCY" and a sub-headline "It's nice to know that even as the world changes, Dunkin' coffee remains the same. Always great, always there, when and where you need it to be. Here's to the greatness of sameness." At the bottom, there is a pagination indicator with numbers 1, 2, 3, and 4.

Typical financial projections

- Complex process to illustrate economies of scale
- Examines pre-transaction operations of both organizations
- Projects costs and revenues for post-transaction operations



How do businesses think about human Capital

	<u>December 31, 2013</u>	<u>December 31, 2012</u>
Assets:		
Cash and cash equivalents	\$225,755	\$264,544
Restricted cash	51,928	47,149
Marketable securities	46,340	16,904
Accounts receivable, net	210,009	190,386
Prepaid insurance	10,638	15,620
Other current assets	12,053	9,651
Income taxes receivable	409	
Deferred income taxes	8,185	7,211
Total current assets	<u>565,317</u>	<u>551,465</u>
Total property and equipment, net	86,411	93,942
Prepaid health insurance	2,900	9,000
Deposits	85,577	67,201
Goodwill and other intangible assets, net	18,434	23,775
Other assets	1,816	4,817
Total assets	<u>\$766,560</u>	<u>\$750,200</u>
Liabilities and Stockholder's Equity:		
Accounts payable	2,678	3,660
Payroll taxes and other payroll deductions payable	165,604	178,534
Accrued worksite employee payroll cost	173,801	150,070
Accrued health insurance costs	5,103	13,942



Human Capital?

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:

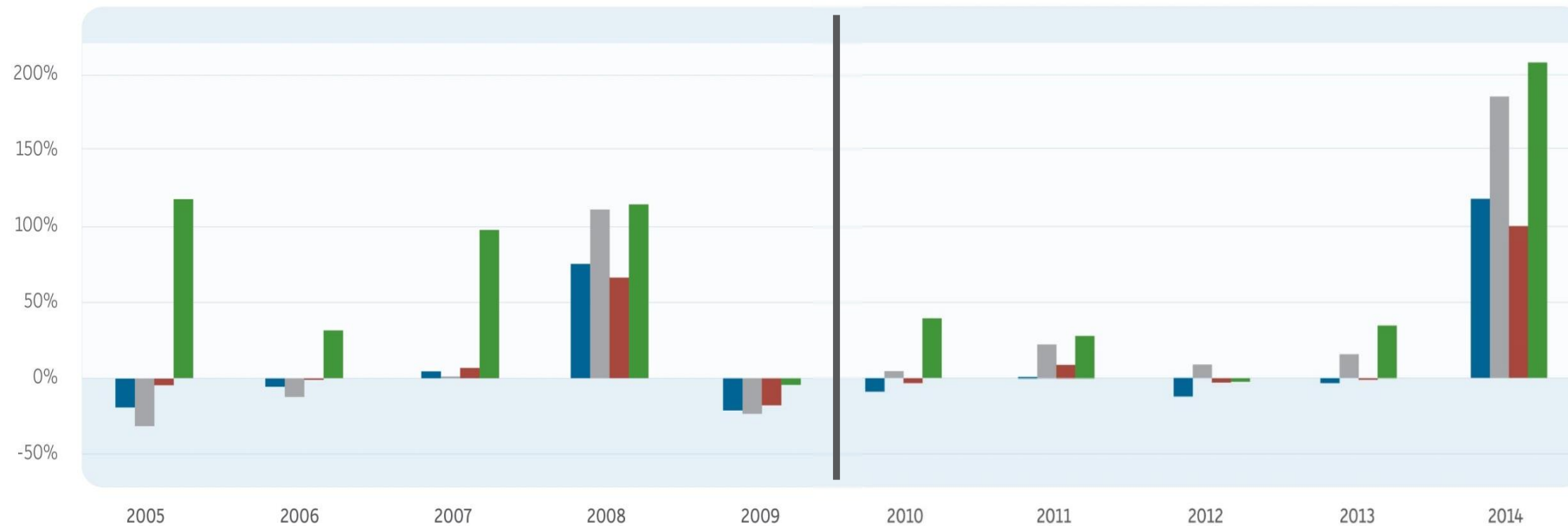
Human capital directly impacts all of these!



To evaluate the impact of investing in human capital practices, Insperity compared the performance of publicly traded companies to the performance of those on Fortune 100's Best Companies to Work For list.

What did we find?

Do “The Best Companies to Work For” significantly outperform their peer group?



Legend

S & P NASDAQ DOW FORTUNE



An Insperty® study comparing the overall performance of publicly-traded companies vs. those who made the Fortune 100 Best Companies to Work For list.

