July 2008

TOWERS PERRIN

CHINA UPDATE: HR NEWS FOR YOUR ORGANIZATION

CHINA’ S NEXT STEP: EMPLOYEE ENGAGEMENT IN CHINA, 1996 TO 2008

Sandra O’ Neal and Roger Maitland

The companies with high employee engagement had a 19% increase in operating income and almost a 28% growth in earnings per share.

Confucian philosophy identifies “Quietism” as a key tenet. Yet, in January 2007, in an effort to continue pushing China’s modernization, the Shanghai City Council authorized 24-hour a day construction. Blending and balancing these two realities will depend on many factors, but one of the most critical is China’ s historical approach to employees and the employment relationship itself. The company-employee relationship may well prove to be the most critical key to the long-term success of businesses in China.

China’s planned economy has historically provided the most secure employment system in the world, known as the “iron rice bowl”(铁饭碗). Traditionally, young Chinese were assigned to a work unit, or danwei (单位), which provided cradle-to-grave benefits. But in the last decade, things have changed dramatically, and the bowl is shattering — into 1.3 billion pieces.

China is experiencing the fastest industrial revolution the world has ever seen. Since 1978, the country’ s per capita GDP has grown at an average of 8 percent a year, and Goldman Sachs estimated annual growth for 2007 to be over 12 percent. The speed of this transformation is reshaping the danwei employment relationship as well. Whereas providing for the worker once captured the entire employee-employer relationship, the emphasis should now be shifting to a model where the interests of both blend together. This means that employees must see contributing actively to the financial success of their firm as being tied to their own interests. For employers, an investment in engaging employees is critical.

Broadly, this entails significant change in how employers and employees connect. As our research consistently shows, engagement is an outgrowth of the rational, emotional and motivational bonds employees form with their employer. These bonds are forged to a great extent by the practices and culture of the work environment, including, for instance, leadership behavior and actions, and the organization’s commitment to both career development for employees and service excellence for customers.

IN THIS ISSUE

China Update Online
For recent issues of China Update and other Towers Perrin publications, visit www.towersperrin.com.

CHINA UPDATE

TP PERSPECTIVE

China’ s Next Step

EMPIRICAL ARGUMENT FOR ENGAGEMENT

Our research demonstrates the clear and measurable link between levels of employee engagement and an organization’s financial performance. For example, we examined 50 global companies over a one-year period, correlating employee engagement levels with finan-cial results. The companies with high employee engagement had a 19 percent increase in operating income and almost a 28 percent growth in earnings per share. Conversely, companies with low levels of engagement saw operating income drop more than 32 percent and earnings per share decline 11 percent.

According to our research, Chinese employees’ levels of engagement are fairly low — about a quarter lower than the global average. Equally problematic, 34 percent of Chinese employees are disengaged from the work of their companies. This has implications not only for productivity and performance, but also for retention of key talent, since highly engaged employees are far more likely to stay with their employer than are their less engaged colleagues, saving training costs and increasing efficiency.

REDUCING TURNOVER, INCREASING EFFICIENCY

If China can make the transition from an emerging market-where the local context drives most strategic and operational decisions-to a maturing market with worldclass execution, it will have to develop a different attitude towards the workforce. Chinese or ganizations have to move from viewing employees as costs to be controlled, to assets in which to invest. For example, half of Chinese workers report that work objectives change too frequently to support efficiency. Partially as a result, Chinese employees, once remarkably loyal, are becoming decidedly mobile.

In 1996, two-thirds of Chinese workers reported that their managers made little effort to solicit their opinions. While that number has dropped by just over 10 percent, only a third were satisfied with their training opportunities and even fewer with their opportunity for long-term advancement. Furthermore, satisfaction with pay was just 24 percent. Mobility will continue to be a reality as cultural barriers towards changing jobs erode and Chinese employees seek better wages and advancement opportunities.

Of course, there are currently pockets of engagement in China. Over the past decade, the percentage of Chinese employees reporting that morale in their department is high has increased slightly, from 57 to 62 percent. The percentage of employees expressing overall satisfaction with their company as an employer has risen from 48 to 59 percent. These are noteworthy trends.

FOUR STEPS TO TAPPING THE POWER OF EMPLOYEES

Both domestic companies and foreign multinationals in China face a host of issues: rising labor costs, more stringent employment laws, a shortage of skilled employees and managers, larger tax burdens, and volatile stock prices and exchange rates. The success of China’ s economy over the past decade has been dramatic and unique. However, the country’ s ability to evolve smoothly and prosperously toward an efficient and stable economic and political system is in question.

The good news? Our data indicates Chinese employees are a vast, untapped source of discretionary effort, and we see four ways that Chinese companies can use this tremendous resource:

- **Build on current strengths.** For the most part, Chinese employees report that they work for well-managed and well-led organizations that tend to be economically successful. Two-thirds of Chinese employees say their company is well managed, up from 58 percent in 1996. Three-quarters think their top management has a well-formulated business strategy for the present, up from 68 percent in 1996. And 80 percent agree their top management has a clear vision for the future, up from 76 percent in 1996. But management teams need to build on these strengths with clear, focused and continuing communication, and reward strategies that align desired behaviors with required performance results.

