

# Navigating the Risks of the Contemporary M&A Market

Results of a 2016 Crowe Horwath LLP  
and FERF Survey

## Executive Summary

Mergers and acquisitions (M&A) remain a popular growth strategy for companies. In 2015, global transaction volume reached \$4.28 trillion,<sup>1</sup> the highest total of all time. In the first half of 2016, \$1.71 trillion of deals were consummated around the globe.

In spite of this activity, however, many deals fail to add the value or capture the synergies expected during the planning and execution process.

In this environment, Financial Executives Research Foundation (FERF), in collaboration with Crowe Horwath, conducted a survey focused on both the predictable and overlooked risks inherent in contemporary M&A execution. The survey was designed to gauge the perspectives of financial leaders on a broad range of risks across the full spectrum of the M&A value chain. The report also offers insight into how these risks might be mitigated. We believe the findings in this report provide unique insight into risks and opportunities related to the execution of a merger or acquisition.

The survey respondents represented a mix of public and private companies, both domestic and international. An “average respondent” had the following profile:

- Chief financial officer
- Privately held company
- Domestic (U.S.) headquarters
- \$350 million in annual revenue

Furthermore, the average annual M&A activity of survey respondents included:

- 6 targeted transactions
- 2 due diligence completions
- 1 deal closed (worth \$47 million)

Clearly, the majority of issues and findings apply to a broad range of deals and deal-makers. Nevertheless, we thought it important to consider this demographic profile (i.e., professionally-managed companies pursuing mid-market deals) so we are not tempted to think these complexities and risks are only the purview of large-cap transactions. As the survey documents, the challenges inherent even in basic mid-market transactions often far exceed what the modest purchase price would suggest.

Following are some of the key findings:

- Overpaying for deals was viewed as the biggest risk in M&A. This is the result of a number of underlying factors – some controllable, some less so.
- Successful integration was identified as the most overlooked risk area, and one of the biggest impediments to ultimately realizing the full value of the deal.
- Challenges related to securing the requisite involvement, insight, and sustained focus and urgency from the operating team were a recurring concern for both the pre- and post-close periods.
- Transition risks associated with people and culture, perhaps not surprisingly, also registered near the top both for domestic and international transactions.
- Limited M&A experience and availability of the internal team were highlighted as critical issues. Despite these concerns, respondents weren't quite sure when or how to bring in the necessary external help.
- Those respondents pursuing cross-border deals reported that local target identification, sales and marketing practices, and workforce transition were all formidable challenges.

It is clear that a wide range of M&A deals are being pursued for many different reasons, and often with their own unique mix of risks, opportunities, and dynamics. This is, indeed, one of the inescapable challenges of deal-making activity. Yet it's also clear that, when looking at enough deals and registering the experiences of enough deal-makers, common themes begin to emerge.

Despite the risks, deal-makers can overcome many of the challenges they face with proper preparation. Throughout this report, we offer advice about how to mitigate the risks identified in the survey.

We invite you to take some time to review this report – to hear the voices of deal-makers around the globe, to consider their candid perspectives, and find value in their experiences.



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## Introduction

In the current corporate climate, CFOs and finance professionals are being asked not only to steer a company's financing efforts and manage transaction accounting, but also are often on-point to develop valuation models, vet synergies, identify critical deal risks, and benchmark projected integration expenses.

Increasingly, financial leadership has a very active role in:

- Assessing the strategic fit of the M&A opportunity
- Investigating the financial, tax, and commercial affairs of the target company
- Planning for the integration of financial departments and information-reporting systems
- Creating and pressure-testing the valuation model and synergy assumptions
- Developing a scorecard to track the transaction results
- Providing an objective view of the deal to the CEO and the board
- Providing executive-level guidance about post-close optimization opportunities

The "2016 Crowe Horwath and FERF Strategic Buyer Survey" report is based on a 20-question online survey that was conducted during May and July 2016. Nearly 200 senior finance professionals from public, private, and not-for-profit organizations, both domestic and international, completed the questionnaire.

While the research is not intended to cover a statistically significant sample of the corporate population, the survey findings do provide a valuable, up-close look at current M&A risks, for which we offer mitigation strategies.