The quality of human capital practices

- Culture
- Recruiting
- Benefits
- Compensation
- Payroll
- HR Support
- Organizational Design
- Decision Making
- Performance
- Training



It's not just the overarching business strategy that culture can eat away at – it's any business decision that you're implementing!



A percentage of target's annual revenue base during initial year is at risk due to decreased efficiency and resistance to change

Most decisions that are made in the early stages of a transaction will directly impact the culture of the future organization.



Culture

Culture Change

Process focused

Overbearing

Winners and losers

Replaces existing values with “new” or “right” values

Research suggests
MOST
change
initiatives fail

Cultural Alignment

Outcome focused

Collaborative

Win-win

Leverages values that drive existing individual employee behaviors

**Integration has to do with alignment and fit
so it should begin with due diligence!**

**“Successful organizations are
internally coherent and congruent.”**

– William E. Schneider, *The Reengineering Alternative*

Human capital due diligence should allow leaders to address questions such as...

Recruiting – Will the newly combined company have the right bench strength to meet short- and long-term targets? What is the selection process for hiring and identifying key bench players? What is the current turnover rate?

Benefits – What does a comparable benefits package include? What can continue to be offered and what is no longer available? How will ancillary benefits (401k, pension plans, AD&D) be integrated?

Compensation – Do salaries for similar positions match peer organizations? Are the commission plans equitable and do they encourage the right behaviors?

Payroll – Are the pay cycles similar? Does the company pay in arrears while the other forecasts to close? Are all employees classified correctly?

HR Support – How do HR policies, procedures and current practices differ between each organization?

Financial impact of cultural differences: How do they hire?

Company A

- Preliminary Due Diligence Finding
- 12% turnover

- Extensive Due Diligence Findings
- Robust hiring process
- Senior manager headcount approval
- Headcount is tied to budget
- Interviews conducted by panel
- Interviewers are trained
- Standardized 1 week orientation process
- 90-120 days time to fill open positions

Company B

Preliminary Due Diligence Finding

- 12% turnover

Extensive Due Diligence Findings

- Front-line manager hires staff based on productivity needs
- Hiring manager conducts all job interviews with no training
- No formal standardized interview process
- First day is spent completing new hire paperwork with HR
- No formal onboarding/training program in place
- 5-20 days to fill open positions

Financial forecasts include cost implications of strategies informed through due diligence



Recruiting Process Changes



Reduction in Productivity



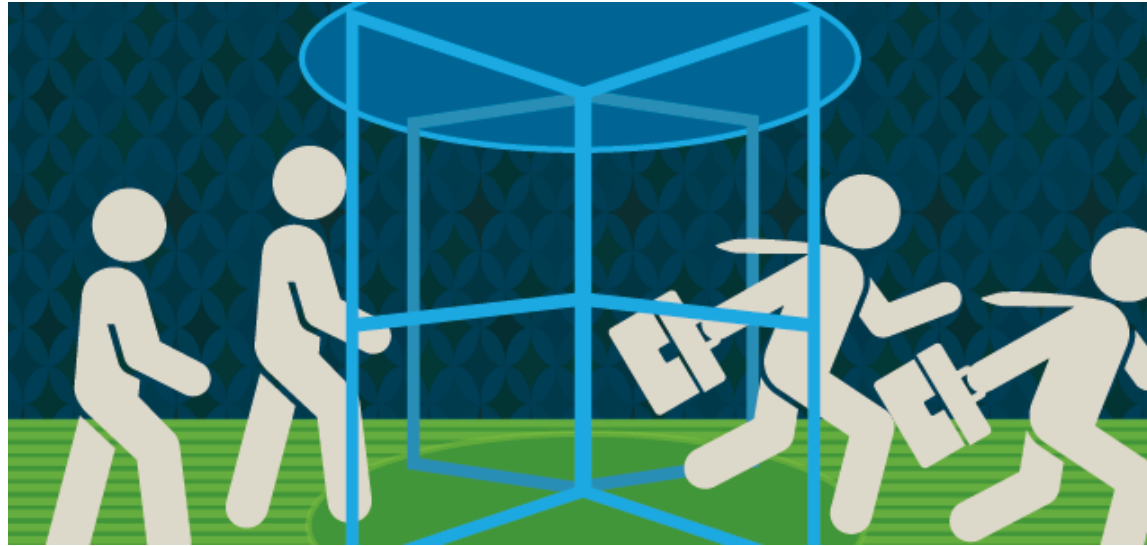
Retention Bonuses



Contingency Staff

Budgeting for Culture Clash

When it's unavoidable



By proactively identifying areas where two companies fail to align, financial projections can account for strategies that will be necessary.

