Hewitt

Survey Findings

M&A Transactions and the Human Capital Key to Success—Global Report

About Hewitt Associates

Hewitt Associates (NYSE: HEW) provides leading organizations around the world with expert human resources consulting and outsourcing solutions to help them anticipate and solve their most complex benefits, talent, and related financial challenges. Hewitt consults with companies to design and implement a wide range of human resources, retirement, investment management, health management, compensation, and talent management strategies. As a leading outsourcing provider, Hewitt administers health care, retirement, payroll, and other HR programs to millions of employees, their families, and retirees. With a history of exceptional client service since 1940, Hewitt has offices in 33 countries and employs approximately 23,000 associates who are helping make the world a better place to work. For more information, please visit **www.hewitt.com**

About This Survey

Merger and acquisition (M&A) activity continues to be a powerful and popular method for corporate growth. While the overarching goal of any acquisition is to create a combined company that's larger, performs better, and generates more revenue (and profit) than the sum of its pre-deal parts, experience shows that most deals do not create their anticipated value. Yet, even though pursuing an acquisition is fraught with risks, it remains a key element of the growth strategy of many companies.

In the fall of 2008, Hewitt Associates embarked on a research study to examine how companies globally are managing to secure the value of an acquisition, with a specific focus on **human capital**. Human resources executives from across the globe were invited to participate in our survey on "M&A Transactions and the Human Capital Key to Success."

The survey examined questions such as: How do some of the world's most acquisitive companies approach human capital issues during due diligence and integration? How do they intend to improve upon this approach in the future? In what ways do human capital issues impact the perceived success or failure of a transaction? What are the most prevalent human capital risks?

The following document summarizes the results from all regions surveyed—Asia, Europe, Latin America, and North America. It reflects the responses of 96 companies that over the past two years represented more than $568 billion (USD) in deal volume.

Throughout the report, comparisons will be made between respondent companies from emerging markets (56 companies from Asia and Latin America) versus respondent companies from mature markets (40 companies from Europe and North America). Comparisons also will be made to Hewitt's last global M&A survey conducted in 1998.

Note About the Data

Values in tables and charts are rounded to the nearest whole number. Therefore, percentage totals may not add to exactly 100%.

We wish to thank those who participated in this survey and look forward to discussing the results.

Executive Summary

The M&A Environment Is Changing

More than half of participant companies anticipated M&A activity would increase in the next two years, with emerging market companies anticipating rising M&A activity to a greater degree than mature market companies. However, since our survey closed, the global economic environment has changed quickly and unexpectedly. The year 2008 ended with significantly lower levels of M&A activity, and 2009 is expected to bring further declines.

Financially driven, private equity megadeals have disappeared for the moment. Yet strategic, company-financed deals continue and are expected to proceed at a slow to modest pace as companies with cash reserves or stock find themselves positioned to make opportunistic acquisitions at bargain prices. Here, high activity is anticipated for transformational deals that change the landscape of entire industries.

Companies engaging in M&As in 2009 will face more stringent financing requirements and a tough economic environment. They will experience heightened scrutiny and shorter time frames in which to realize value from their deals. HR and human capital will play a significant and arguably unavoidable role in whether or not desired returns are achieved within the required time frames.

Companies Are Taking a Conservative Approach to Deal-Making

Companies are focusing on the more “secure” costs side of transactions. Nearly half reported a combination of cost savings and growth objectives to be the primary reason they engaged in M&As over the past two years. This focus on the return aspects of deals tends to be easier for companies, but also tends to generate less total value than more complex value drivers such as revenue and market share increase.

Human Capital Challenges Persist

In our 1998 global M&A survey, few companies reported having fully achieved success in their M&As. In 2008, companies were still struggling to fully reach the objectives of their M&As, with 78% of respondents indicating that they were unable to meet or exceed all of their M&A goals. Human capital issues continue to be the major factor in M&As falling short of their objectives. Cultural integration issues have held up their place over the past ten years as the top challenge to companies fully realizing their deal objectives.

Complex Human Capital Processes Need Mastering in Both Due Diligence and Integration

Respondents reported that the more complex, less tangible human capital issues needed greater examination in both due diligence and integration, suggesting a need for more holistic, end-to-end deal processes. Respondents named cultural fit, followed by leadership selection, as the human capital issues most in need of greater attention for both due diligence and integration. Mastering these more complex aspects of due diligence and integration in the future will be critical for companies as these are the most powerful drivers of deal value.

Key Employee Separations Erode Total Deal Value

Retention of key employees is a core M&A challenge for companies across the globe, one that we estimate is significantly eroding total deal value. At 26% of respondent companies, critical employees separated at a higher rate than noncritical employees during and immediately following an M&A. We estimate that our sample of 96 companies, representing more than $568 billion (USD) in total deal value over the past two years,[1] had over $54 billion (USD) of deal value riding on the rate at which critical employees separated during or immediately after deals, enough to wipe out much of the synergy value sought in the deals themselves.

[1] Total Deal Value obtained from Capital IQ, September 2008.

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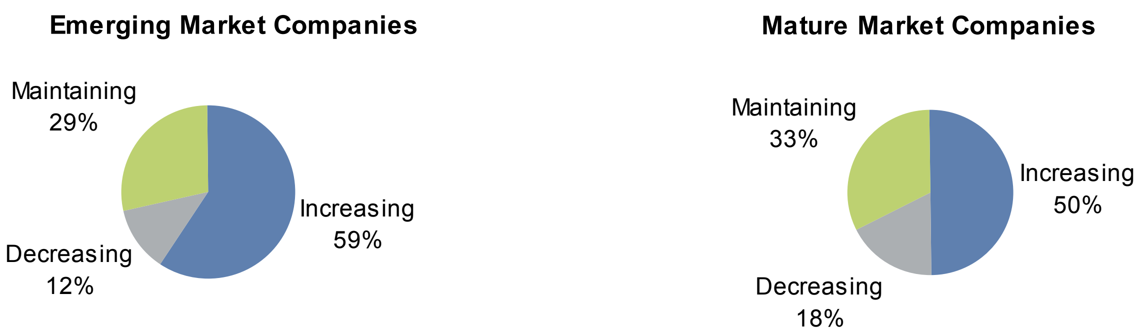
What is the projected level of M&A activity?

When Hewitt last conducted a global M&A survey ten years ago, M&A activity was on the rise, having reached a global record of $1.6 trillion in deal value in 1997.[2] This growth continued through 2007 when M&As totaled $4.8 trillion (USD) worldwide, an increase of 23% from 2006.[3] Our survey respondents expected this growth would continue, with more than half of them anticipating M&A activity to increase in the next two years. Only 14% anticipated it would decrease. More emerging market companies anticipated rising M&A activity than mature market companies, showing that survey respondents expected existing global M&A trends—where emerging market M&A activity increased by 43% in 2007, while Europe saw a smaller 37% increase[4]—would continue.