For the respondents, the average deal size was \$47 million, while the median deal size was \$25 million. Even though the multibillion-dollar, large-cap transactions garner much of the press, the vast majority of transactions being pursued by corporate acquirers are mid-market transactions.

Exhibit 1 summarizes the typical annual M&A activity for the surveyed companies.

Respondents were asked to rank 52 specific risk areas across nine different categories. Respondents who indicated they had participated in international deals were asked to rank an additional 14 risks.

### Exhibit 1: Typical M&A Activity in a Given Year

	Number of Targets	Receive Due Diligence	Deals Closed
Average	15	4	2
Median	6	2	1
Minimum	1	1	1
Maximum	100	25	15

Exhibit 2 summarizes the top 15 risks across the entire survey, identified using a weighted ranking to adjust for a varying number of responses in each category. Leading risks fell into three categories: deal valuation, operations team

involvement, and people/culture issues. Please note that the respondents did not categorize the risks into the three major categories in the exhibit below. The exhibit was prepared by Crowe based on its assessment of the survey results.

## Exhibit 2: Top Risks

Rank	Specific Risk	Category
1	Overpaying for deals	Deal valuation
2	Insufficient operational diligence and/or insight	Operations team involvement
3	Maintaining strategic clarity and focus	Operations team involvement
4	Current valuations	Deal valuation
5	Culture assimilation challenges	People/culture issues
6	“Fuzzy” growth strategy or specific deal rationale	Deal valuation
7	Employee anxiety, morale, and/or engagement issues	People/culture issues
8	Limited access to target company (management, facilities, data, etc.)	Deal valuation
9	Underestimation of time/effort/resources required to realize projected synergies	Operations team involvement
10	Insufficient financial due diligence rigor and/or insight	Deal valuation
11	Underestimation of integration work/challenge	Operations team involvement
12	Synergy capture not a priority for operating team	Operations team involvement
13	Target company management team operating capability	Operations team involvement
14	IT infrastructure capability, transition costs	Operations team involvement
15	Inconsistent M&A planning and execution	Operations team involvement

## Risks by Category

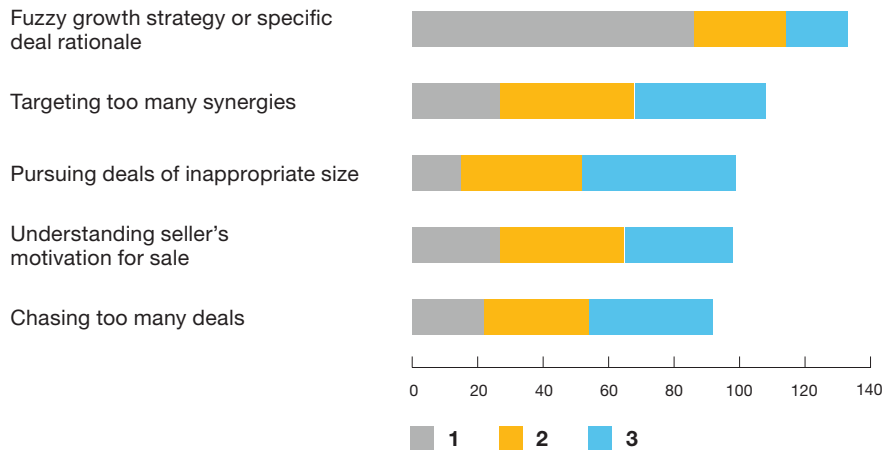
The centerpiece of the survey was registering respondents' experiences with the identified risks in nine M&A execution categories. For each category, respondents ranked their top three risks on a scale of one to three, where one represented the highest level of risk or concern and three represented the third highest level of risk. The nine categories are:

- Targeting
- Valuation
- Due diligence
- Integration
- Commercial
- Operational
- People and culture
- Internal resources
- Governance and decision-making

The results are presented according to the total number of responses for each specific risk within each category. The exhibits also show the number of respondents who ranked each risk as highest, second highest, and third highest.

## Risks by Category – Targeting Risks

### Exhibit 3



With respect to targeting activity, respondents indicated that “fuzzy growth strategy or specific deal rationale” was the biggest risk factor. In addition, this emerged as one of the top risks cited in the survey as a whole.

This is a very significant insight from the respondents, particularly given the demographics, company size, and sophistication of the average respondent, as noted earlier (CFO in a privately held company with domestic (U.S.) headquarters and \$350 million in annual revenue).