TP PERSPECTIVE

China' s Next Step

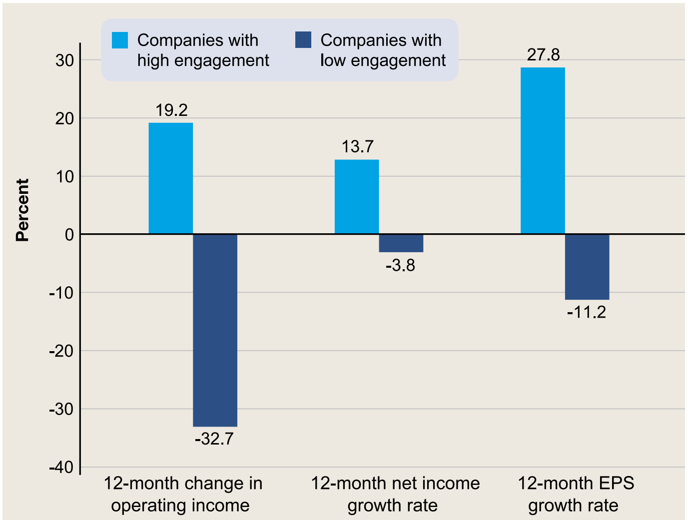
■ **Make rewards strategic.** Despite spectacular economic growth, Chinese employees' level of satisfaction with their compensation has actually declined marginally since 1996 (from 27 to 24 percent), well below pay satisfaction levels in neighboring countries. Digging deeper into this issue, we also find that satisfaction with internal pay differentials in China-people feeling fairly paid in comparison with others in their companyhas dropped from 47 to 38 percent. In addition, employees' satisfaction that their company pays well in comparison to others declined marginally as well.

These downward shifts indicate growing frustration and mistrust that can, over time, lead to a more serious erosion of employee engagement and performance. Our study of the impact of reward strategy on employee attitudes and behaviors shows that fairness is one of the fundamental principles employees look for. People need to know their company sets pay fairly relying on a sound compensation system and reasonable assumptions about job value and level of contribution-and, even more critically, that it implements its pay system fairly. When people believe they are rewarded in a manner and level commensurate with what they do and how well they do it, they focus on other aspects of work, engaging their heads, hands and hearts to give discretionary effort freely and consistently.

■ **Focus on training.** China faces a challenge in sourcing and developing a skilled workforce of sufficient scale and breadth to meet its dual objectives of global economic and political prominence. It is clear that Chinese workers want training and development opportunities.
According to our most recent employee research, the top driver of higher engagement is employees' trust that they have excellent career advancement opportunities. Yet,only 49 percent of employee respondents in China rated their company highly in this regard. Organizations that invest in appropriate training will not only equip themselves to compete more effectively on the global stage, but will also build a foundation for more workplace engagement.

■ **Enable management talent.** Recognizing China's demand and the sizable gap in the available supply there is a clear need to develop new management talent and better enable existing management. Chinese workers respect their managers and respond to them. Liu Xueqin, a researcher at a think tank affiliated with the Chinese Commerce Ministry, said recently, "For years, China has beaten its competitors with low costs. This strategy has now run its course." Chinese organizations must now engage their workers, and to do that they first need to engage the supervisors and managers.

Impact of Engagement on Financial Performance



Our data confirms that Chinese employees have a positive view of both senior leaders and their immediate managers in many respects, but that view is by no means an overwhelming endorsement. Chinese companies will have to work at helping their managers build a more collaborative work environment, deal with performance issues and convey that both the organization and its senior team have workers' wellbeing in mind when making decisions. For employees, these are not academic notions but visible signs of the kind of work experience and environment they want, the aspects that matter to them in strengthening their rational, emotional and motivational bonds with their organization over time.

TP PERSPECTIVE China’ s Next Step

CONCLUSION

There is no doubt that China faces some very significant challenges, from improving the environment to addressing safety for workers and in products, to growing beyond the “China price” as its source of competitive advantage. It also needs to recognize that employees are assets to be invested in rather than costs to be managed. For the enterprises that recognize the importance of employee engagement, significant opportunities lie ahead, both in the emerging market economy of the present and in the maturing market economy of the future.

Further information

Shanghai-Patrick Tham
Tel: +86-21-2211-5381,
patrick.tham@towersperrin.com
Hong Kong-Michael Chan
Tel: +852-2593-4536,
michael.chan@towersperrin.com

TP PERSPECTIVE

NEW INCENTIVE SYSTEM FOR LARGE STATE-OWNED ENTERPRISES UNDER WAY

Interview with Towers Perrin Principal Mingang Chai

Capital Market Weekly China

On the 29th floor of Beijing Kerry Centre, reporters from Capital Market Weekly met Mr. Mingang Chai, a Principal of Towers Perrin Consulting. The young, yet experienced senior consultant has introduced the concept of executive pay to Chinese enterprises since 2002. He and his team have designed executive pay and long-term incentive plans for many leading domestic companies, which has taken up half of the market. In his office, dozens of drafts of equity incentive plans were lying on the floor, most of which were for state-owned enterprises and financial institutions.

In the conversation, the reporters learnt that Towers Perrin also played an assistant role in designing the whole incentive plan for COFCO(China National Cereals, Oils)which was under hot discussion. Due to the principle of confidentiality, “COFCO” was not the primary subject of this interview. Instead, the conversation between Mr. Chai and the reporters was centred on long-term incentives for Chinese state-owned enterprises.

The long-term incentive plan for Lenovo after its acquisition of IBM’s PC, and the first equity incentive plan for the large state-owned enterprise after the Opinions on Regulation of Equity Incentive were announced by the State-owned Assets Supervision and Administration Commission (SASAC) and China Securities Regulatory Commission (CSRS), were both excellent records in Towers Perrin’s history. After 2007’s ice age for equity incentives, several companies announced their equity incentive plans, most of which were designed by Mr. Chai’s team.

Last year, as a result of supervisory authorities tightening up the conditions for implementing equity incentives, and reorganizing corporation governance, there were only 13 companies that implemented incentive plans. However, the situation this year may be reversed, even blown out. According to Mr. Chai, the Long March for large state-owned enterprises’ overall listing is just beginning, but long-term incentives for non-listed state-owned companies have been researched. Although it is not perfect to argue by market value, its target has a positive import.

After COFCO-Property (17.42,0.61,3.63%) (000031) and Sinochemintl (14.98,-0.06,-0.40%) (600500) took action in December 2007, it is said that a lot of listed companies have set out to apply to implement equity incentive plans. As the number of listed companies which have implemented equity incentive plan increases, the problem of unbalanced interest has been becoming apparent in some large state-owned enterprises, including both listed and non-listed companies. At present, have these large enterprises felt under pressure because of this? Have they reflected this to State Council, SASAC and asked their headquarters to take measures to solve the problem, such as implementing equity incentives across the whole group?

