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Human Capital Considerations in Cross-border Deals in Latin America

Acquiring an overseas company can open up new markets and business opportunities. However, foreign companies may also include a number of unique human capital considerations that can impact deal value.

Latin America, for one, may be a particularly attractive region for foreign acquirers, with a growing middle class and wealth of natural resources. What many buyers do not take into account, however, is that relationships between employer and employee are typically more complex in Latin America than elsewhere. Employers are expected (and often required) to provide a wide variety of benefits. To reinforce these cultural norms, most countries in the region have intricate labor laws and pro-employee courts. For foreign buyers, knowing what to expect and how to navigate the expectations of newly-acquired employees can go a long way to help avoid expensive missteps and create productive relationships.

"Human capital considerations are often left to the latter stages of deal negotiations, but buyers could avoid many common problems by planning ahead," says James Jones, Human Capital Specialist Leader with Deloitte Consulting LLP in the US.

Human capital considerations in the due diligence process

While human capital considerations should not necessarily drive deal structure, it is important to factor them into the valuation and risk assessment associated with a transaction. In the due diligence phase of a deal in Latin America, for example, the full scope of a potential target's obligations to employees may not be obvious. The target may face exposure for non-compliance with statutory employee benefits, it may be subject to claims or litigation from employees, or it may have independent contractors that may be deemed to be performing employee functions. Some Latin American companies also maintain unwritten agreements with their employees on matters such as long-term incentive plans -- including phantom stock or stock options-- which may require settlement upon a change in control. Essentially, buyers need to make sure they understand how the work force is remunerated, as compensation is often structured to reduce corporate and personal income taxes and may be subject to scrutiny by government authorities. This could lead to additional legal and/or tax exposures for the buyer, and potentially incremental costs post-transaction.

During the deal: Employee transition process

In the US and Europe, employees of a target company typically continue as employees under the new ownership, with no break in employment status. In Latin America, however, a deal that is structured as a sale of assets (and not the stock of the company) often requires the seller to terminate all the employees associated with the business to be acquired and to settle whatever financial benefits are due to employees, such as severance. While rehiring efforts are often successful, the buyer should be careful to offer similar pay and benefits to what employees received before the transaction, in accordance with terms set by an employee union if applicable. In a more competitive hiring market, buyers may even need to increase their compensation offers and provide additional incentives to retain key employees. These steps are crucial to mitigate the risk of losing employees, and to help protect the value of the acquisition.

Conversely, in a deal that is structured as a stock sale, the employees come with the company. However, it is important for a buyer to understand that employees are not likely familiar with all the nuances of the deal structure, and may still be expecting the payout of vested benefits upon a change in control. "You may avoid paying termination benefits in a stock sale, but you should still address the topic to manage employees' expectations around the deal," says Jose Velaz, Specialist Leader, Deloitte Advisory - Mergers, Acquisitions & Divestitures with Deloitte & Touche LLP in the US.

In both deal structure scenarios, a critical question for the buyer is when to engage with the employees of the target company. The answer often depends on the seller's willingness to communicate the sale of the company to the employees. If the seller has been open about their goal to find new owners, it may be appropriate to approach employees as soon as practicable. If the sale has been a closed-door process, it may be necessary to wait until just before, or even slightly after, the transaction closes.

Regardless of when they occur, the initial conversations with employees should focus on how important each person is to the transaction, and to the continued success of the company. "Make sure employees know why they are valued, what to expect from the closing process, and what their future is within the company," says Hernan Marambio, M&A Transaction Services Leader, Americas Financial Advisory with Deloitte & Touche LLP in the US. In the case of a stock sale, it is also important to reset employees' expectations around immediate financial payouts. "You can point out that nothing has changed, they have the same pay and benefits, and the money they were expecting stays with the company, for a future payout," indicates Marambio.

After the deal: Ongoing human capital considerations

In general, foreign acquirers in Latin America may confront a number of compensation and benefits practices that are not standard practice in their home countries. For example:

- In some countries, unions cover all levels of employees from the rank and file to the executives, and dictate detailed terms for compensation and benefits.

- Independent contractors and interns are critical parts of the workforce in Latin America. Companies often form relationships with local universities through their internship programs to create a robust pipeline of new employees. Foreign buyers should be careful to nurture these relationships and not underestimate them.

- Foreign buyers might be surprised to learn that for payroll purposes, most calendars in Latin America have 13 months rather than 12. While the salary is broken into thirteen parts, the thirteenth part essentially becomes a bonus. This may be in addition to a standard holiday bonus.

- In certain countries, companies are required to pay a percentage of their profits to employees. To effectively manage this statutory payment, some companies create separate, wholly-owned entities for the purpose of hiring employees. However, these entities may be subject to scrutiny by government authorities.

- Certain perquisites not normally seen in the US include employer-provided meals. Many companies are expected to offer free lunches, either through cafeterias or through credit cards (known as tickets) that can be used at local restaurants. Some employers even provide a stipend for groceries. In certain countries, car and housing allowances are also more prominent at lower management levels than they are in the US.

Conclusion

Human capital challenges can significantly affect the ultimate value of a cross-border acquisition. Buyers should be aware of the local human capital landscape and the potential exposures before they close in order to address key risks and identify opportunities in a transaction. Latin America is a region with some particular challenges in this regard, as employers are often expected to provide a wide range of employee benefits. Buyers who go into transactions fully aware of these risks and opportunities, and have a plan to constructively address them, will typically be far more likely to retain employees—who often are one of the most valuable assets in a deal.

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