Anticipated Level of M&A Activity in Next Two Years



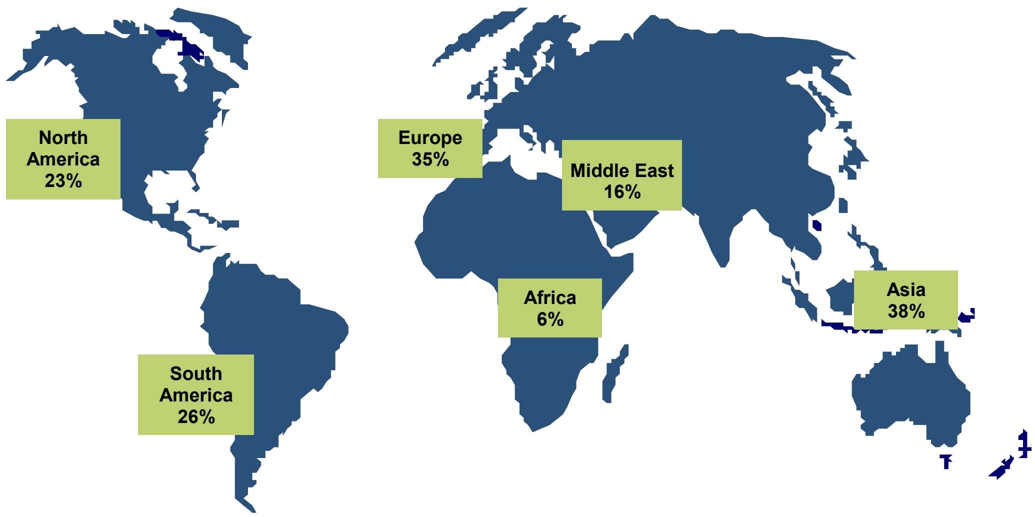
Since our survey closed, the global economic environment has changed quickly and unexpectedly. The year 2008 ended with significantly lower levels of M&A activity, and 2009 is expected to bring further declines. Not only are fewer deals being announced, but also many previously announced deals are being withdrawn. Financially driven, private equity megadeals have disappeared for the moment. Yet strategic, company-financed deals continue and are expected to proceed at a slow to modest pace as companies with cash reserves or stock find themselves positioned to make opportunistic acquisitions at bargain prices. Here, high activity is anticipated for transformational deals that change the landscape of entire industries.

Companies engaging in M&As in 2009 will face more stringent financing requirements and a tough economic environment. They will experience heightened scrutiny and shorter time frames in which to realize value from their deals. Mastering the human capital aspects of deals will be critical. And, as we'll see later in this report, HR and human capital will play a significant and arguably unavoidable role in whether or not desired returns are achieved within the required time frames. More than ever before, companies will need replicable M&A processes and methodologies designed to yield efficiencies, meet business objectives, and increase profitability.

[2] "Survey Findings: Mergers, Acquisitions, and Joint Ventures: Critical HR Success Factors—U.S. Findings," Hewitt Associates, 1998.
[3] "Global M&A Outlook," World Economic Prospects, Spring 2008.
[4] "Global M&A Outlook," World Economic Prospects, Spring 2008.

Respondent companies anticipated the focus of their M&A efforts in the next two years would be on Europe and Asia. These results are consistent with external reports that M&A activity has been growing to the greatest degree in Europe and Asia. They show continued growth in the pace of cross-border deals, something we saw emerging in our 1998 M&A survey, where half of U.S. respondent companies had done cross-border deals, yet most of those had conducted only one.

Anticipated Geographic Focus of M&As in Next Two Years



The mature market companies in our survey anticipated they would be conducting M&As in more regions than did emerging market companies. As in our 1998 survey, emerging market companies anticipated they would be doing local deals in the near future.

Mature market companies have already realized cost savings within country or region (through industry consolidation, for example) and must look elsewhere for additional cost savings. Emerging market companies still have opportunities to save costs through consolidation within country or region (for example, by consolidating back-office operations).

It's important to note, however, that emerging market companies, especially those headquartered in Asia, have steadily increased their share of total cross-border M&As.

Policy and Practice Differences for Consideration in Cross-Border Deals

- Cost effects of statutory or supplemental benefits
- Culture
- Employment relationship
- Executive compensation
- Reductions in force
- Unions and collective representation

Legal Issues Affecting Cross-Border M&As

With the number of cross-border M&As on the rise, HR must stay abreast of case law and statutory developments affecting employment. For example:

- **When does a mutual agreement to terminate employment fail to terminate employment in the event of a transfer of undertaking?**

  The Austrian Supreme Court has ruled that a mutual agreement to terminate employment during a transfer of undertaking is null and void unless it's concluded "solely in the employee's interests"—for example, to allow the employee to take or find another job.

- **In what two countries can employees object to the transfer of their employment and require their old employer to retain their employment?**

  In Germany, individual employee notification is typically required only for asset transactions. Any employee affected by a change in operation is entitled to receive information about this change, regardless of whether a works council is present. Either the seller or buyer may provide this notification. If employees do not receive complete and accurate information, the notification is considered invalid, and employees may object to a change in their employment relationship. To avoid this situation, the seller and buyer should jointly draft employee notices.

  In Japan, the seller and buyer, by agreement, can determine which employees will be transferred to the buyer in a divestiture. Employees in ancillary positions (e.g., HR or finance professionals who cover multiple lines of business or departments) may object to the transfer of their employment. If the objection is made in a "timely" manner, employees are entitled to continue their employment with the seller. The seller's employees do not have the right to object to the transfer of their employment contracts if their work product is primarily dedicated to the divested establishment's activities. However, if these employees are not transferred from the seller to the buyer, they may object to the exclusion.

- **In what Latin American country must employees complete an employment release agreement before a public notary?**

  In Chile, the employment relationship is not deemed to have been terminated legally until the release agreement has been notarized.

  During 2008, the issuance and dissolution of employment contracts, as well as the transfer of employees due to a merger or acquisition, changed due to the adoption of China's Labor Contacts Law and implementing regulations. Germany's Risk Limitation Act created new employee representative notification requirements. The works council or Economic Committee must be informed of a change in control of a company involving at least 30% of voting rights. Under a recent ruling by the United Kingdom's Employment Appeal Tribunal, employers engaged in a merger or acquisition risk assuming up to six years of unequal pay claims if they continue the unequal pay practices of the previous employer, even inadvertently. Employment terms and conditions, typically reviewed during due diligence, changed in China, Japan, Singapore, Finland, France, and the Netherlands, among other countries.

  It is critical to understand local statutory requirements, such as those outlined here, as they directly impact due diligence and integration planning activities including ongoing cost of employment, cost of severance, and timing and activities required to transfer employment.

What are the business drivers for mergers and acquisitions?

