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AON AND HEWITT

The HR Consolidation Wave Continues

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INTRODUCTION

Consolidation in the HR consulting and outsourcing industry continues as two more firms are joining forces. Yesterday, Aon Corporation and Hewitt Associates announced they have entered into a definitive agreement under which Hewitt will combine operations with Aon Consulting to form Aon Hewitt, a human capital consulting and outsourcing organization. The agreement is expected to close in the October/November timeframe with a deal value of $4.9 billion ($2.5 billion in cash and 64 million shares of Aon stock). Russ Fradin, current Chairman and CEO of Hewitt Associates, will be the Chairman and CEO of Aon Hewitt.

Hewitt's dominance in the large-market total benefit outsourcing space combined with Aon's significant mid-market client base will give the combined company capabilities across the full spectrum of the benefits outsourcing market.

WHAT DOES THE MERGER BRING TO THESE ORGANIZATIONS AND TO THE MARKET?

1. The recent merger of Towers and Watson Wyatt, which formed the largest HCM consulting firm in the world, presented a challenge to both Aon and Hewitt. Their new organization will be on par with the size and scope of Towers Watson and will help them retain their ability to compete in the market. Additionally, Aon's presence in over 120 countries worldwide, particularly in some of the major emerging markets, provides the broader global footprint Hewitt has lacked.

   From an HR Outsourcing (HRO) perspective, the market has questioned whether Hewitt was big enough to sustain the level of investment required to compete in the broad-scope market over the long haul. The combined cash flow of Aon and Hewitt will put the new organization in a stronger position to invest in the business and reap the benefits of Hewitt's successful re-emergence in the HRO market this past year.

2. Hewitt's dominance in the large-market total benefit outsourcing space combined with Aon's significant mid-market client base will give the combined company capabilities across the full spectrum of the benefits outsourcing market.

3. Many are speculating on the potential impact of health care reform on the health benefits market. Having access to a health care brokerage service within the firm will position Aon Hewitt well for an expansion of benefits administration services down-market as well as potential reform-driven plan design changes.

4. Aon seems bullish on this merger, agreeing to pay a 41% premium over Hewitt's share price the day before the announcement. However, the market reacted less optimistically, pushing Aon's share price down 7.1% on a modestly up day. With the merger still 3-4 months away, we will have to wait and see how investors ultimately view this tie-up.

WHAT DOES ISG SEE AS THE CHALLENGES CLIENTS OF THESE TWO FIRMS SHOULD BEAR IN MIND?

1. **Distractions –** Any merger brings a level of distraction as the senior leadership of the merging organizations works to integrate the two firms both from an infrastructure and a staffing perspective. Clients should insist on frequent updates from their Account Management teams as well as from the top management of Aon Hewitt.

2. **Technology –** While at this time Aon and Hewitt say they plan to keep all of their existing technology platforms, we would expect to see the retirement of some, especially in benefits outsourcing, where both firms have existing large- and mid-market offerings. It is unrealistic to expect the new organization will achieve its annual cost savings targets, which they project to be $355 million beginning in 2013, without some platform integration.

3. **Culture –** Hewitt is known for having a unique, positive culture, although that perception has changed quite a bit over the last decade as the firm has grown and struggled financially. Still, the integration of two very different cultures will be a challenge for Aon Hewitt.

The merger of Aon Consulting and Hewitt Associates signals that the HR outsourcing market is continuing to bounce back from the challenges of 2008.

Although this merger came as a surprise, it makes very good business sense. It positions the new organization to maintain a leadership position in HCM consulting globally and it brings the cash flow necessary to make the investments that leadership in the HRO market requires. When considered alongside the acquisition of ACS by Xerox and the purchase of Convergys' HRO business by NorthgateArinso, as well as the frequency of renewals of existing HRO contracts, the merger of Aon Consulting and Hewitt Associates signals that the HR outsourcing market is continuing to bounce back from the challenges of 2008. ISG looks forward to welcoming Aon Hewitt to the marketplace.

ABOUT ISG

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