Insufficient strategic clarity is a killer in many business contexts, but never more so than in the competitive, high-stakes world of M&A. Without strategic clarity, companies invariably end up:

- Chasing too many targets
- Being more reactive than proactive
- Participating in a higher percentage of auctions than proprietary deals
- Overpaying
- Being less disciplined about post-close synergies and operating priorities
- Undermining post-close focus and accountability

“Today, many companies face increasing pressure for growth and limited organic growth prospects in local markets, but have access to high levels of available, inexpensive capital.

“Given this kind of environment, it’s really no surprise that M&A activity and general interest in M&A continues to be quite strong. This is, in and of itself, not problematic. What’s troublesome, however, is observing deal-makers repeatedly chasing deals with little critical reflection concerning factors such as strategic fit or commercial and culture risks, and then wondering why those deals’ post-close performance falls far short of the purchase model projections. As the old adage goes: ‘If you don’t know where you’re going, then any road will take you there.’

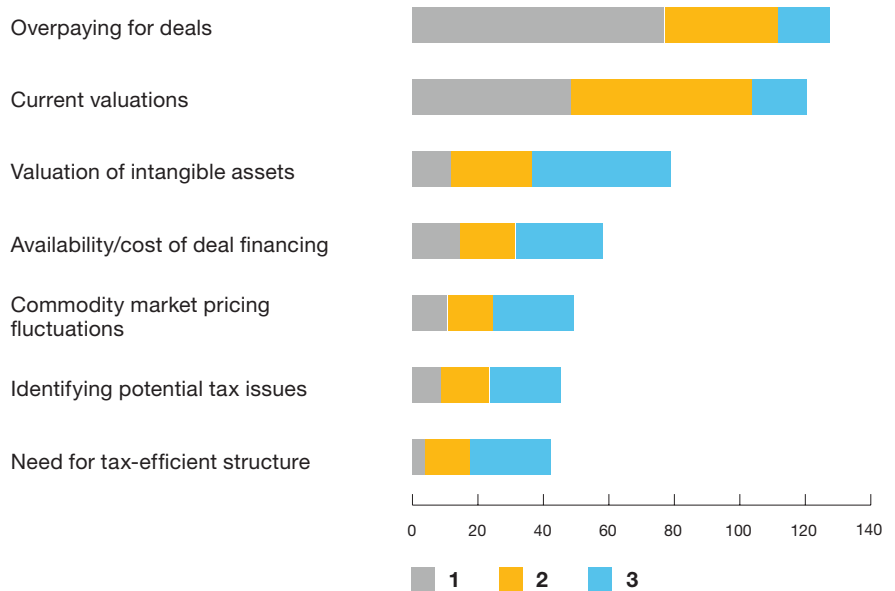
“Today’s M&A market is just too competitive and the pricing too expensive to rely on financial arbitrage, inflated cross-selling models, or wishful thinking that you will find a diamond in the rough. You must have a clear picture of what you’re looking for, and understand what a good deal looks like before casting off into the market. Some effective practical steps include:

- Developing a specific M&A strategy as an outgrowth of overall company strategy
- Developing a pipeline of proactive, proprietary targets that fit the M&A strategy profile precisely
- Instituting a simple M&A governance process that includes controls such as stage gates and a deal committee
- Involving the responsible operations leaders in the due diligence activity
- Enlisting professional, third-party specialists, where possible, in due diligence and integration to maintain objectivity, focus, and sustained execution.”

– Chris Nemeth

## Risks by Category – Valuation Risks

### Exhibit 4



Respondents identified the risk of “overpaying for deals” as the top valuation risk. This is likely driven by:

- High valuations in the market
- Availability of low-cost capital
- Fuzzy deal rationale
- Limited access to the target company



The second biggest valuation risk, “current valuations,” likely contributed to the top risk of overpaying for deals. These top two risks received nearly as many responses as the remaining five risks combined. Current valuations refer to the high multiples that buyers are paying, which are the result of high-cash balances, the low cost of debt, and the limited availability of targets.