The alternative erodes the contingency or one-time cost budget due to unbudgeted reactionary responses.

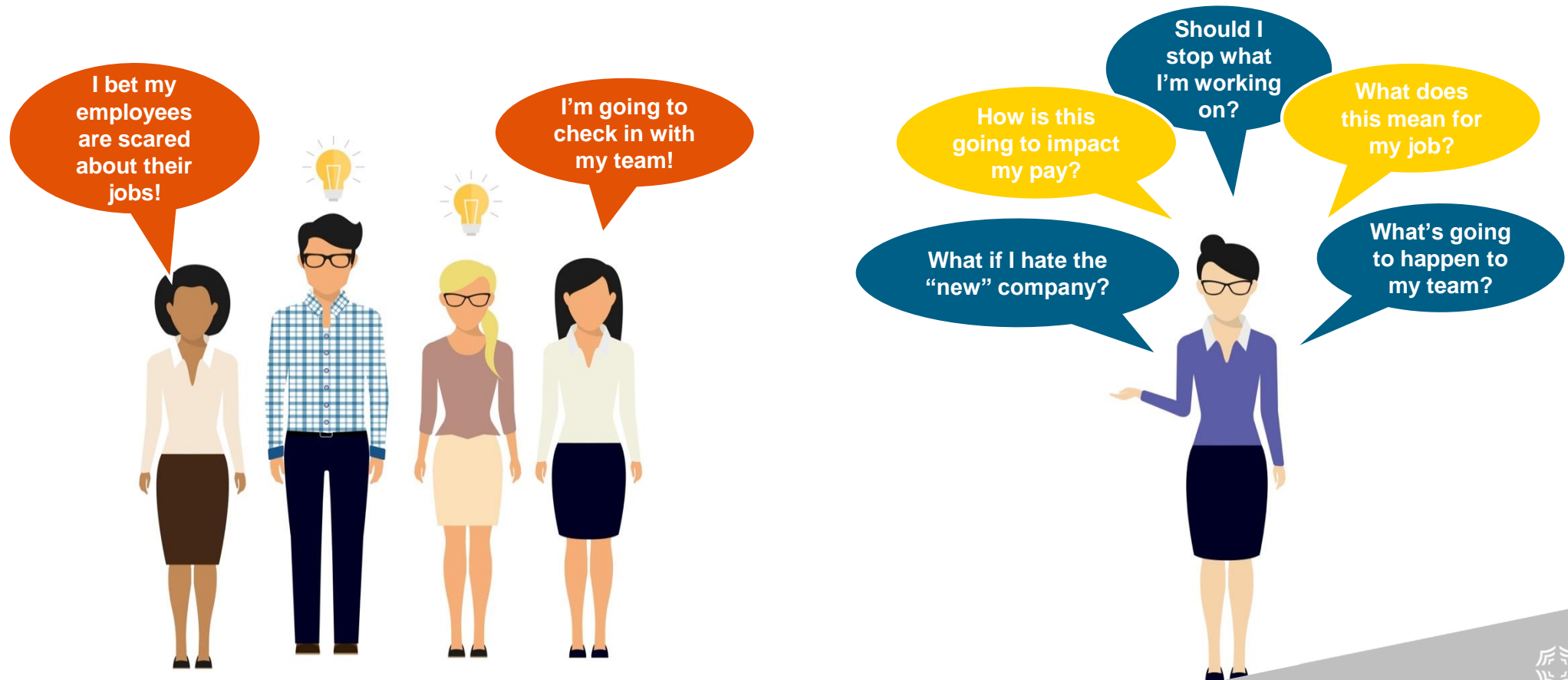
Largest critical success factor for transactions:

Leadership team who understands and conveys the importance of the deal



Where the rubber meets the road

Strong leaders communicate “What’s in it for the employees?”



Human capital questions for scenario planning and developing financial models

Communication

- How will changes be communicated?
- Who are the internal stakeholders?
- What are the key messages that need to be shared?
- Who is responsible for creating and approving these messages?
- How does the company keep avenues open for both top-down and bottom-up communication?
- What key business objectives (short term and long term) should be shared?
When should they be shared?
- What education should be provided on new products and service offerings?

