



Survival skills for the
financial services recovery
Implementing targeted strategies
can enable financial services firms
to achieve M&A success

Constrained capital, increased regulatory oversight, and intense public scrutiny contributed to the decline in M&A volume and value of transactions at the end of 2008 and beginning of 2009.¹ Additionally, government bail-outs, write-offs on bad debt and decreasing profit margins are driving firms to focus intently on how best to compete in the new business climate. While trying to make the most of the new reality, firms will most likely evaluate the benefits of M&A activity either as a target, acquirer, or divestor.

Although these challenges may seem daunting, we believe it is important to use this deal “downtime” to prepare for the opportunities that lie ahead. Before the market recovers, your organization may look to acquire competitors at a discounted price or divest “orphan” entities (e.g., middle market businesses) that might not be aligned with overall long-term business strategies. Is your firm prepared across the different aspects of your business that will be affected by these decisions?

While there are many aspects to a transaction that need to be considered, one of the most critical assets for any organization is often overlooked during early planning stages: its people. At a high level, you will need to develop a clear people strategy for potential transactions including: evaluating your people, figuring out whom and how many people to add or subtract from the future organization and putting tailored talent and retention strategies in place to support execution. The challenge is – how does this get done operationally?



To effectively align people strategies with potential transaction scenarios², there are two key priorities you should consider focusing on while transaction volume is low:

1. Adapting your Human Resources (HR) service delivery model to support transactional planning by building a deep understanding of your talent pool through predictive modeling to help identify how to best focus existing resources and what risks might need to be mitigated.
2. Developing your talent strategies to attract, retain, and motivate key talent for the future based on a people analysis.

Priority #1: Understand what you are working with

You will no doubt face mounting pressure to stabilize and turnaround your organization’s financial health. Transactions are often an external signal of clear and decisive action. However, to avoid the long-term consequences of an untimely or ill-conceived transaction (i.e., quick sell-off, spin-out or acquisition), an organization needs to exercise a disciplined approach to transaction due diligence. By directing the HR organization to establish a baseline for change efforts and by assessing the financial exposure associated with a firm’s revenue producers, firms can greatly improve their chances for success.

HR organization: Focusing your HR organization on transaction due diligence can provide significant benefits during the preparation for and the execution of a transaction. Typical analyses address current state rewards programs, headcount, organizational structure and overall HR budget allocations, using costing models and benchmarks, to formulate a response to changes that will be driven from transactional activity.

For example, a large firm’s plan to generate desperately needed short-term revenue with its restructuring plan required immediate and fast action. Teams were deployed to determine which entities would be separated, stand-alone or remain part of the future organization. In order to execute these simultaneous transactions in a cost effective manner, the organization conducted an analysis of HR’s current state service model and delivery method, and made adjustments to align with the goals of the new organization.

Revenue producers: Using advanced analytics to conduct scenario planning can help quantify the likelihood and potential impact of future events for both customers and employees as it relates to retention. Predictive techniques can be used to anticipate employee populations that may be a flight risk, giving you the data to determine which individuals could be at risk and why. Effectively used, predictive modeling is superior to traditional workforce planning in helping to identify proper development programs, top performers, retention mechanisms and succession plans to support firms in driving additional value at a lower up-front and lower long-term cost.

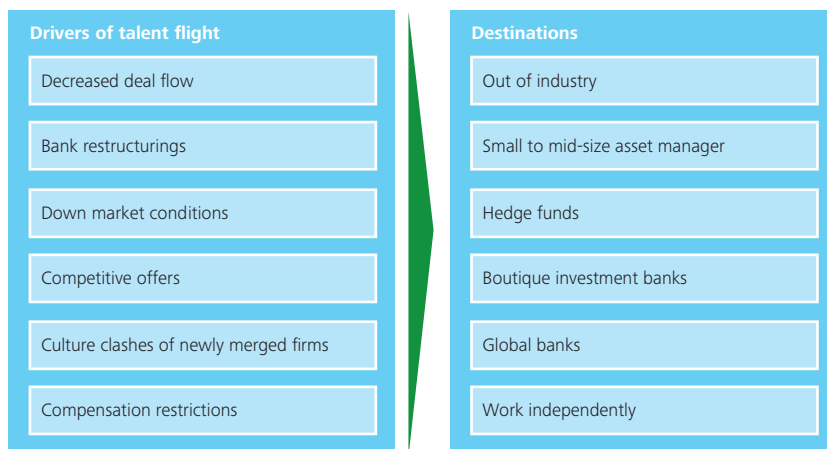
The benefit opportunities of predictive analytics are twofold. First, by determining the probability of talent flight at the individual level, you should be better able to anticipate risk and develop tailored, actionable plans

to triage key employee segments and individuals before decisions have been made. Second, due to spending constraints, you should be better able to target spending more effectively at the individual level based on clear data, rather than tribal wisdom. In other words, focus limited resources on actions that can yield the largest economic benefit: motivating and protecting your revenue producers.