Chai Mingang: I think so. In foreign countries, there are incentive mechanisms in both listed companies and non-listed companies. The imbalance and unfairness must be generated in some large state-owned enterprises, including both listed companies which implement equity incentive and non-listed companies which don’t. Besides, not only listed companies but also their non-listed counterparts, which pursue their profits in the long term, need the long-term incentive mechanisms, because the purpose of the long-term incentives is to urge top managers to pursue the companies’ targets.

It is said that the regulation on implementing equity incentives for

TP PERSPECTIVE Interview with TP Principal

non-listed state-owned companies is under discussion. Maybe SASAC is waiting for the proper time to announce it. After the policy is released, implementing equity incentives by non-listed companies included in the large state-owned enterprises will speed up according to the regulations. There are some sensitive areas in implementing equity incentives by non-listed companies, for instance, supervisory authorities will be very cautious on pricing in order to protect state-owned assets.

Are non-listed companies included in large state-owned enterprises not implementing equity incentives mainly because the valuation is relatively difficult?

Chai Mingang: The key problem for non-listed companies to implement equity incentives is how to price the assets or stocks. There are many valuation methods, but how to choose a proper one is difficult. For listed companies, no matter whether the stock price is reasonable or not, there is always a relatively fair price in the market. The situation for non-listed companies is different, which makes it compulsory for non-listed companies to use a valuation method to calculate it.

Among the Top 500 all over the world, are there some good examples on this (similar to Chinese large state-owned enterprises)?

Chai Mingang: Most of the Top 500 companies have been overall listed, and equity incentive mechanisms have been mature, such as at GE. It has been overall listed, so the object of equity incentives is more comprehensive. At the same time, the criteria to assess performance are diversified, including not only finance criteria but the return rate of shareholders. Some companies implement incentives both at the company level and at business unit level. Take GE as an example. It consists of a financial unit, a medical unit and some other units, each of which is equivalent to a large company. Some units were not even listed, and it could still take special instruments such as virtual stock options to implement incentives separately, which are more specific to the management of the unit.

Now some listed companies also use virtual stocks as their long-term incentive plan. The reason is that the stock price may fluctuate in such a wide range that the relativity between the price and the performance of management is relatively small. On the contrary, if virtual stocks were used, it would urge managers to improve the performance rather than staring at the stock price.

The trend for many companies that, besides implementing the traditional equity incentive plan, they will implement another virtual equity incentive as a supplement is more and more obvious, especially in the last 2-3 years. For instance, Dell implements virtual equity incentives to top management based on the business units, the period of which is 3-5 years.

The virtual equity incentive is realized not by stocks, but by cash. For example, this year the result of assessing one business unit (using a proper method and a criterion) is one dollar per share, while the following year the result is 1.5 dollars due to an improvement in performance. If the business unit is given 100 virtual shares according to the virtual equity incentive plan, then the following year the virtual incentive is equal to 50 dollars. In practice, it can use a curve to describe the value changes, which is the same as the trend in the virtual stock price. As long as the valuation method is defined, the trend in the virtual stock price is available.

In order to price virtual stocks, is the performance of the company used, or a competitor's performance, or the average in the industry?

Chai Mingang: It depends on your target. Virtual stock price is dissociated from the capital market. Generally speaking, the company uses performance criteria such as Net Asset, Economic Value Added and so on or a universal method in the industry such as the ratio of P/E or discount of cash flow to simulate the stock price. Every method has its own advantages and disadvantages. Which criterion or valuation method to choose depends on the target, which means you hope the management will achieve the target — increasing net asset, rate return of asset, profit or EVA. The valuation method should identify with the target you want the management to achieve. Domestic companies usually choose net asset per share, while P/E is also used. Furthermore, some companies are trying the EVA proposed by SACAC.

Currently, does the State-owned Assets Supervision and Administration Commission tend to be more market value-oriented, like economic value added (EVA)?

Chai Mingang: EVA was popular abroad for a while, and it cooled down later. Now it is becoming popular with some Chinese enterprises. But I' m not sure how long this popularity will last. EVA is excellent in theory, but it' s very complicated, and it will increase the cost of implementation and communication. A large amount of financial figures are needed for the computation of EVA. Usually few people can understand it except for the financial staff of the company. Therefore, it' s not easy to understand and communicate, and it may lead to financial manipulation, which is astray from the purpose of incentives. A good incentive mechanism needs a clear purpose and understandability. The advantage of EVA is that the capital cost is taken into account, and the capital efficiency is weighed. So it is applicable for capital-intensive industries or enterprises which attach importance to capital efficiency. This index is more frequently used in steel and automobile industries abroad. Our opinion is that whether to use EVA depends on the specific industry and company.

Recently EVA was mentioned by the State-owned Assets Supervision and Administration Commission. My understanding of the intention of the supervisory role is that many large-scaled state-owned enterprises utilize a lot of capital, and capital itself has costs. EVA can encourage state-owned enterprises to focus on their major sector. Thus when enterprises are making investment decisions, they will make judgments from the perspective of EVA. Then some investments with poor EVA can be avoided.

Take Vanke A (21.58, 0.44, 2.08%) (000002) and Dr.Peng (21.68,0.09, 0.42%) (600804) as examples. They include a requirement on stock prices as a precondition of shareholding incentives. Does it mean that the market value of enterprises is associated with the importance of stock incentive compensation?

Chai Mingang: I think it' s a good phenomenon. In terms of stock incentive compensation in British enterprises, it' s common to set up 'shareholder return', which is composed of two parts: dividend and share price. The rise of stock prices and dividends needs to be taken into consideration before the incentive objects are exercised. The shareholder return equals the rise of stock prices plus dividends divided by the original stock price. The exercise can be done when shareholder returns reach a certain level. It was seldom adopted by American enterprises. Now some enterprises have begun to use shareholder return or other operational indexes.