Corporations learned to operate with lean practices during the financial crisis at the end of the last decade, becoming more reticent to invest in M&A and capital expenditures that did not provide quick returns. This resulted in an accumulation of cash on their balance sheets. In addition, private equity funds have

continued to outperform alternative investments, which provides an easy environment for raising capital. Interest rates have been at their lowest levels since the 1950s, and with regulated banks now mostly following the leverage guidelines of the U.S. Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corp., nontraditional lending sources that provide cheaper M&A financing have grown. Lastly, because the M&A market has been quite active since the Great Recession, the remaining number of available, well-operated companies coming to market, or being discovered, has declined.

The implication of this environment is that valuations are largely outside of a company’s control; however, overpaying is a controllable risk. So, in a high-valuation environment, companies can guard against this risk by:

- Clarifying the deal rationale to fit with strategy, and constantly assessing that fit during the diligence process
- Having the discipline to resist offering more than the value of the asset in the hands of the acquirer and not being tempted to follow the market when a multiple grows to a level that makes the required return on investment risky
- Increasing due diligence rigor, particularly focusing on the sustainability of the value

“One of the things this data seems to suggest is that, due to a lack of strategic clarity and specific deal rationale, some companies pursue too many of the wrong transactions – a painful and costly mistake. Companies are clearly under pressure for growth, and the lure of M&A proves to be an attractive, almost irresistible impulse – albeit a dangerous one in the absence of strategic rigor. This is analogous to what one sometimes hears from professional poker players. Namely, that the single most common mistake that more inexperienced poker players make is simply playing too many hands. It’s indeed hard – and takes real discipline – to wait on the sidelines, at the ready, until precisely the right opportunity comes along. M&A professionals, quite simply, like doing deals. Executives, boards, and investors are all pushing for growth. And in today’s market, capital is affordable and reasonably easy to come by. It’s a scenario that holds opportunity, but also one rife with risk. Strategic clarity, focus, and discipline are paramount.”

– Marc Shaffer

## Unique Situation Considerations

A specific risk when acquiring a commodities-driven company (commodities such as metals, agricultural products, or petroleum) is that sellers may come to market with temporarily inflated profits. This can occur if they have benefited from pricing arbitrage created by fluctuating commodity prices and fixed-price contracts, or contracts without commodity cost inflator/deflator clauses.

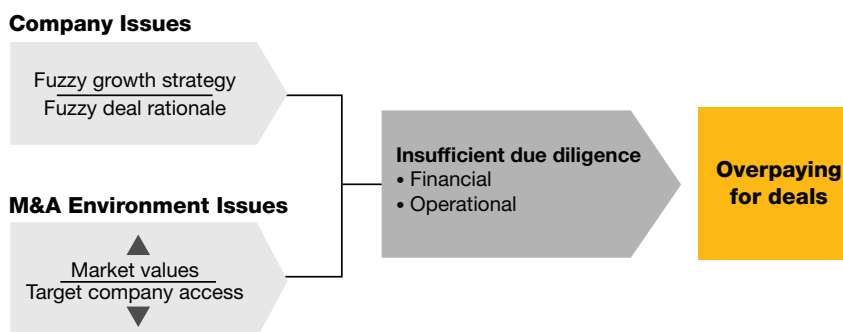
A similar concern exists with cross-border transactions when a company has been operating in a favorable currency conversion ratio relative to the buyer. If the buyer's home currency gets stronger post-transaction, the deal results will look less attractive.

Respondents noted that risks that are considered "transaction-specific," such as structure and taxes, are typically more manageable and are therefore considered less risky to an M&A transaction.

drivers of the target, the true fit with the buyer's strategic plan, and the achievability of the planned synergies that are likely supporting the high multiple required to win in the bid process