Analyzing revenue producers and their books of business can help you to identify potential revenue risk exposure and tailor retention strategies to maintain business continuity. With increased oversight, regulation and red tape, the banker/broker/agent value proposition at larger firms may be called into question, which could turn revenue producers into flight risks for a variety of reasons (Figure 1). In the current market environment, revenue producers with successful track records and large books of business are being enticed by both traditional and non-traditional competitors. For example, top bankers have been leaving large financial services and other organizations in rising numbers to join banks that do not face strict regulation, including foreign banks and start-up companies.³ Other revenue producers are leaving due to early retirement or culture clashes at merging companies.

Although predictions range, Deloitte⁴ estimates that revenue producers in financial services typically take 50%-60% of their business with them when they join a new firm. This is a hidden risk that can have a material impact on a potential transaction as well as result in a shortfall against your forecasted revenue expectations.

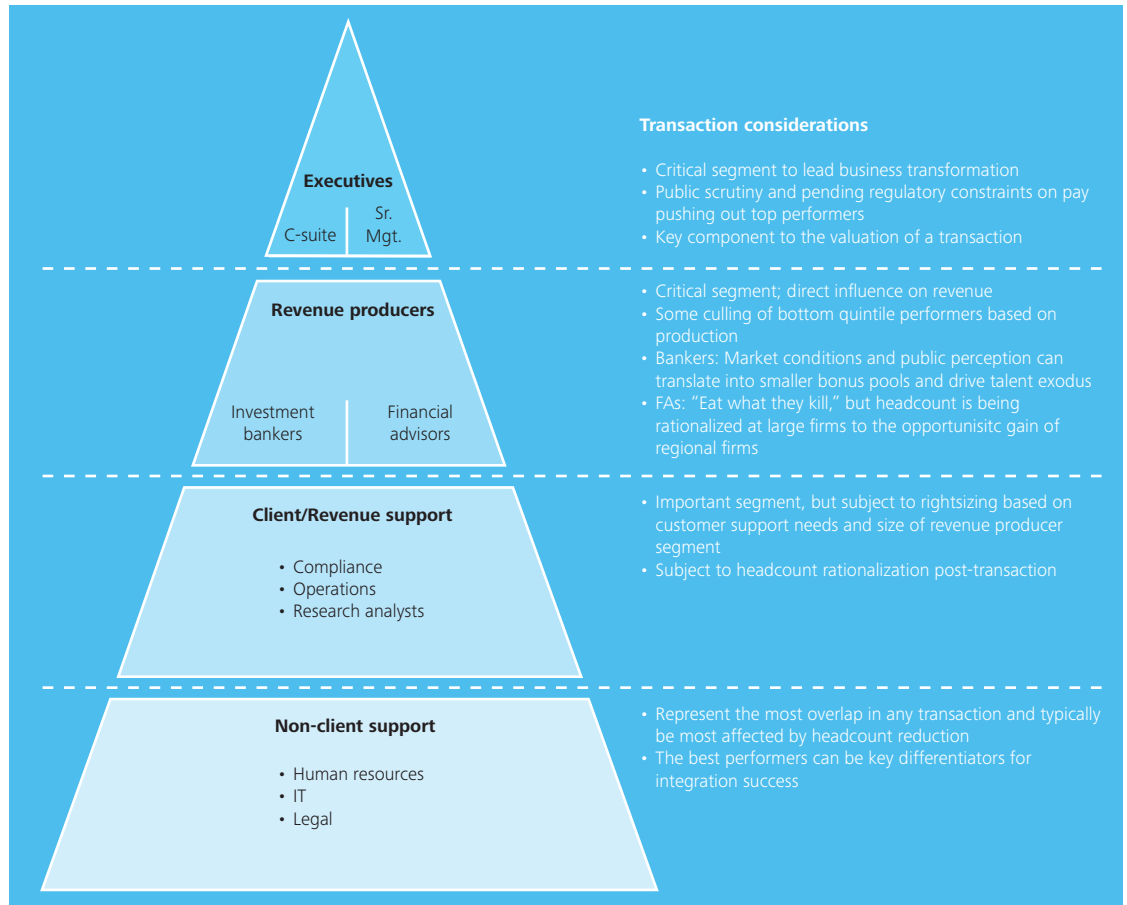
Figure 1.