In fact, enterprises both domestic and abroad should all avoid such a phenomenon. When exercised, the senior executives acquire huge wealth through options, while the wealth created for shareholders is decreasing — mainly embodied in the falling of stock prices, which runs in the opposite direction of stock incentive compensation. The stock prices aren' t rising, but the senior executives still get incentives. It is why many plans are criticized by the public.

"British enterprises usually require that the senior executives exercise only when the shareholder return reaches a certain standard, to ensure the consistency of the interests of the senior executives and shareholders. Thus the shareholders and the public can accept it better. It is a win-win result and it can avoid the negative influence on the company. Vanke and Dr. Peng actually introduced shareholder return indirectly, which I believe will exert positive influence on the market."

Under the circumstance that the stock prices are plummeting, it might happen that some enterprises which implement long-term incentives have good performances, but their stock

TP PERSPECTIVE Interview with TP Principal

prices are still below the level at which they can be exercised. Is that reasonable?

Chai Mingang: When the stock prices are falling, the interests of both the senior executives and shareholders are jeopardized. From the perspective of shareholders, their interests are hurt no matter what caused the falling of stock prices. The senior executives must share the losses (i.e., not exercising options). Take HSBC as an example. If the stock prices are lower than the industrial targets, the stock incentive compensation can be partly exercised or totally cancelled. Certainly some companies will use the operational indexes as the condition of exercise. It may avoid the impact from the stock prices, but the connection with the shareholders' interests is diminished. So there are advantages and disadvantages for all indexes. The key is what the company is focusing on during a certain period.

Besides, if the operational performance is good, the senior executives can still get bonuses. Bonuses and salaries are generally based on the operational performances, and they are part of the payment. Long-term incentives are closely related to shareholders' interests. Therefore, when stock prices are falling, it is normal to share losses with shareholders. And options usually have a long validity period. The current falling of stock prices doesn' t mean a permanent falling, which is also one of the purposes of long-term incentives.

What are the differences for the coverage of the persons eligible for incentives in different industries? For instance, how do large-scale state-owned enterprises like COSCO determine the persons eligible for incentives?

Chai Mingang: Some newly emerging industries may have a large coverage, for example, many employees go into the IT industry just because of the equity incentives. These people are creative, ambitious, and like to take risks, so the equity incentive is attractive to them. The incentive targets of traditional industries mainly focus on the management level. The SAC has provisions for state-owned enterprises that the incentive targets can only be the management level and core backbone, not all employees.

How does the high-level group make an incentive plan for state-owned enterprises which are not wholly listed?

Chai Mingang: There are several incentive methods for such enterprises' management-level executives: First , let the executives in the listed enterprises participate in the making of the incentive plan. Second, let the high-level group make the long-term incentive plan by themselves according to performance of all their subordinate enterprises or just the performance of some key enterprises. Third, let the high-level group make the long-term incentive plan by themselves according to the company performance index.

I suggest that the subordinate enterprises should implement long-term incentive plans of their own respectively, because such plans can be more targeted, and they can be more in line with the corporate identity. Then the management-level executives of all business units are responsible for the units while the high-level group are responsible for all enterprises, without problems such as the internal imbalances, or decision-making bias on some subsidiary, and so on.

If the non-listed enterprise groups mentioned above implement the equity incentive, how do you determine their performance indicators, the conditions on rights, and how to calculate the group' s shares and market value?

Chai Mingang: We can choose the valuation methods in reference to the financial statements according to the corporate identity, and we can also add the market value of the subsidiaries all together to calculate it.

How to choose depends on how the group' s incentive is oriented. Choosing the aggregation means that the management is concerned about the development of their subsidiaries, because the market value of the group is dependent on that of subsidiaries. They can add some key subsidiaries' market value together if they want to highlight the main businesses. Then the subsidiaries outside the scope of calculation

TP PERSPECTIVE Interview with TP Principal

will fade out from the group because they are not the group' s key business and the group' s resources will not be allocated in favor of them.

It may not be accurate because of the difficulties in the valuation of the non-listed enterprises, and the market environment has a big influence on the market value which will cause obvious fluctuations.

Chai Mingang: An accurate valuation is not the most important factor for the enterprises (it is more important for the investment bank or valuers) while making the incentive plan. The most important factor the enterprises should consider is the incentive orientation. For example, there are three methods for the valuation of non-listed enterprises. They are the benchnarking, net asset assessment, and discounting cash flow. The first two methods are relatively simple. But I still want to stress that the accuracy is not very important; the key point is to figure out what the incentive orientation is.

Whether the SAC is more concerned about the evaluation of the market value?

Chai Mingang: I do not think so yet. Because in the Chinese A-share market, the rise and fall of shares is not under the management-level' s control as strictly as before, so the management-level in SAC is more concerned about the business performance. Of course, to establish a standard is also important, but this needs all-round consideration in order to be responsible for the market.

The best incentive mechanism is a series of appropriate plans and constraints which is closely linked with the enterprise' s business strategy on the basis of a good understanding of the driving mechanisms of the corporate.

At present, some national enterprises advocate the wholly equity incentive and the SAC talked about the wholly listed enterprises not as much as before. Is the reason the SAC wants the national enterprises to implement the equity incentive before they become wholly listed enterprises to do with the long-term-process of the wholly listed enterprises and the growing contradictions in the seriously unbalanced internal interests?

Chai Mingang: Now there are some national enterprises exploring the wholly incentive plan at the management level, but they are still just in the stage of exploration and discussion. After the introduction of the regulation of the equity incentive for non-listed enterprises which the SAC is now developing, the wholly incentive plan can apply for formal approval and be truly implemented. But there is another possibility, that if the program is mature, operational and is in conformity with the relevant requirements of the SAC, such national enterprises can strive to be pilot units.

This interview with Towers Perrin Principal Chai Mingang was first published in Halies, and then modified in China Update.