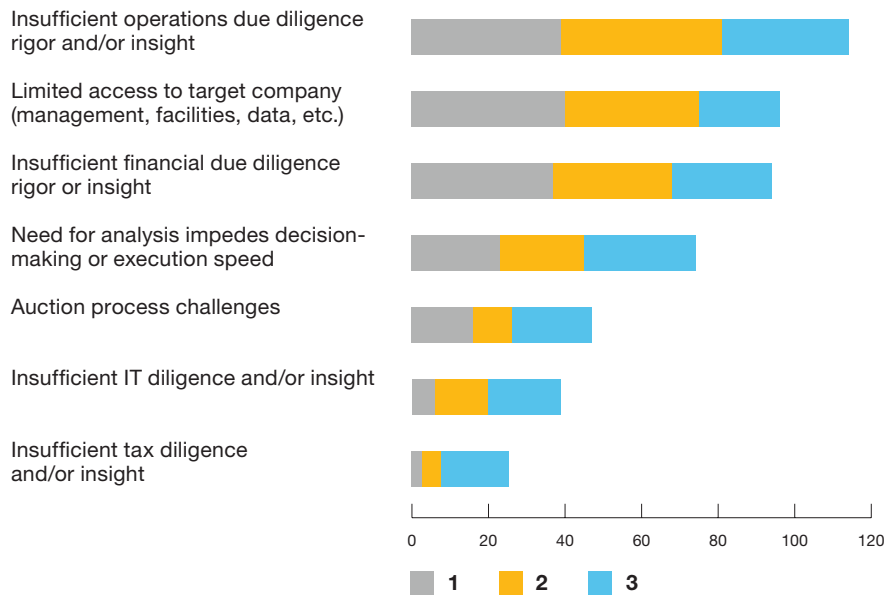
- Renegotiating the deal based on any discoveries during due diligence that do not support the seller's contentions during its marketing process
- Understanding the geopolitical and macroeconomic influences on the business and its long-tail history to determine how the target performed during prior challenging times
- Learning the target's business well enough to create quick cash returns through selling or outsourcing noncore operations, and/or selling and leasing back real estate
- Including some of the purchase price as variable consideration dependent on the target's post-transaction performance
- Performing a pre-deal accretion analysis for public companies to understand the net income effect of the fixed asset step-up depreciation and identifiable intangible asset amortization charge

## Exhibit 5: Factors Contributing to Overpaying for Deals



## Risks by Category – Due Diligence Risks

### Exhibit 6



The respondents' ranking of due diligence risks reflects the following:

- The operations and financial functions have more risk than the information technology and tax functions.
- Companies do not have sufficient access to target company personnel, data, operations, and key stakeholders, such as customers and vendors.
- Because insufficient operational due diligence is ranked in the top two of all risks across all risk categories, companies appear not to be giving enough attention to this critical functional area.
- Despite the fact that financial due diligence has long been a best practice, insufficient financial due diligence continues to be a problem for buyers.
- Risks related to the desire for extensive analyses and buyer auction processes are ranked as mid-level concerns, which is surprising because we frequently hear this mentioned as a concern in our discussions with corporate development professionals.

“Financial due diligence needs to move from the traditional focus on historical results toward a forward-looking examination of top-line risks and the validation of the real achievability of synergy opportunities – an activity that includes challenging the execution plan.”

– Marc Shaffer

Despite the apparent realities of poor due diligence rigor and limited access to the target, companies can still implement the following risk mitigation tactics:

- Work on proprietary deal targets, which should provide better access.
- Document the key deal points in a one-page presentation, which allows the deal team to prioritize opportunities and risks.
- Make any offer contingent on the ability to assess the prioritized opportunities and risks.
- Develop, stress test, and use an M&A playbook.
- Use a document-request process that focuses solely on items that might change the buyer's view of value or cause the buyer to withdraw.
- Keep due diligence data requests at the organizationwide level, instead of the functional level.
- Include data requests necessary to assess whether synergies can truly be achieved.
- Prioritize financial, operational, and human resource aspects of diligence when determining deal team assignments.
- Use internal personnel experienced with M&A or experienced external resources with industry knowledge during due diligence.
- Require the target to provide projected financial statements.
- Use the “clean room” concept for assessing critical competitive data that the target is sensitive about disclosing.
- Commission market diligence to understand environmental influences, competitors, and the market's view of the product unless the target is in the same industry.
- Switch to integration planning requirements once deal values have been confirmed.



While survey respondents did not rank the auction process as high-risk, its competitive nature means that not all of a buyer’s wishes may be met. Therefore, companies must concentrate on identifying and validating key value drivers. When access to the data required to investigate those drivers is not granted, a buyer should consider exiting the process. Auctions often provide limited access to management, but buyers that insist on a reasonable timeline and level of access fare much better with their transactions. Conversely, a protracted deal process creates distraction and uncertainty.