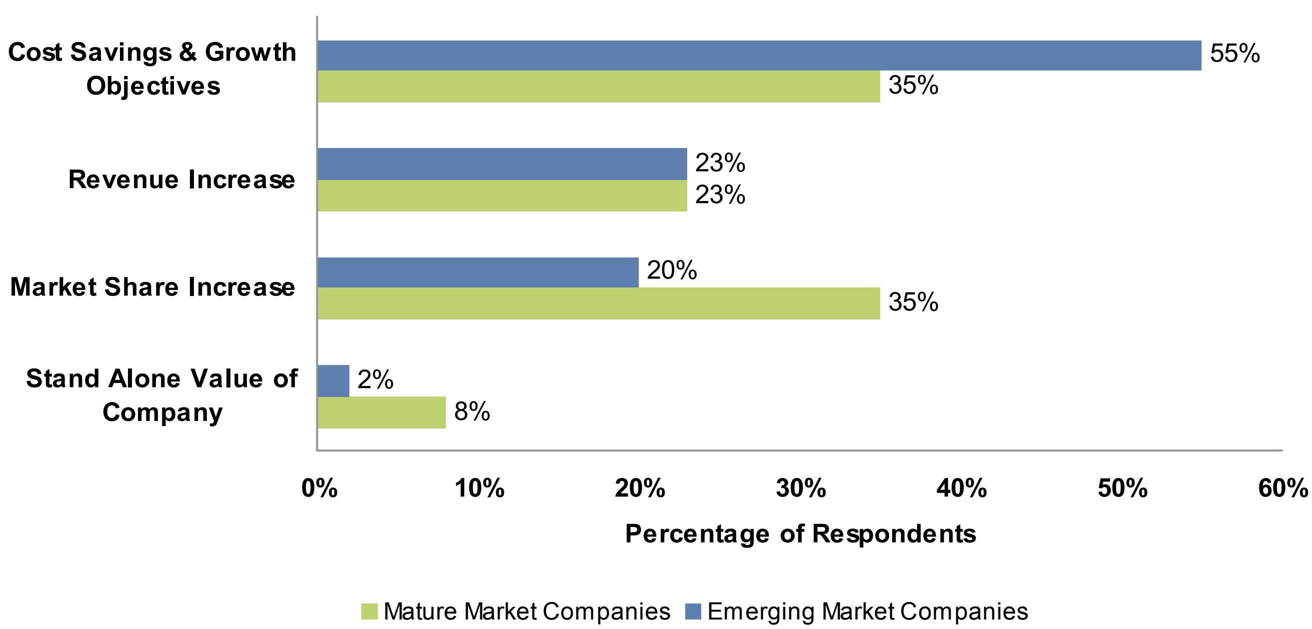
M&A synergy objectives revolve around growth and return. Typically, companies decide to acquire another organization to grow their overall business by accessing new markets and combining businesses, or to improve their financial returns—for example, by consolidating functions and through vertical integration.

The companies in our survey have been focused on the latter, relying on M&As more to build efficiencies and realize cost savings as opposed to engaging in M&As primarily to increase revenue and expand market share. Nearly half of respondent companies from across the globe reported a combination of cost savings and growth objectives to be the primary reason they engaged in M&As over the past two years. These results suggest companies are at risk of having cost savings take priority, as cost savings tend to be the easier aspects of deals. However, cost savings also generate less total value than more complex growth objectives that generate longer-term value.

This risk of focusing on cost savings at the expense of growth objectives is heightened in a global economic downturn, where companies tend to focus more on the more "secure" costs side of transactions. Yet, it's important for companies to acknowledge that long-term sustainable value creation can't only be achieved via cost synergies. Growth is required to accelerate meeting or exceeding business objectives.

Looking at the responses for emerging versus mature markets reveals two notable differences—more emerging market companies are engaged in M&As to achieve a combination of cost savings and growth objectives. Many emerging market companies are looking at deals within their own countries to consolidate back office operations. In contrast, more mature market companies have moved beyond a primary focus on generating cost savings through M&As toward a greater emphasis on boosting deal value through the pursuit of pure growth goals such as increased revenue or market share. Many industries in mature markets have already consolidated within country, so they look for synergies from market or product access rather than cost savings.

Primary Business Drivers of M&As Over Past Two Years



How is success measured?

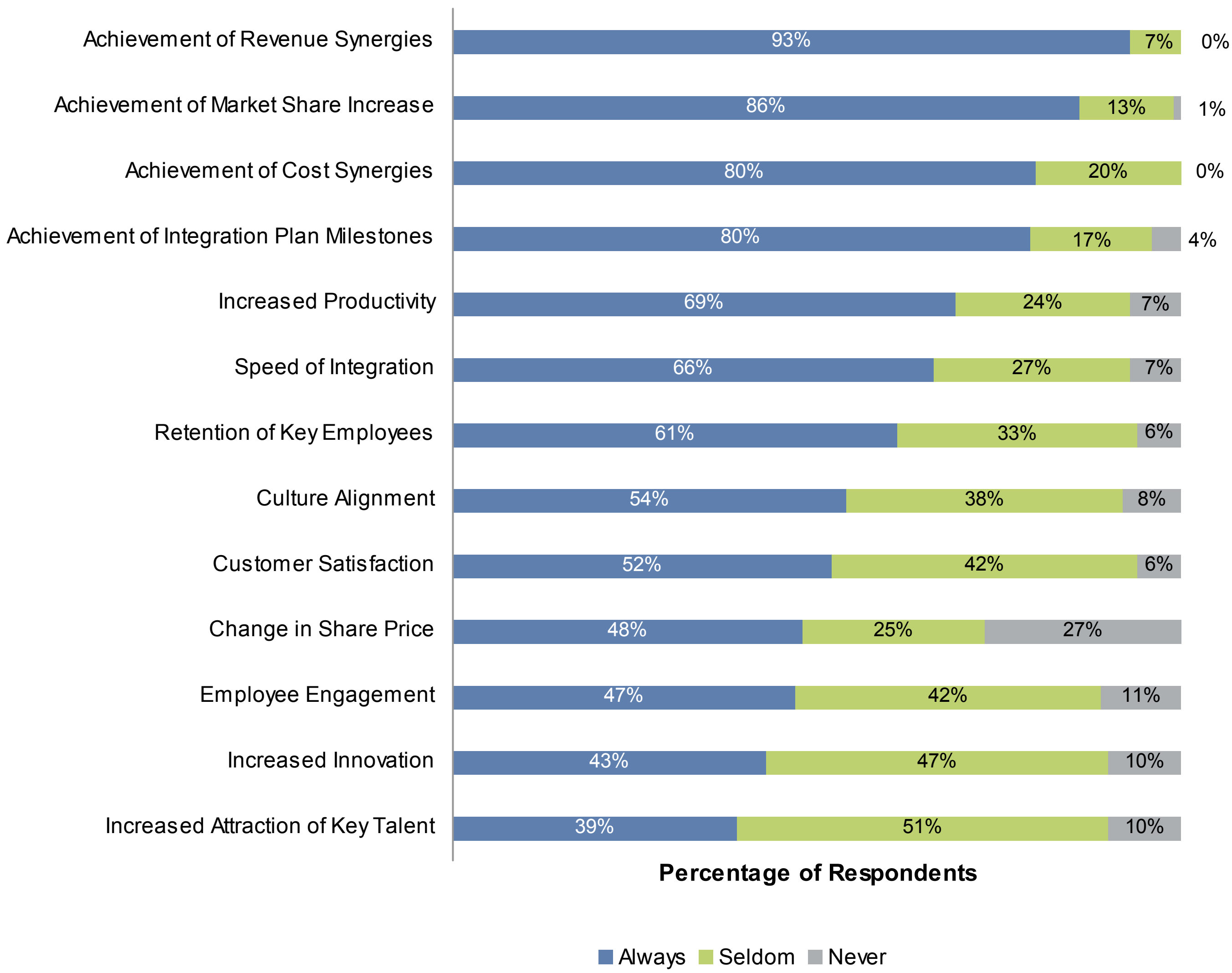
Key to realizing efficiencies and establishing a record of success with M&As is learning from previous M&A experiences. As companies increase their use of M&As, they're becoming increasingly sophisticated in their measurement practices—putting more emphasis on having some type of post-deal review and relying on measurement tools such as scorecards.

Our survey results reflect this increasing sophistication. They show that companies are moving beyond relying solely on financial metrics to also incorporating human capital-related metrics in their post-deal reviews. Metrics focused on human capital issues such as retention of key employees, culture alignment, and employee engagement, however, were used less frequently by participant companies than non-human capital-related measures such as achievement of revenue or cost synergies.