Further Information:
China-Minggang Chai
mingang.chai@towersperrin.com

TP RESEARCH STUDY

IF YOU CAN DO IT, DO IT NOW!
DEALS IN POST-PEAK YEARS OF AN M&A CYCLE CREATE MORE VALUE!

"If it were done when 'tis done, then 'twere well it were done quickly." According to the latest iteration of our study on the last three global M&A cycles, whatever the tragic outcome for Macbeth, companies should "Just do it!"

Over the past three years, in the face of conventional wisdom, our Towers Perrin-Cass Business School M&A study has found that companies continue to create value through M&A. With 2007 looking as if it was the peak year of the current merger wave, companies may be battening down the hatches in 2008 preparing to wait out the storm. But it may be too early for that. Our latest research shows that, on average and based on the last two merger waves, deals done in the year following the peak create more value for their shareholders than those completed during the upswing and peak years of the wave.

M&A CONTINUES TO CREATE VALUE IN CURRENT CYCLE...

Corporates have so far continued to be active in the current M&A wave although private equity firms have tightened their belts due to the sub-prime mortgage crisis and the ensuing reduction of credit lines by lenders.

But is value being created?

For a number of years now the Towers Perrin-Cass Business School M&A studies have examined shareholder value six months following deal close. Therefore the most up-to-date research available to assess value creation in global deal-making is based on the full year 2006 figures. (Our initial take on the 2007 full year figures will be completed in the summer.) According to this, deals conducted in 2006 on average outperformed the market by 9.1%.

This analysis builds on work conducted by Towers Perrin and Cass comparing M&A performance in the current merger wave with the previous two cycles that peaked in 1989 and 1999. It confirms that deals especially for medium-sized deals (defined as those worth between $400 million and $1.5 billion, inflation adjusted) continued to work and create value.

NEW TWIST: POST PEAK YEARS ARE EVEN BETTER FOR M&A VALUE CREATION!

Our research now also shows that, historically, deals in post peak years create even greater opportunities!

We are well aware of the inevitable problems around actually executing an M&A transaction in the current climate, not least because of the constraints on leverage and debt financing. However, if past trends repeat themselves, companies who could do it probably should do it.

TP RESEARCH STUDY

TP-Cass M&A Study

The two previous merger waves give a statistically significant picture of performance in pre-peak (1988 and 1998), peak and post-peak (1990 and 2000) years. The post-peak years show the performance outperformed the MSCI World Index by 5.4% on average over the two periods.

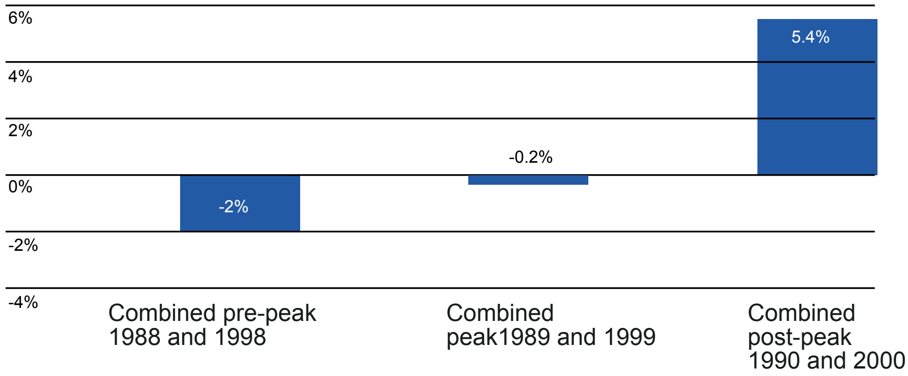
Although, as yet, it is impossible to analyse the 2007 figures-and therefore the current merger wave- to determine how the recent peak year has performed, the analyses previously conducted showed that this merger wave has already been outperforming the previous merger waves in the pre-peak years (and outperforming the global indices).

We have utilized this logic in predicting that the post-peak year in the current merger wave will continue in the same way as the previous two.

On this basis, our study indicates that companies should not necessarily back away from opportunities even though they may be seeing a falling off of deal activity.

Companies have consistently outper-formed the indices each year during the current wave. **This fact and our research on three merger waves points to a stellar 2008 in terms of creating shareholder value for those deals that can be done.**

Combined deals share price over/under performance (6 months, Mar Cap weighted)



HOW VALUE IS CREATED

The Towers Perrin-Cass study was initially conducted in 2005 to provide a quantitative analysis of worldwide M&A deal success, with a comparison of the first full year of this merger wave (2004) against prior merger cycles. Based on public data from a number of sources but principally Thomson Financial, it was the first study to provide extensive evidence that, contrary to what was experienced in previous merger cycles, the average M&A deal in this wave generated shareholder value and improved financial performance for the newly combined companies. The same study was repeated in consecutive years, with similar results - M&A deals on average continues to create shareholder value.

Why the change in fortunes? Over the years and working on thousands of transactions, Towers Perrin has identified the following seven critical factors for success:

- Leadership
- Culture
- Total rewards
- Organization design
- Staffing and selection
- Governance
- HR service delivery.

CONCLUSION

Our latest analysis reinforces the view that corporations should remain positive about the current merger wave and especially the up-side potential for the post-peak year, 2008. It shows that deals continue to offer a potential to create long-term value and achieve deal growth objectives.

The merger wave continues to offer many exciting possibilities for success. The research shows that companies who choose to complete deals in a mindful way, paying attention to critical people issues are on a pathway to sustained success.

TP RESEARCH STUDY TP-Cass M&A Study

THE SEVEN CRITICAL VALUE FACTORS

A company' s ultimate goal during a transaction is to achieve the strategic business objectives of the transformed organization and maximize long-term shareholder returns. The seven areas of critical value across the M&A life cycle, with embedded project and change management support, deliver measurable results. To a greater or lesser degree, all seven areas of critical value are in play during each stage of an M&A deal. These areas of critical value ensure you optimize employee engagement, which is essential to long-term financial success of any deal.