Priority #2: Retain critical talent

Financial services firms need talent that will lead and drive revenue in the face of public scrutiny and continuous changes in regulations. Studies have suggested that, from a talent management perspective, firms face an employee retention issue.⁵ While predictive modeling can assist in defining the critical talent to focus on retaining, an overall retention strategy must be aligned with the marketplace and a firm’s overall business objectives. In other words, there is a need for better alignment between organizational and individual success.

Figure 2.



Four broad employee populations should be evaluated and further segmented by critical skill sets, performance history and other strategic criteria: executives, revenue producers, client/revenue support and non-client support. Companies should consider identifying the unique needs and challenges of each employee population (Figure 2). Understanding how these employee populations differ in terms of value contribution to the firm, flight risk, influence on revenue and customers, and headcount can serve as a critical baseline for future talent strategies.

Redefine executive leadership and pay. In the current environment, financial services firms may be hamstrung by new regulations on executive compensation, scrutiny of

company compensation policy, and "say-on-pay"⁶ efforts. Additionally, many existing long-term incentive plans were tied to forecasted financial metrics that are now well below pre-recession target pay levels. As a result, firms are faced with the challenge of how to motivate and retain key leadership talent by replacing depressed equity holdings with alternative earnings vehicles, while simultaneously operating within regulatory constraints and satisfying shareholders sensitive to any dilutive impact. In short, firms are tasked with bringing compensation practices more tightly in line with shareholder interests to address concerns about short-term individual gains versus long-term firm performance risk.

Historically, retention bonuses have been a prominent instrument used to attract or keep key talent during periods of change. However, the new federal restrictions that limit firms' ability to use such bonuses for top executives are forcing firms to contemplate alternative approaches.⁷ With restrictions limiting bonus pay that can be earned⁸, you should consider evaluating multi-year executive compensation approaches for executives using risk-adjusted compensation vehicles, such as premium priced stock, option grants, performance based equity grants and grants tied to leverage adjusted return ratios.

Perhaps the more critical retention focus is the second tier of executives that are not governed by pay restrictions due to earnings levels. Not having quite reached the top of the executive ladder and pay scales, these executives arguably have more career and earnings opportunities. If pay for the top tier of executives is restricted there could be less motivation to advance within their firms, and it could be an enticement to exit regulated financial institutions to join hedge funds or private equity funds. One approach to mitigate this risk is to reach deep into the organization and accelerate leadership development and succession planning. Leadership assessments are integral in identifying a leadership pipeline, and applying limited training and incentives spend to individuals with highest probability of success. While this is not a direct financial incentive, the potential for accelerated career path can be a compelling retention driver and component of a firm's employee value proposition.

Drive a smart Pay-for-performance culture with revenue producers. Products are important, but many financial services sectors are driven by relationships. Typically your best revenue producers have the most sought after relationships. Pre-transaction planning needs to factor in these relationships, and post-transaction execution should not lose sight of how to sustain these relationships to support the strategic goals of a deal. With revenue producers, pay is a primary motivation and retention lever. The current challenge is balancing individual performance and pay with broader firm interests.

With pressure on budgets prior to and immediately after transactions are announced, the challenge is how to do more with less. This is particularly true for paying employees below the management level, which represents the largest portion of compensation dollars. Effective pay schemes are usually designed to skew distribution of bonuses towards top revenue producers, leaving little money left for low performers. As bonus pools as a percentage of profitability or assets under management diminish from recent years, it becomes even more critical to retain the ability to direct pay to the right talent.

Be prepared to justify "pay-for-performance" practices to a broad set of constituencies during due diligence and immediately after a transaction. In light of the recent economic situation and recent financial performance by financial services firms, the justification typically involves one of the following:

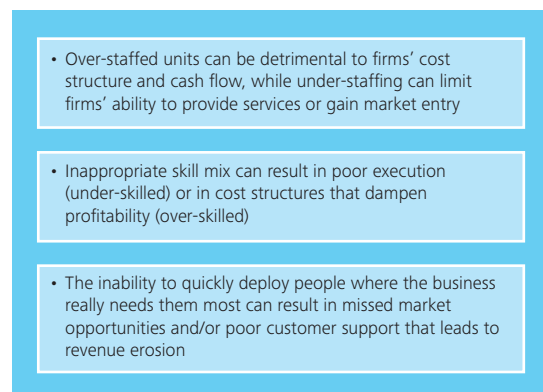
- Certain businesses could soon rebound and cutbacks could adversely impact such businesses
- Contractual obligations to pay people for achieving specific pre-defined benchmarks
- Increased competition from traditional and non-traditional competitors for the best people

While you may be tempted to reduce investments in pay schemes, the need to address flight risk should remain a key concern. Successful producers in the wealth management and the insurance business are being lured for multiples of their past production (as much as 200% to 300%) as a land-grab occurs in preparation for a recovery in financial advisory businesses. However, depending on the sector, the answer to addressing flight risk need not be as simple as offering greater annual production to top performers to match competitive offers in a post-merger scenario.