'Cost Neutral' May Not be Enough

Cost neutrality (i.e., combining or separating HR platforms on a cost neutral basis) historically has been a common transactional goal. Increasingly, organizations are now looking at transactions as an opportunity to significantly reduce overall costs—both through leveraging increased economies of scale as well as fundamental design changes or benefit elimination. Organizations are finding cost savings of 20% or more in some countries.

Metrics Used to Measure Success of M&As

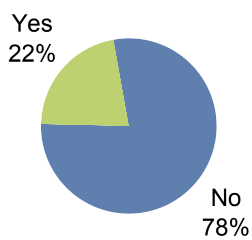


Was the last critical deal a success?

In our 1998 global M&A survey, few companies reported having fully achieved success in their M&As. While many had achieved their transactional goals, most found integration and sustained success elusive. In 2008, companies were still struggling to fully reach the objectives of their M&As. Seventy-eight percent (78%) of respondents indicated that they were unable to meet or exceed all of their M&A goals. This high percentage is due to the survey question having been relatively strict in asking about achieving “all” objectives. Yet, this finding is still important because achieving “all” objectives within a given time frame is how M&As create value.

Were All Transaction Goals Achieved?

Human capital issues continue to be the major factor in M&As falling short of their objectives. Companies in 2008 still appear to have most of the quantitative and transactional human capital deal issues under control. It’s the less tangible, qualitative, more complex human capital issues, however, that continue to cause deals to take longer than expected to execute and to fall short of meeting or exceeding desired objectives.



As in 1998, cultural integration issues were cited as the top challenge to fully realizing deal objectives. Inconsistent and unclear communications have also persisted as top issues while payroll, benefits, and HR integration continue to be rated as lesser challenges.

Factors Contributing to Deals Not Meeting Goals—Scale of High, Medium, Low

Most Frequently Rated High	Most Frequently Rated Low
■ Cultural integration issues	■ Payroll integration/implementation issues
■ Inconsistent/unclear communication of synergy objectives	■ Compensation integration/implementation issues
■ Integration/implementation took longer than expected	■ Benefits integration/implementation issues
■ Insufficient attention/priority to workforce/people issues	■ HR operations integration/implementation issues
■ Insufficient/incorrect employee communications	■ Staffing selection issues

In 2008, the top contributing factors for emerging market and mature market companies were more similar. However, inability to retain key employees and delayed involvement of HR stood out as bigger issues for emerging market compared to mature market companies. In addition, emerging market companies tend to have a tougher time than mature market companies with tactical issues such as benefit and HR integration.

> As we concluded in 1998, "managing the more concrete HR tasks associated with integrating programs and policies is an easier feat than successfully integrating disparate groups of people and getting them to work together."

It's clear that companies engaging in M&As need a stronger connection between corporate objectives (e.g., increasing shareholder value), transaction objectives (e.g., realizing growth and cost synergies), and HR contributions and measures.

How can HR's value in M&As be measured?

By focusing on three primary issues, HR can have a direct impact on corporate and transaction objectives—paying the right price, achieving growth synergies, and managing costs.

The following diagram depicts how HR can help its company achieve a positive return on its M&A investment.

Measuring HR's Value—Return on Investment

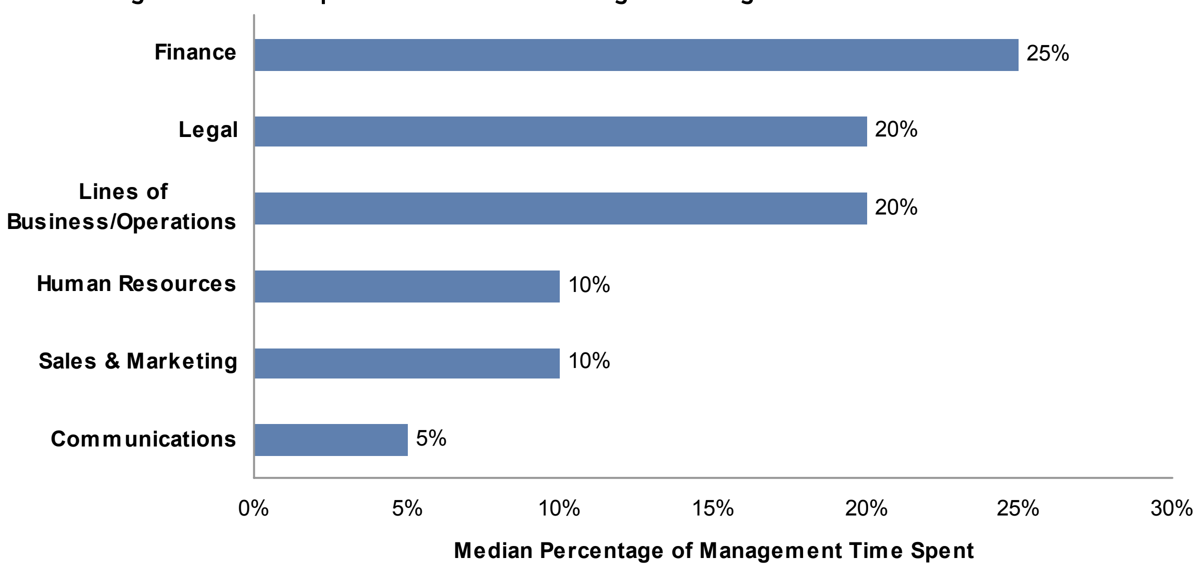
Corporate Objectives	M&A Objectives	HR's Contribution	Examples
	Pay the Right Price • Accurate purchase price • Protective purchase agreement • Qualification of risk	• Identification of HR liabilities • Purchase price adjustments • Protection for HR liabilities and costs	• Executive contractual liabilities • Pension underfunding • Indemnivication for preclose employee liabilities • Asset transfers to cover benefit obligations
• Creation of shareholder value • Profitability/Additive to corporate earnings	Achieve Growth Synergies • Capture market share • Access new markets • Share knowledge/ competencies	• Retain key talent • Retool the workforce • Maintain productivity • Minimize disruption	• Leadership retention • Stability in workforce production • Labor/improved relations • Retrained/engaged workforce
	Manage Cost Synergies • Achieve cost reduction targets • Realize economies of scale	• Identify HR cost savings • Identify HR integration costs • Estimated severance and restructuring requirements • Minimized litigation • HR process efficiency	• Consolidate HR programs • Increased purchasing power for HR vendors/ services • Compliance with local labor laws • Cost-efficient administration

How much time is spent on due diligence?

Most respondents indicated that insufficient attention/priority to workforce/people issues was a high or medium factor in their M&As not meeting objectives. Thus, it's not surprising that both emerging market and mature market respondents spend only a median of 10% of management time during due diligence on human resource issues. Instead, most dedicate the majority of management time during due diligence to financial, legal, and operational issues.

To achieve the goals of their M&A deals, more time will need to be devoted to assessing human capital, organization structure, and leadership capabilities. In addition, more resources will need to be committed to assessing HR programs and processes, reviewing compensation and benefits, and evaluating change readiness and organizational culture. Numerous studies indicate that human capital issues significantly inhibit deal success. If not addressed adequately during due diligence, it can be too late to fully rectify people-related problems such as declines in engagement or productivity.