Human capital questions for scenario planning and developing financial models

Employee Retention

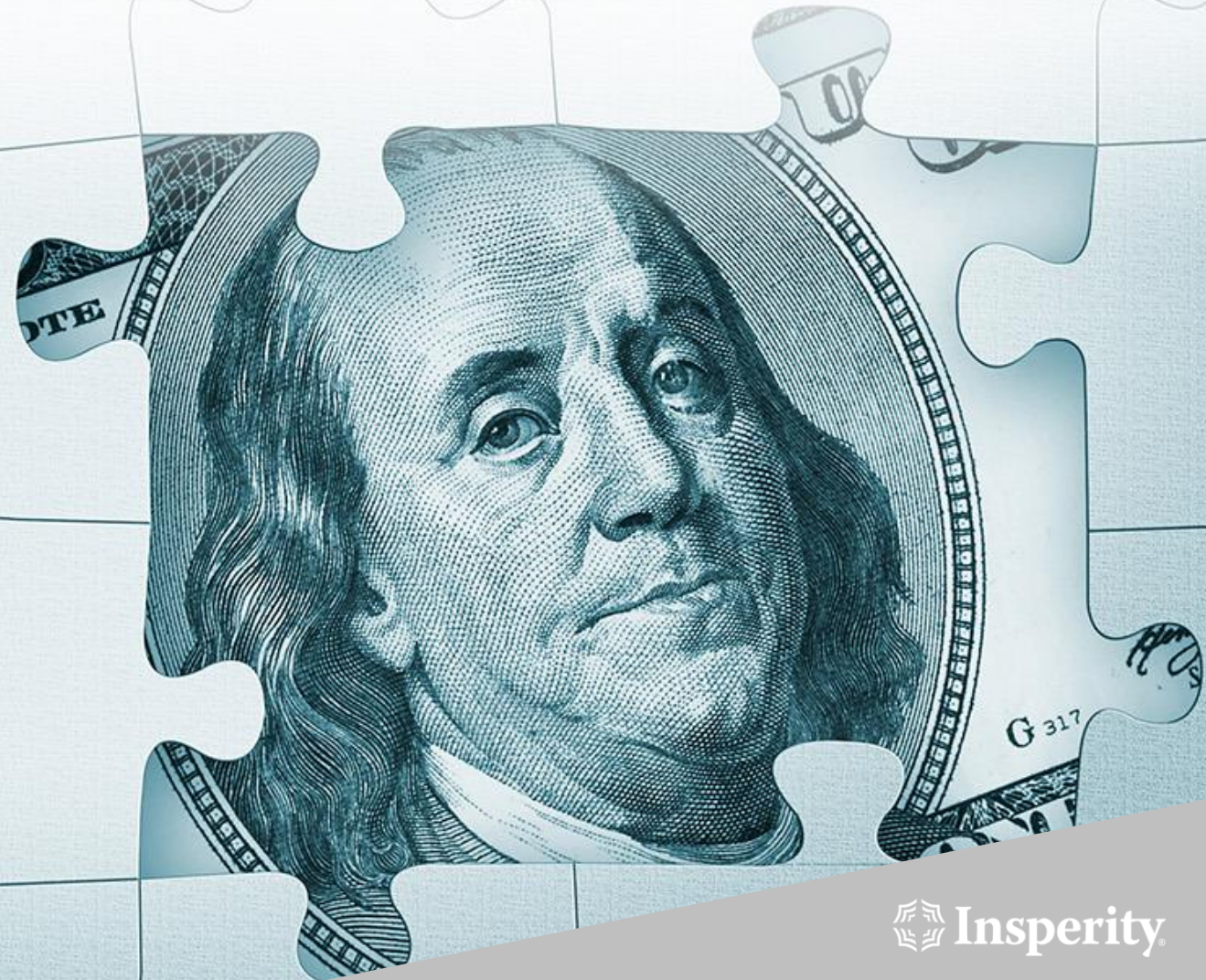
- What is the retention plan to keep key employees for a set time period after the transaction is complete?
- Will cash or equity payments be used?
- What is a reasonable payment size that will still be worthwhile for key employees to remain at the company?
- How will the retention packages be funded?
- What is a reasonable timetable for distribution?

Human capital questions for scenario planning and developing financial models

Employee Engagement

- How will the company keep employees engaged post acquisition?
- What does the new organizational structure look like?
- How will job titles change (role clarity)?
- What do the salary structures/pay practices look like?
- Will the company's paid time off policy change?
- Will the pay schedule change?
- What will the new organization's benefits plan offer?
- How might that change from what was offered in the past?

**Synergy is created through cultural alignment;
similarly, it is devastated by culture clash**





Questions?



Thank You for joining us

For more information, or to speak with an Insperity®
business performance advisor, visit
insperity.com/acg or call us at 866-814-6817.