1. Leadership

During periods of organization transition and disruption, employees look first to leaders for guidance, motivation and focus. Towers Perrin research shows that leadership becomes the most important driver of employee engagement as companies transform.

2. Culture

The rate of past merger failures highlights the importance of aligning cultures in merging organizations. Assessing the cultures of the acquirer and target; developing a strategy and interventions to create a culture that rewards the right behaviours; developing change management and communication strategies for the transformation; and aligning culture transformation activities with other merger integration work streams are all important activities during a deal acquiring target companies.

3. Total Rewards

Total rewards represents the area of greatest visibility and concern to employees. Aligning the reward programme of the integrated company with overall business objectives is critical to both the short- and long-term success of the transformation.

4. Organization design

Merging two separate organizations, each with its own unique culture and history, is probably your single biggest challenge in an M&A transformation. Aligning organizational structure and the people and processes of both companies drives synergies and rapidly achieves targeted business results.

5. Staffing and selection

People-related issues are among the most often cited reasons for M&A failures. A strategic approach looking at future organizational needs is required to business plan objectives.

6. Governance

The waves of unsuccessful M&A activity in 1988 and again in 1998 were characterised by less-than-rigorous governance throughout the entire process of identifying and acquiring target companies. A unified corporate direction should be created by identifying a governance framework and associated guidelines that define organizational and individual accountabilities based on desired business outcomes.

7. HR Service delivery

As part of any merger, acquisition, restructuring or divestiture, HR must service a reconstituted employee population. Interruptions in basic HR services can negatively affect workforce engagement and productivity. The HR team must define and design the future state of HR technology; assess, select and integrate HR technology systems to support the needs of the new organization; and capture key data quickly and effectively using data bridging techniques to be successful.

For further information, please contact:

AMERICAS
Mark Arian, +1-212-309-3906, mark.arian@towersperrin.com
ASIA PACIFIC
Steve Allan, +81-3-3581-6602, steve.allan@towersperrin.com
EUROPE
Marco Boschetti, +44-20-7170-3150, marco.boschetti@towersperrin.com

TP RESEARCH STUDY

TOWERS PERRIN HONG KONG HR COUNCIL

Pulse Survey Results on Human Capital Metrics & Measures

What is our ROI on C&B? How does our employee productivity compare with our competitors? Do we have a training and development strategy and programs that build workforce capability and help engage and retain staff? These and other questions about the effectiveness of HR-related investments are increasingly being asked by senior executives and HR leaders in Hong Kong and globally. To help respond to such results-oriented questions, Towers Perrin is exploring how organizations in Hong Kong are using and thinking about Human Capital measures and metrics.

What are Human Capital Metrics? How do we select which ones to use, and measure them? Effective HC metrics are a spectrum of leading indicators of performance and capability which are aligned to business strategy. In order to measure the value of Human Capital, leading companies are collecting these metrics, benchmarking their performance, and linking them to quantify their impact on other organizational performance areas, such as financial and customer data.

This Pulse Survey explored from an HR perspective — the challenges companies are facing in executing their HC strategy to deliver business performance. This pulse survey aims to develop a snapshot of the current state and future direction of HC measurement in Hong Kong. We will also compare this pulse survey result to the results of our global study on HC measurements. And we will investigate the best practices among the companies around the globe.

HUMAN CAPITAL MEASURES IN COMPANIES IN HONG KONG

Participants were asked whether their organizations formally assess the value of its Human Capital assets and the impact of those assets on business performance. Nearly 70% of surveyed companies did not formally assess the value of its Human Capital assets and the impact of those assets on business performance. This is 18% lower than a similar recent global study of 100 leading companies undertaken by Towers Perrin, indicating that HK organizations are after lagging their global peers in developing a HC measurement and management program that has demonstrated links to the business.

In contrast, 63% of surveyed companies measured HC among their organizations' business performance scorecard/KPI metrics. This is very similar to the global study result.

And 44% of surveyed companies are using employee engagement surveys in their organization's scorecards. This is perhaps not surprising given the established links between engagement and business performance, including customer loyalty, productivity, staff retention, and operating margins.

Companies without HC measures indicated that they either do not have the resources ready for employee engagement surveys or other metric collection, or HC measures are not yet a top priority among the senior management. However, they see a growing awareness of HC measures.

TP RESEARCH STUDY TP Hong Kong HR Council

THE IMPORTANCE OF HUMAN CAPITAL METRICS IN AN ORGANIZATION

When asked about the level of pressure from top management to increase the ROI on investments in people in their organizations, 29% of surveyed companies rated “3” (Moderate) and 38% rated “4” (High). In other words, the majority of HR professionals are experiencing pressure to enhance the ROI of their people programs.

Top management is increasingly paying more attention to Human Capital issues, e.g. how much they are spending on people, and at the same time, how effective is the investment. This can be seen by the substantial increase in the focus of top management and HR on HC Measurement that surveyed participants expected over the next 2 years(see Exhibit 2). 41% of surveyed companies have rated 3 and 4 on this question respectively, and 9% have rated 5. The results are shown in the table.