Total Management Time Spent on Function During Due Diligence

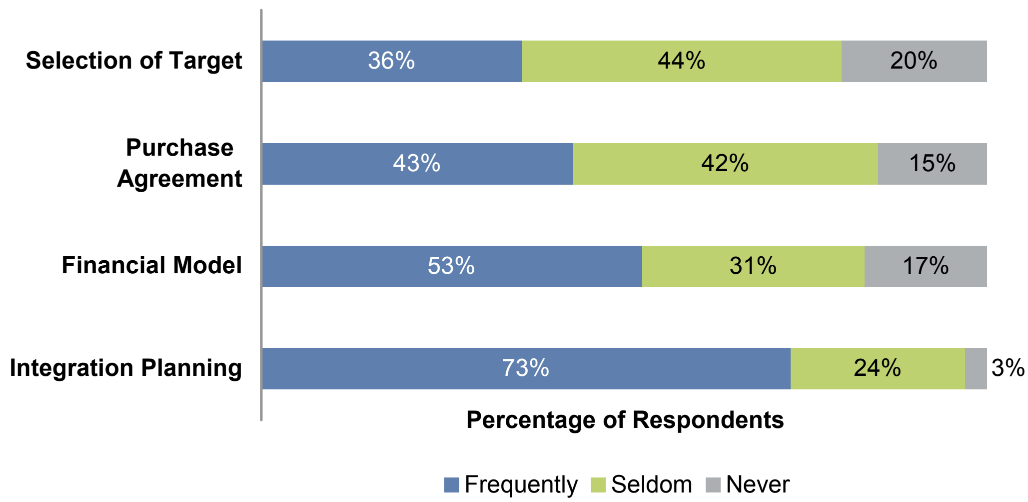


How frequently do human capital issues influence due diligence decisions?

Companies appear to be spending minimal time identifying the human capital risks and opportunities inherent in each potential M&A transaction. As we saw in our 1998 survey, HR is more involved in integration planning than due diligence activities. Only about a third of respondent companies reported that human capital issues frequently influence the selection of target companies and fewer than half of respondent companies claimed human capital issues frequently influence the purchase agreement. Human capital issues do, however, more frequently influence the financial model and integration planning.

Companies stand to gain a lot by more frequently incorporating HR input into target selection as well as into the purchase agreement. Companies are missing opportunities to shelter themselves from HR liabilities and to establish the human capital requirements for the transaction when HR does not influence or have input into the purchase agreement. In addition, companies should—based on learning from previous experiences—quantify as many human capital aspects of due diligence as possible, in order to make the integration into the financial model easier.

Influence of Human Capital Issues on Different Aspects of Due Diligence

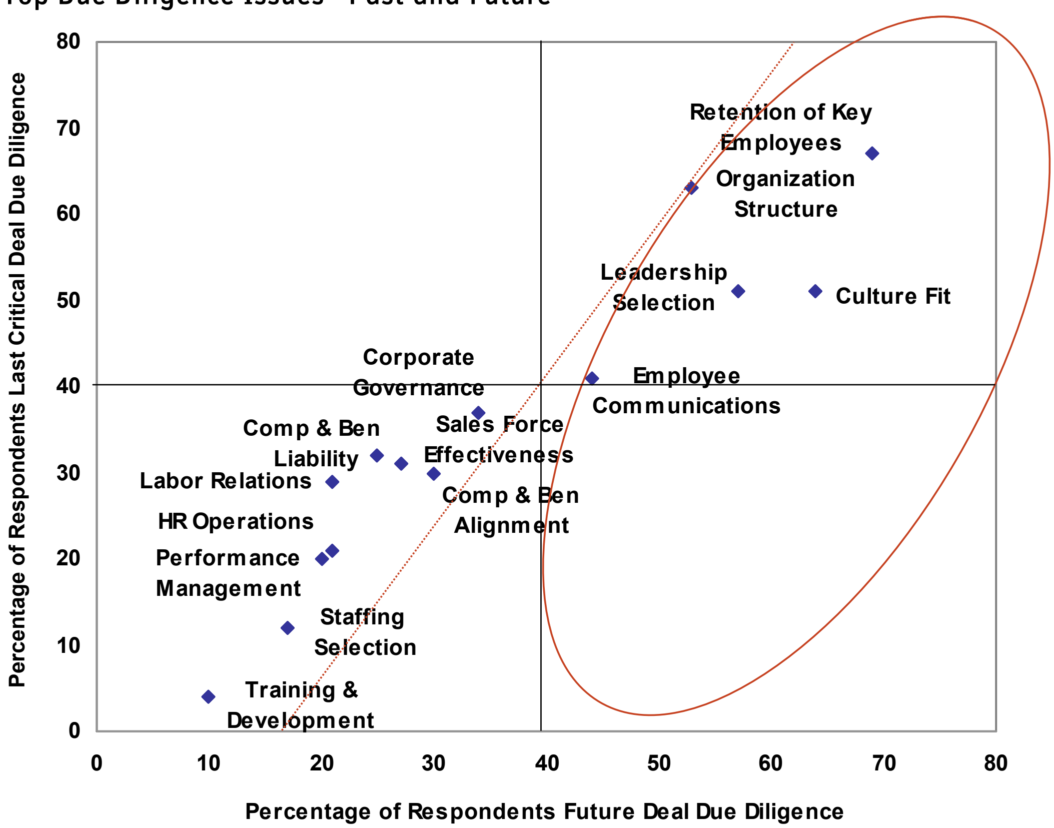


What are the primary HR challenges in due diligence?

When asked about top due diligence issues in past and future M&As, companies indicated that the more complex, qualitative, less tangible human capital issues were either maintaining or growing in importance. Companies cited the more tactical and transactional human capital due diligence issues as less important in past and future deals, suggesting that these issues are under control.

Respondents named cultural fit as the human capital issue growing most in importance. Respondents also indicated that leadership selection and training and career development have been important due diligence issues in the past and will remain important due diligence issues in future deals. Mastering these more complex aspects of due diligence in the future will be critical for companies as these are the most powerful drivers of deal value. In addition, only these more complex issues ensure that company growth objectives will be fulfilled. So even if certain issues are not a priority in the due diligence phase, they'll need to be addressed during integration or later for the company to achieve growth objectives. We'll see in the integration section of this report that both cultural fit and leadership selection persisted as important issues for survey participants.

Top Due Diligence Issues—Past and Future



There were some notable differences in the responses of emerging market and mature market companies. Emerging market companies cited retention of key employees, training and career development, and staffing selection as the due diligence issues growing most in importance. In contrast, mature market companies put more focus on the growing importance of cultural fit, employee communication, and leadership selection. These differences may be reflective of the more nascent yet ultra competitive human capital environment in Asia.

Due Diligence Issues Growing Most in Importance

Mature Market	Emerging Market
■ Cultural fit	■ Retention of key employees
■ Employee communications	■ Training and career development
■ Leadership assessment/selection	■ Staffing selection

Looking solely at current due diligence practices, emerging market companies place much less emphasis on the core HR program analysis (compensation and benefits) than mature market companies, which consider compensation and benefits liability and leadership assessment and selection more important. It seems that in emerging market companies, HR is less involved in the due diligence process. Therefore, the classic areas of HR costs, risks, and liabilities are integrated into other functions such as Legal. However, since the valuation of liabilities in compensation and benefits is one of the core sources for big risks related to transactions, the HR function at emerging market companies needs to become involved.