For example, to deepen client and firm/producer relationships well before transactions occur, some firms are providing greater production opportunity through teaming strategies. In this scenario, top performing bankers and financial advisors are paired with less tenured producers and allowed access to a new book of business to pursue untapped account penetration opportunities. The team is able to approach the book of business holistically, better matching service levels to customers as less tenured (and lower cost) producers focus more on customers that might otherwise receive little attention from more experienced producers. This practice simultaneously offsets declines in business for the top performer while improving the development of average performers through a mentoring arrangement. As important, the teaming approach can help drive customer-centric behavior and serve as a protective measure for the firm by breaking the cycle on individuals exclusively owning customer relationships. Firms are better able to maintain a pay-for-performance approach while mitigating the impact of flight risk.

Upgrade capabilities with client and non-client support. As you restructure and potentially downsize your organization, you will need to determine how to size the new organization, as well as identify the talent profiles required to drive the business. A transaction can present opportunities to upgrade organizational capabilities in areas where there will be headcount redundancy for the scale of the new organization. Who do you keep, redeploy, or cut? While the answers to these questions should be driven by the circumstances of a transaction, a vital consideration should be business continuity. As such, your P&L owners should be involved in this continuous evaluation process, which should help you in your efforts to effectively assess the right combinations of roles, skills, and scale required. Miscalculations can have a far-reaching impact (Figure 3), ranging from non-optimal cost structure to the inability to execute customer-facing services.

Figure 3.



Mapping operating model requirements now to talent profiles of individuals can provide the vital linkages to help transform the organization in any future transaction. A staffing strategy focused on redeployment of key talent to core business areas while harnessing internal capabilities that drive transaction success should allow companies to maintain the critical knowledge of an organization. To the extent that new talent needs to be acquired, recruiting efforts can target talent portfolio gaps with a defensible and focused strategy.

Summary: Positioning for the upturn

Regardless of the uncertainty of where the market is heading, financial institutions will continue to undertake acquisitions and divestitures in order to compete. The steps that you take now should help you in your efforts to emerge as a strong player in a reshaped competitive landscape. First, focusing your HR organization on transaction planning can enable you to better manage true risk exposure (talent flight and revenue continuity) with a data-driven approach. Second, implementing tailored talent strategies for the four key employee groups should help you protect the inherent value of the future organization and allow your organization to capitalize on opportunities as they arise. In a climate of high scrutiny and diminished resources, a disciplined approach to investing in the right people is not just responsible management, it is necessary for M&A success.

Endnotes

¹ Thomson Financial data cited in M&A Market Overview, May 1 2009.

² In the context of this article, “transaction” activity can refer to any or all of transaction scenarios, including acquisitions, divestitures or restructurings.

³ Graham Bowley and Louise Story: “Crisis Altering Wall St. As Stars Begin to Scatter,” *New York Times*, April 12, 2009.

⁴ As used in this document, “Deloitte” means Deloitte Consulting LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries.

⁵ Deloitte Consulting’s five-part longitudinal study “Managing talent in a turbulent economy: Clearing the Hurdles to Recovery;” July, 2009; Dbriefs Webcast, “Avoiding a Post-Recession Resume Tsunami,” October 14, 2009.

⁶ All TARP-recipients are required to submit to annual, non-binding, “Say-on-Pay” shareholder vote on the appropriateness of the compensation packages for the senior executive officers. See Investor Protection Act of 2009 at www.treas.gov/press/releases/docs/tg205071009.pdf

⁷ In February, TARP legislation imposed several restrictions to executive compensation and expanded restrictions beyond the top five executives to the top twenty earners within a firm. Notable restrictions include limitations on earnings tax deductions, clawback provisions and limitations to bonus pay to no more than one-third of total annual compensation. See <http://dodd.senate.gov/?q=node/4759>

⁸ On October 22, 2009, two key pieces of guidance were issued that significantly impact compensation for Financial Services companies: 1) the Special Pay Master for Executive Compensation (“Special Pay Master”) issued Determination Memorandums to each of the seven companies that received “exceptional assistance” under the Troubled Asset Relief Program (“TARP”); and 2) the Federal Reserve System issued proposed guidance for financial institutions regarding the development of incentive compensation arrangements that discourage excessive risk-taking and protect the safety and soundness of banking organizations (includes U.S. bank holding companies, state member banks, Edge corporations, and U.S. operations of foreign banks). For details related to the aforementioned guidance, see <https://treas.gov/press/releases/tg329.htm> and <http://www.federalreserve.gov/newsevents/press/bcreg/20091022a.htm>

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