Exhibit 1: Current Pressure from Top Management on People Investment

How would you assess the current pressure from top management to increase the ROI on investments in people in your organization?				
Little Pressure 1	2	3	4	Intense Pressure 5
12%	9%	29%	38%	9%

Exhibit 2: Current Pressure from Top Management on People Investment

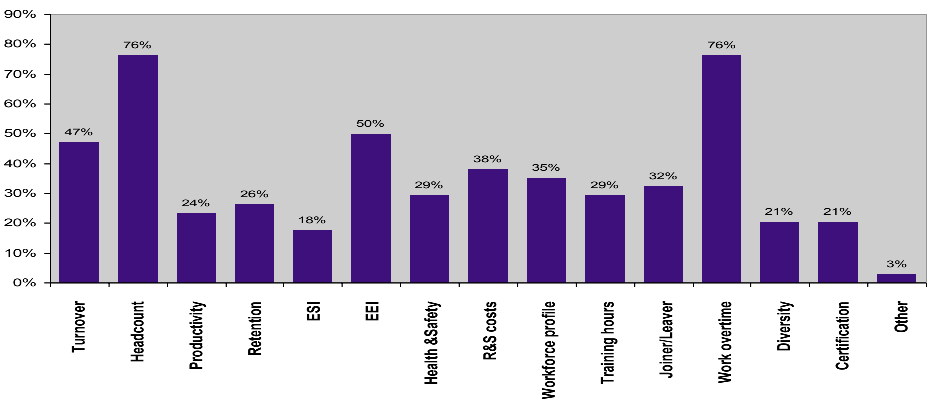
How do you expect focus of top management and HR relationship on HC Measurement to change over the next 2 years?				
No Change 1	2	3	4	Significant Increase 5
12%	9%	29%	38%	9%

Our research uncovered that organizations that most successfully measure and manage their human capital do so by integrating an appropriate set of strategy focused metrics into their management reporting systems. Often the organizations' leaders are rewarded for achieving high levels of performance. For example, Towers Perrin's work with financially high performing organizations globally has revealed that unique aspects of Human Capital measurement and management typically underpin success across five common strategic priorities: efficiency, quality, innovation, customer service and corporate image. In other words, the most effective HC measurement strategy is one that is aligned to the organization's business strategy.

HUMAN CAPITAL METRICS IN COMPANIES IN HONG KONG

The most frequently used HC metrics are Turnover (76%) and Headcount (76%). “Hard” measures such as these are typically the starting point for companies in measuring HC performance.

Exhibit 3: The HC Metrics That Companies in Hong Kong Are Using



However, these are also lagging indicators of performance, rather than leading indicators of the capability of workforce to deliver value to the business.

BENCHMARKING PERFORMANCE

Most of the surveyed companies (76%) are not currently benchmarking or comparing their performance on HC measures against industry, regional or high performance norms (Exhibit 4), and only 47% of surveyed participants are planning to benchmark or compare its performance on HC measures to their competitors in the next two years. (Exhibit 5). This represents a challenge for organizations to truly understand performance on HC metrics.

Exhibit 4: Company Currently Benchmark/compare Its Performance On HC Measures VS Its Competitors

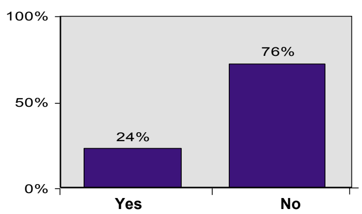
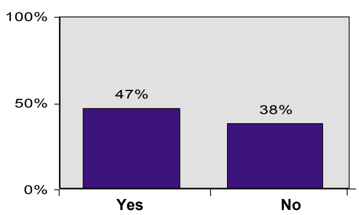


Exhibit 5: Company Planning To Benchmark VS Competitors In The Next 2 Years?



Without such benchmarks it is often difficult to interpret performance, prioritize investment and set realistic targets for change.

Nearly 90% of surveyed participants agreed HC benchmarking is important to their organizations and the performance of the HR function. (26% of surveyed participants scored importance as a 3, 35% rated 4, 26% rated 5) However, not many companies have incorporated metrics into performance appraisals and incentive programs to make them truly "metrics that matter". In fact, only 38% of surveyed participants in Hong Kong have used HC metrics as part of their organization's senior management performance appraisal, compared

Exhibit 6: Are HC Measure or Metrics Used As Part of Your Organization's Senior Management Performance Appraisal?

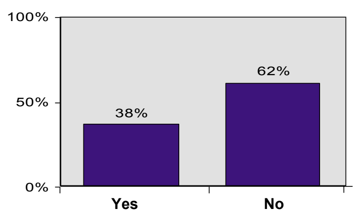
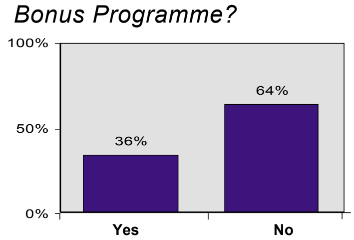


Exhibit 7: Are HC Measure or Metrics Used As Part of Your Company's Annual Incentive or Bonus Programme?



56% globally. (Exhibit 4) Similarly, 62% surveyed participants have not used HC metrics as part of their companies' annual incentive or bonus programme. Indeed, Towers Perrin's consulting experience is also that leading companies globally hold leaders accountable for performance on key HC metrics to ensure the appropriate focus to performance and capability building in areas necessary to deliver future value to the business.

CONCLUSION

Overall, the Pulse Survey indicated that there remains significant opportunity for Hong Kong companies to develop a more strategically focused Human Capital measurement and management approach. HR leaders and senior executives in Hong Kong reported that the effectiveness of HR-related investments directly affect their organizations' business performance and that the importance and pressure to maximise the value of HC will continue to increase in future years. However, the incidence, as well as the depth, of HC metrics implemented is generally lower than what our global study indicated across many dimensions.

For many companies that have implemented some form of HC metrics, these tend to be lagging indicators of past performance rather than strategy-contingent measures of future performance and capability. The major reason that organizations do not implement HC more broadly is the difficulties in identifying the most appropriate metrics for their organizations that align to the actual business performance.

RECOMMENDATIONS

To maximize the effectiveness of HC metrics in driving business performance, it is important that organizations first clarify and align their business priorities and the resulting human capital imperatives. For example, an organization with a growth agenda requiring mergers and acquisitions overseas is likely to need organizational capabilities that are quite different than one with a profitability agenda requiring a razor sharp focus on efficiency and costs. Ultimately, these organizational priorities will drive the HC strategy and the associated metrics that need to be in place to track success.