Key HR Due Diligence Considerations

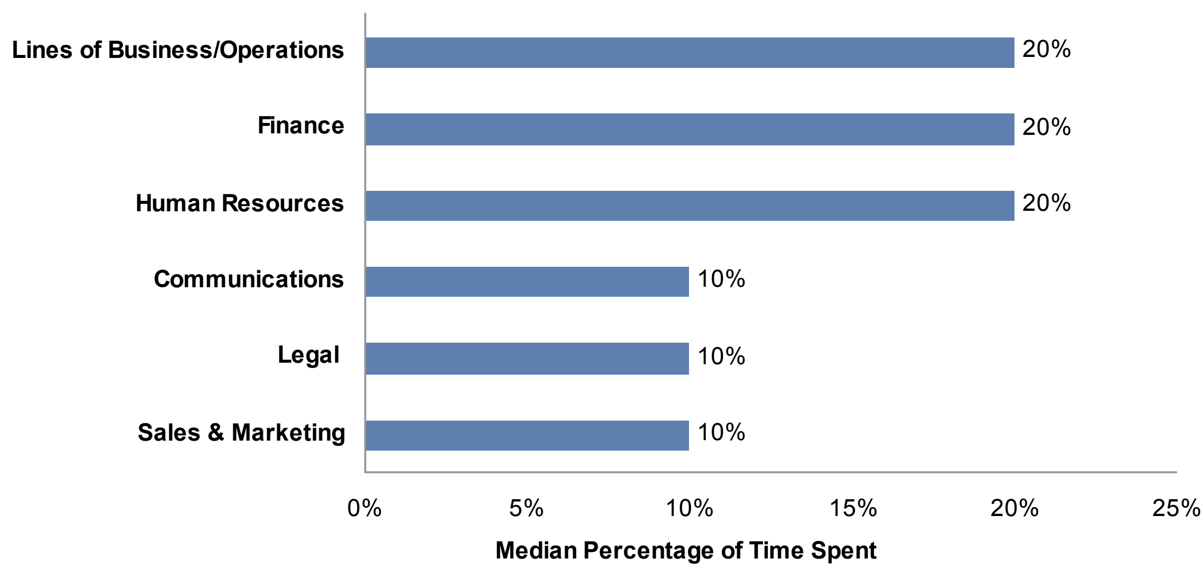
Company	■ Organization structures ■ Legal compliance
Culture	■ Compatibility of cultures
Leaders	■ Compatibility of leadership styles ■ Change in control provisions ■ Identification of key executives to retain
Talent	■ Identification of key talent to retain ■ Workforce reduction requirement ■ Pending employee litigation ■ Existing employee engagement levels
Union	■ Collective bargaining agreements
Compensation and benefits	■ Pay structures and benefit plans and obligations ■ Equity-based plans ■ Executive compensation
HR practices	■ HR delivery and shared services processes and agreements

Integration: Making the Deal Work

How much time is spent on integration?

Compared to due diligence, a greater percentage of total management time in integration is dedicated to issues that have a direct impact on employees. Yet, with many companies reporting that integration took longer than expected and that cultural integration issues were encountered, perhaps the median of 20% of management time during integration being spent on human resource issues is not enough or perhaps companies are not spending this time on the right things. For the best due diligence efforts to yield results, M&A implementation must address the human capital needs that commonly arise during major corporate transformations.

Total Management Time Spent on Function During Integration



Emerging market companies had a slightly lower median for HR at 18% compared to 20% for mature market companies. This difference may reflect the relative newness of HR and M&As in emerging markets. Emerging market companies may have fewer resources and past experiences to guide them in carrying out deals in a holistic manner from due diligence through integration.

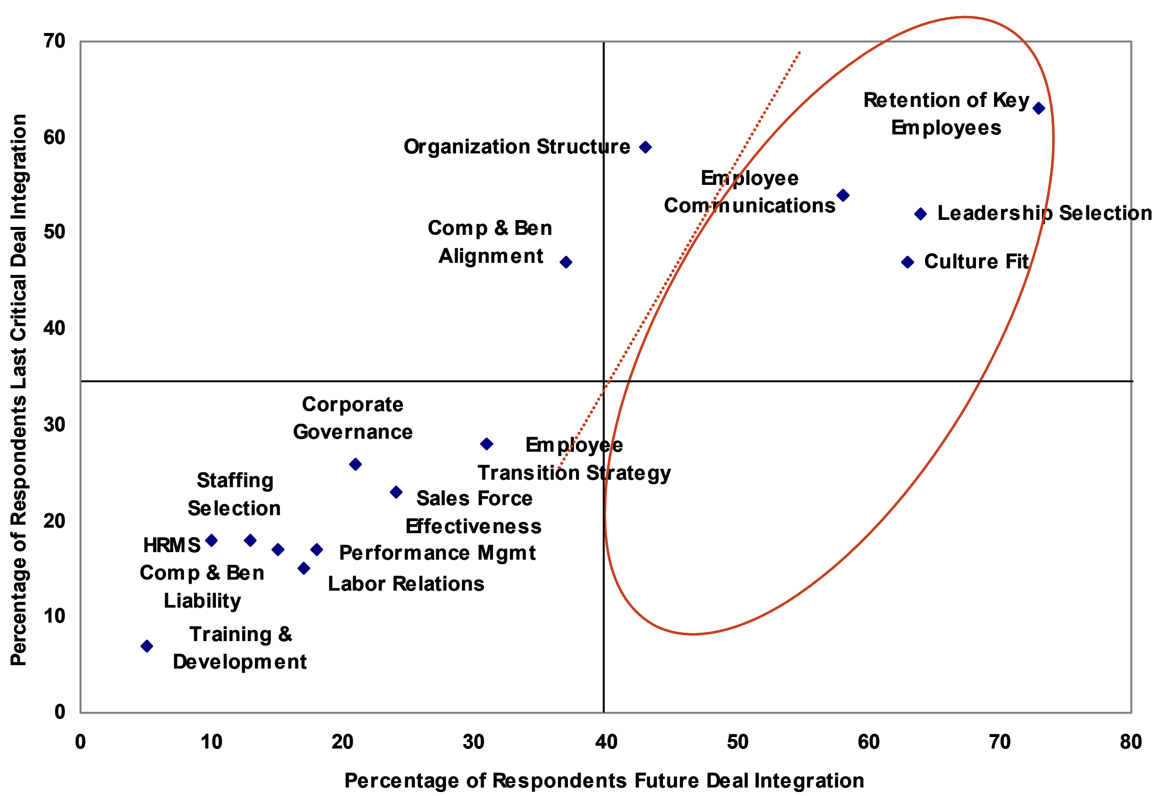
What are the primary HR issues during integration?

When asked about top integration issues in past and future M&As, respondents showed consistency in their thinking, reporting that many of the factors they found challenging in due diligence remained challenging for them during integration. This finding suggests that companies are working to have holistic, end-to-end deal processes and look at the key human capital issues in both due diligence as well as integration.

As with due diligence, the more complex, less tangible human capital issues were either maintaining or growing in importance for integration. Cultural fit was the human capital issue growing most in importance, while leadership selection and retention of key employees—important integration issues in the past—were cited as remaining important integration issues for future deals. Similar to due diligence, it's these more complex issues such as cultural fit and leadership selection that must eventually be addressed for a company to achieve growth objectives.

Participants did report some differences in their thinking about due diligence compared to integration. For example, providing effective employee communications was viewed by participants as more important in future integration than in future due diligence. Not surprisingly, organizational structure and corporate governance were cited as more important for future due diligence than future integration. Leadership selection and retention of key employees were cited as growing in importance more for integration than for due diligence.

Top Integration Issues—Past and Future



Some slight differences were observed between mature market and emerging market companies in terms of which integration issues were seen as growing most in importance. Mature market companies saw cultural fit as growing most in importance while emerging market companies viewed retention of key employees as the integration issue growing most in importance. This discrepancy may reflect the tight market for talent that Asian companies face.

Integration Issues Growing Most in Importance

Mature Market	Emerging Market
■ Cultural fit	■ Retention of key employees
■ Employee communications	■ Leadership assessment/selection
■ Leadership assessment/selection	■ Cultural fit

Comparing emerging market companies to mature market companies, looking solely at current integration practices, we find that emerging market companies place more importance on culture fit, while mature market companies consider retention and compensation and benefits alignment. Similar to due diligence, HR in emerging market companies is less involved in integration, with integration issues instead included in other functions. HR at emerging market companies needs to become involved because HR integration issues such as compensation and benefits alignment, if not addressed adequately, can become barriers to realizing deal value.

How can culture be managed in corporate transactions?

Over the years, cultural differences have been cited as one of the key reasons why deals fail. Although not much progress has been made, we see an increasing trend in companies that establish process and tools to ensure culture is being recognized as an important factor to be considered in any potential workstreams.

Culture is "the way we do things around here." In order to influence culture, the organizations need to simultaneously assess the existing norms, values, and behaviors in the organization and how they relate to the business/synergy objectives. There's no such thing as a "good" or "bad" organization culture—only good or bad consequences relative to your business objectives. In order to influence culture and the respective behaviors, companies need to also look at all potential cultural levers in the organization, especially within the governance, organizational structure, and HR policies and programs.

A vital connection exists between culture and leadership. A leader's actions, communication, and values have a critical influence on culture. In addition, the planned degree of integration will influence the complexity of cultural integration. Even in situations where the entities will not integrate, a company needs to operate with consistent values. Therefore, an analysis of differences in the value systems in the leadership teams is core. In addition, assessing leadership and critical employee "touch points" between the organizations is key to success.

Mastering the cultural integration is the key to achieving faster and smoother integration.

There are three general approaches to cultural integration:

- Preserve distinction in culture;
- Combine cultures; and
- Create a new culture.

Each approach has its own advantages and disadvantages that must be weighed against the achievement of business drivers and deal synergies. Possible advantages and disadvantages of each approach are considered in the tables below.

Preservation of Cultural Distinctions

■ Addresses market or geographical differences	■ Reduces synergy gains
■ Allows stronger subcultures	■ Inhibits solidarity of purpose
■ Gives greater flexibility	■ Slows movement of people, ideas
■ Maintains productivity during merger	■ Reduces standardization of practices

Combined Cultures

■ Creates unified identity	■ Appeals to certain types of employees
■ Provides one face to the customer	■ Minimizes subculture development
■ Allows for standardized policies and practices	■ Reduces flexibility
■ Encourages the development of informal employee networks	■ Requires managerial commitment

New Culture

■ Provides fresh face to merged companies	■ May cause high resistance to change
■ Creates more flexibility to align with corporate direction/purpose	■ Likely to have a negative impact on productivity during transition
■ Allows new partners to be integrated more easily into the merged companies	■ Takes longer to implement

Human Capital Related Integration Activities

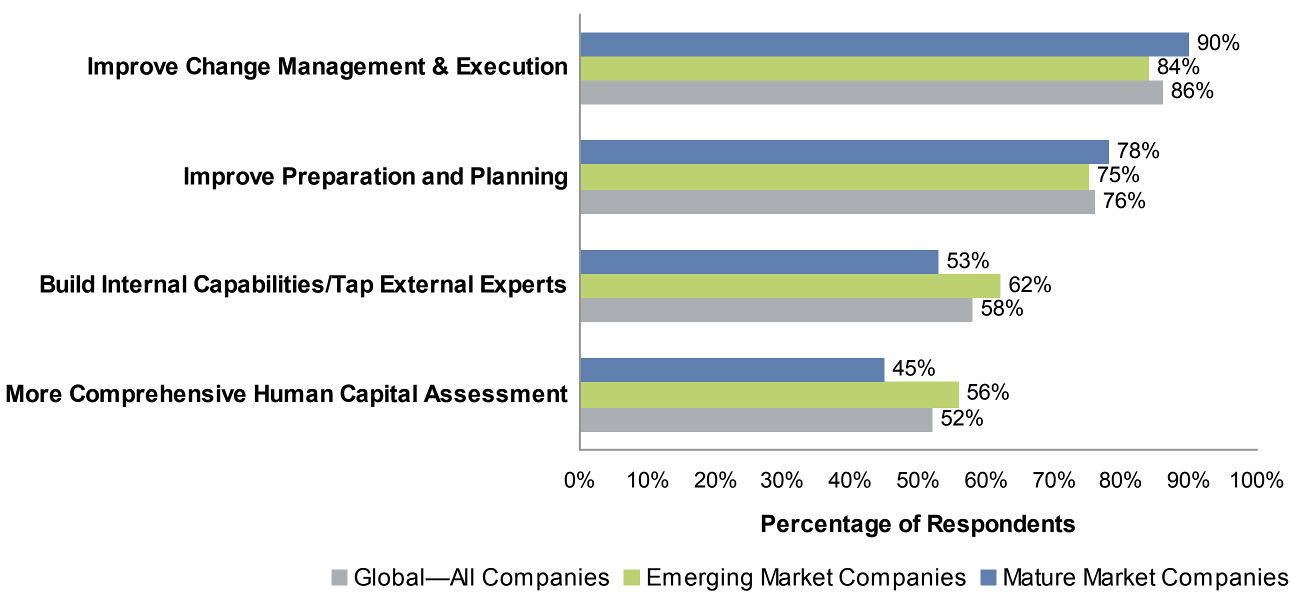
1. Build integration principle guidelines
2. Establish synergy objectives, evaluate transaction success, and establish longer-term goals
3. Assess and integrate culture in alignment with business drivers and manage change
4. Design and implement new organization structure, including leadership model
5. Design and implement staffing plan
6. Transition employment and labor arrangements and manage employee relations
7. Align and implement desired HR programs and processes
8. Transition to desired compensation and benefits platform

What M&A practices will be changed in the future?

All of the M&A practices cited as most likely to change, demonstrate that companies want to develop a disciplined M&A methodology and process, follow these to build internal capabilities, capture lessons from previous deals, and support proactive and smooth integration. Companies will also need to take a holistic approach to assessing human capital risk related to their deals. Here they'll need to integrate more systematic culture and talent/leadership assessments into the due diligence processes.