Next, identify the high-value HC metrics that form the core of the HC-related business agenda. For example, if your organization is particularly focused on raising profits, you may need to break down the profit measure into its key components (e.g., revenues and costs), and further drill-down into sub-components thereof, e.g., sales from various customer segments, pricing, cost of goods, selling costs, etc. (Towers Perrins' "Value Driver Analysis"). Comparing these sub-components against benchmarks then enable you to identify the areas needing improvement. The accompanying human capital imperatives needed to improve those targeted areas will help you determine the right metrics, whether it is driving higher productivity, recruiting talent, or reducing SG&A(Selling, General & Administrative Expenses) .

Cascade the identified metrics down the organization to the extent possible. These become part of the performance management KPIs of the affected business segments. Careful design of these goals can ensure that they are SMART (Specific, Measurable, Achievable, Relevant, Time-bound), and given the appropriate focus. It is particularly important that some of the "soft" metrics are sufficiently fleshed out to be actionable.

Set up systems to track the performance of these metrics. If not properly and consistently tracked, these metrics quickly lose focus within the organization; evaluation of these metrics during performance appraisals risk reverting to "subjectivity". These systems will also support management reporting on these metrics on a regular basis to maintain focus of leadership and the broader organization.

Finally, senior leadership needs to be committed to HC measurement for it to succeed. The proof of the commitment is when HC metrics are part of senior leadership's performance appraisals and, potentially affect their incentives.

Remember:

" What gets measured gets managed "

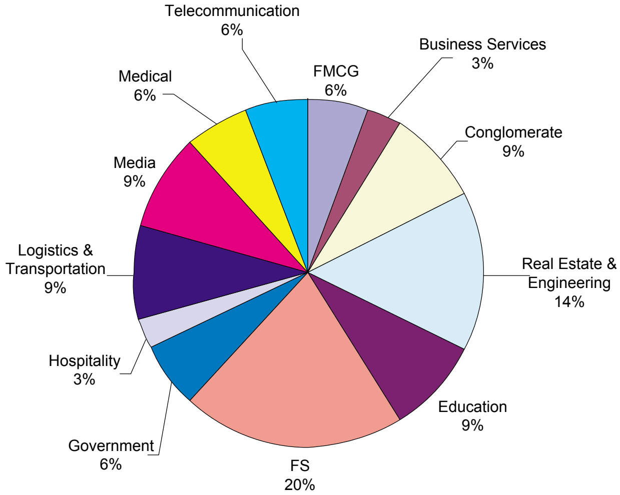
If you have any questions regarding the survey results, please contact Patrick Tham (patrick.tham@towersperrin.com), or Carmen Siu at Towers Perrin (Tel: +852-2593-4580, carmen.siu@towersperrin.com).

RESPONDENTS' PROFILE

This Hong Kong HR Council Pulse survey was conducted in April 2008. We would like to thank you for your participation in this survey. In total, 34 companies took part in the survey.

Exhibit 8 shows the breakdown by industry of the participating companies. The sample represents a cross-industry group of companies.

Exhibit 8: Respondent Profile by Industry



ABOUT THE TOWERS PERRIN HKHRC

The Towers Perrin - Hong Kong HR Council (HKHRC), which was established by Towers Perrin, is composed of top HR executives from selected leading local and multinational companies in Hong Kong. It has been designed as an exclusive network for top human resource professionals to exchange insights into best HR management practices as they apply to conducting business in Hong Kong and Greater China.

For more information on the HKHRC, please contact Carmen Siu at +852 2593-4580 or carmen.siu@towersperrin.com.

TP UPDATE

RECENT PUBLICATIONS

- Towers Perrin 2007～2008 Global Workforce Study
  - ☐ Global Report
  - ☐ China Report
  - ☐ Hong Kong Report

RECENT ACTIVITIES

- Towers Perrin Roundtable for Hong Kong's Financial Services Sector on "Employee: Assessing their impact on your company's bottom line"

  5th August, Hong Kong

To request GWS PDF report or activity details, please complete the Reply Slip, and return it via fax to: Carmen Siu on +852-2868-1517.

REPLY SLIP

NAME：________ COMPANY：________

DEPT：________ TITLE：________

TEL：________ Email：________

ADD：________

Favorite Column：

☐ TP PERSPECTIVE ☐ TP RESEARCH STUDY ☐ TP UPDATE

Information Request

☐ GWS PDF Report

☐ Activity Details

Challenging Issue ：________

Suggestion & Feedback：________

Thank you for your feedback!

ABOUT TOWERS PERRIN AND HUMAN CAPITAL GROUP

Towers Perrin is a global professional services firm that helps organizations improve their performance through innovative human capital and risk and financial services solutions.

In the human capital area, Towers Perrin helps organizations develop and implement workforce strategies that align with business needs, address critical talent issues, drive higher performance and ensure the right return on their investment in people. Areas of focus include workforce effectiveness; rewards effectiveness; benefit program effectiveness (including retirement and health and welfare program strategy, design, implementation and management); HR function design, service delivery and technology; employee communication; employee research; and change management.

Towers Perrin has offices and alliance partners in the world' s major markets. More information about Towers Perrin is available at ***www.towersperrin.com.***

CONTACT US

Email:
inquiry.cn@towersperrin.com
inquiry.hk@towersperrin.com

Beijing
29/F, South Tower, Beijing Kerry Center 1 Guanghua Road,
Chaoyang District Beijing 100020
Tel: +86-10-5821-6000
Fax: +86-10-8529-7884

Hong Kong
Suite 2106-08, Central Plaza
18 Harbour Road
Wanchai, Hong Kong
Tel: +852-2593-4588
Fax: +852-2525-9706

Shenzhen
Suite 1210-1211, Shun Hing Square
5002 Shen Nan Road East
Shenzhen 518008
Tel: +86-755-8246-2022
Fax: +86-755-8246-2122

Shanghai
28/F, Tower 1, Plaza 66 1266
Nanjing Road (W) Shanghai
200040
Tel: +86-10-2211-5300
Fax: +86-10-2211-5353/5351