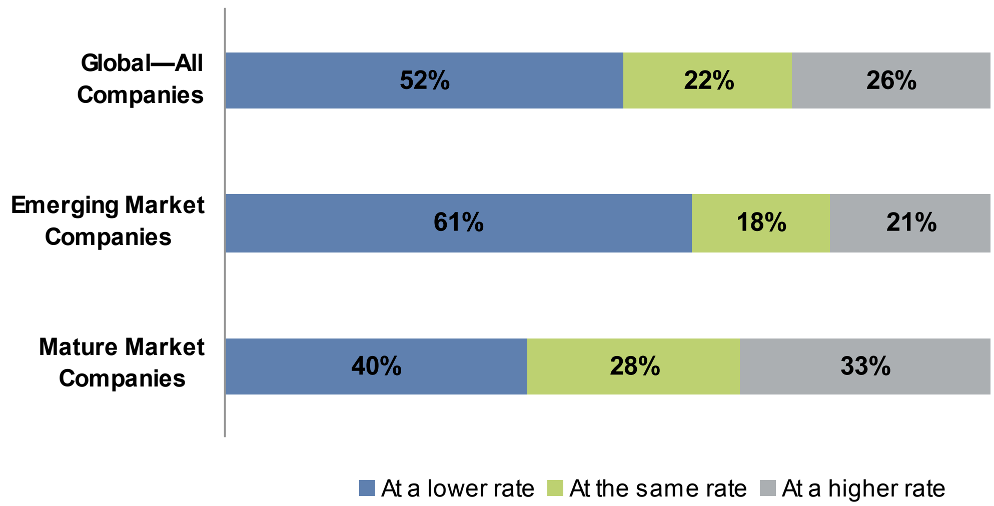
A third of respondents indicated that in past M&As, human capital issues frequently impacted the selection of deal targets. Roughly half of respondents indicated they're likely to change this practice in future deals. Over half of respondents indicated the need to build internal capabilities and/or tap external experts in order to improve M&A outcomes in the future. As we'll see in the following pages, the importance of building internal or tapping external M&A capabilities may be even greater than respondent companies anticipated—not only having an impact on deal success or failure, but also having a quantifiable influence on total deal value.

M&A Practices Most Likely to Change



As noted earlier, the top factor in respondent companies not meeting their M&A deal goals was insufficient attention/priority to workforce/people issues. It appears that insufficient attention to workforce issues is contributing to the loss of critical employees at many respondent companies. At 26% of respondent companies, critical employees separated at a higher rate than noncritical employees during and immediately following an M&A. Retention of key employees is a core M&A challenge for companies across the globe, one that we estimate is significantly eroding total deal value.

Rate at Which Critical Employees Separate Employment During/Immediately Following an M&A



Our research indicates that separation of key employees during and immediately following M&As is having a significant financial impact on companies. By combining the preceding survey responses with Hewitt's proprietary Human Capital Foresight™ (HCF) research methodology, we see that this lack of attention to workforce issues and consequent loss of critical employees [5] is costing many respondent companies a significant portion of M&A deal value. Using Hewitt's HCF methodology, we can estimate that 48% of all respondent companies have lost more than 9.6% of deal value as a result of key employees separating during and immediately after M&A deals. Put another way, with a total deal value of more than $568 billion (USD) over the past two years, the 96 companies in our survey had over $54 billion (USD) of deal value riding on their ability to retain key employees during and after acquisitions. [6]

[5] The standardized definition of critical employees (termed "pivotal" within the HCF methodology) is reliant upon incremental investment measured by percentage pay progression, adjusted for age, pay, and tenure. This captures management decisions regarding employees in a systematic manner applicable to cross-company analysis and linkage to financial results.

[6] Total Deal Value obtained from Capital IQ, September 2008.

How Hewitt's Human Capital Foresight (HCF) methodology approximates the impact of key employee separations during and immediately following M&As

Hewitt's Human Capital Foresight (HCF) methodology applies predictive analytics to Hewitt's extensive collection of HR data to gauge the flow of key employees into and out of companies. This flow is called an organization's Talent Quotient™ or TQ score. Companies with critical employees separating at the same rate as noncritical employees are assigned a base TQ score of 100. Companies with critical employees separating at a higher rate than noncritical employees have a TQ of less than 100. The average TQ score for the companies in Hewitt's massive HR database is 110, which translates to the average company having critical employees separating at a slightly lower rate than noncritical employees.

TQ scores can be assigned to the companies in our 2008 M&A survey. The 48% of respondent companies with critical employees separating at the same or at a higher rate than noncritical employees are assigned TQ scores of 100 or less. The 52% of companies with critical employees separating at a lower rate than noncritical employees are assigned TQ scores of greater than 100. Thus, 48% of respondent companies are performing worse than the market average of TQ = 110.

Referring back to Hewitt's HCF methodology, we know that for every 10 TQ points a standard industrial company sees a 0.7% impact and a financial services company sees a 1.6% impact on Cash Flow Return on Investment (CFROI®[1]). For standard industrial companies in our sample, a 10-point difference in TQ represents a loss or gain of $1.7 billion (USD) (total deal value of $249,131.07 million x 0.7%). For financial services companies in our sample, the gain or loss is $5.1 billion (USD) (total deal value of $318,965.61 million x 1.6%). Taken as a whole, our sample of 96 companies stood to gain or lose $6.8 billion (USD) for each 10-point change in TQ with TQ representing the rate at which critical employees separate.

What is the impact of employee separation on business valuation?

The loss estimated through the CFROI impact can be extended to infer overall business valuation consequences. A representative rule of thumb is that a business value is often about eight times its earnings before interest, taxes, depreciation, and amortization (EBITDA) less debt. Obviously, this varies dramatically with circumstances, but using this simple reference, 8 x $6.8 billion (USD) or $54 billion (USD), represents more than 9.6% of the deal value reflected in the survey, probably wiping out much of the synergy value sought in the deals themselves. These estimates of value loss are conservative as they're based on a long-term representative 8 x EBITDA, while the actual deals themselves took place at multiples exceeding 15 x EBITDA.

Survey Participants

Industry

Commercial and professional services	9%
Pharmaceuticals, biotechnology, and life sciences	9%
Insurance	7%
Software and services	7%
Automobiles and components	6%
Materials	6%
Media	6%
Diversified financials	5%
Energy	5%
Technology hardware and equipment	5%
Food, beverage, and tobacco	4%
Retailing	4%
Consumer services	3%
Household and personal products	3%
Telecommunication services	3%
Utilities	3%
Banks	2%
Health care equipment and services	2%
Real estate	2%
Transportation	2%
Capital goods	1%
Consumer durables and apparel	1%
Food and staples retailing	1%

Number of Employees Worldwide

Fewer than 5,000	32%
5,001–10,000	9%
10,001–20,000	15%
20,001+	44%

About Hewitt's Corporate Transaction and Transformation Services

When it comes to organizational change—mergers, acquisitions, spin-offs, divestitures, joint ventures, and bankruptcies—what initially looks good on paper doesn't always lead to great results. A huge factor in the success of any corporate change is people—part of the equation that's too often overlooked.

As the world's premier human capital specialist, Hewitt can help you maximize the value of your transaction by thoughtfully considering people. Our dedicated team of consultants can help you understand exactly how the change impacts your workforce. We assess everything from what individual skills are needed, to integrated global HR strategy, and legal and financial liabilities.

Our integrated, systematic approach offers you:

- Due diligence support, including key liability and integration issues;
- Detailed plans for executing strategy through people, including assessment of employee leadership capabilities and identification of competencies;
- Staffing models, organizational structure, and detailed role profiling;
- Workforce needs analysis and modeling;
- New country legal entity and HR setup;
- Change management; and
- Culture visioning and transformation.

With more than 250 dedicated consultants in 35 countries, Hewitt has helped hundreds of organizations and their employees navigate a diverse range of change events worldwide. Whatever your needs are, we have the experience and flexibility to help you achieve superior results for virtually any change situation.

To learn more about Hewitt's organizational change services and how your company can benefit, contact your local Hewitt consultant or e-mail humancapitalconsulting@hewitt.com.

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