Even when using the right personnel, the process must provide visibility and accountability for each functional area. Often, team members are initially motivated during due diligence to learn how the target company, often a competitor, functions; however, the pressures of normal daily activities tend to erode deal enthusiasm over time. Using an M&A playbook with scheduled check-ins can help keep the diligence team focused.

## Risks by Category – Integration Risks

### Exhibit 7



Of the five specific risk issues listed, the top three were highlighted as the most troubling and critical by survey respondents:

1. Underestimate integration work/challenge
2. Underestimate time/effort/resources to realize projected synergies
3. Lack of follow-through and post-close accountability

It’s important to note that by identifying these as the most critical risks, respondents pointed specifically to the challenges related to real-world execution. In other words, it is not the theoretical – insufficient planning or targeting too many unrealistic synergies, for example – that respondents found the most risky. Rather, it’s repeatedly underestimating the magnitude, complexity, and difficulty of the work required and being able to maintain focus, accountability, and execution in the post-close period.

Unfortunately, unforeseen integration challenges happen to be the most expensive and the most difficult to recover from because they occur at the tail end of the M&A value chain. It can be devastating to put all of the work into the front end of a deal (e.g. finding, vetting, negotiating, financing, planning, etc.) only to poorly execute the ultimate integration and value capture.

“Integration failures are often the result of insufficient management capabilities to ‘bring the target into the acquirer’s fold.’ If you pay a large premium, you have to bring about significant improvement in the combined entity’s post-acquisition performance to recapture the premium paid (and even more to create value for the acquirer). This requires flawless execution and integration. Thus, you have a chain of causation: premium paid, to required performance improvement, to required management capabilities, to success of integration/execution.”

– Tom Thompson

## M&A Integration Approach

The authors believe that an effective integration centers around three concurrent, macro workstreams:

### Three Macro Integration Priorities

**Accelerate synergy capture**

**1**

#### Full value optimization

- Early identification and vetting of potential deal value drivers
- Prioritization and structuring (such as charters, metrics, and accountabilities) around discrete synergy projects
- Accelerated execution and realization of key synergies

**Secure the base business**

**2**

#### Functional integration

- Verify readiness of critical functions and processes (such as order-to-cash, financial close, and go-to-market approach) for seamless day-one operation
- Confirm seamless customer interface and top-line revenue retention into the post-close period

**Manage the people and culture transition**

**3**

#### People & culture transition

- Manage people and culture transition issues – both at the tactical level (such as job redesign and compensation/benefits) as well as for strategic issues (such as organization redesign, culture transition, and communications strategy)

While a tremendous amount of detail underlies each area, systematically examining each area can help companies organize their process, focus on the critical synergies, and mitigate critical risks.



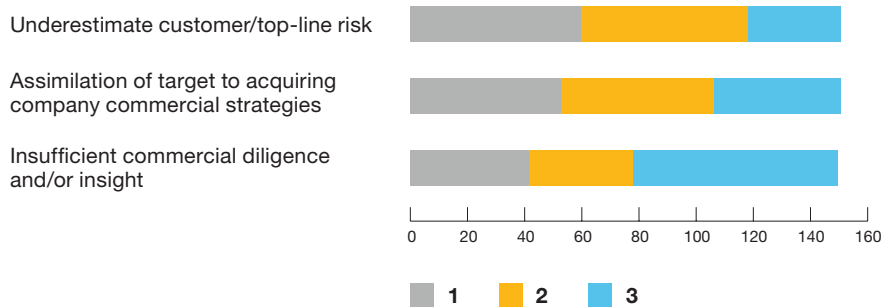
### Commercial Optimization Approach

Some practical steps can help companies navigate the commercial transition more effectively:

- Incorporate an element of commercial/customer diligence in the due diligence period.
- Highlight potential product and/or customer overlaps between the companies.
- Communicate early and often with key customers.
- Realign the sales force early on in the process, if necessary, instead of prolonging ambiguity.
- Focus on executing on the tangible opportunities, like sales force execution, rather than chasing new, “blue sky” opportunities.

## Risks by Category – Commercial Transition/Synergies Risks

**Exhibit 8**



Increasingly, commercial transitions and synergies are central to the deal thesis and the projected deal value. For instance, a company may seek to acquire a target in a new, high-growth market (a primary motivation for many cross-border transactions). In other cases, a company may want to round out its product set or to deliver integrated solutions instead of discrete products or services.

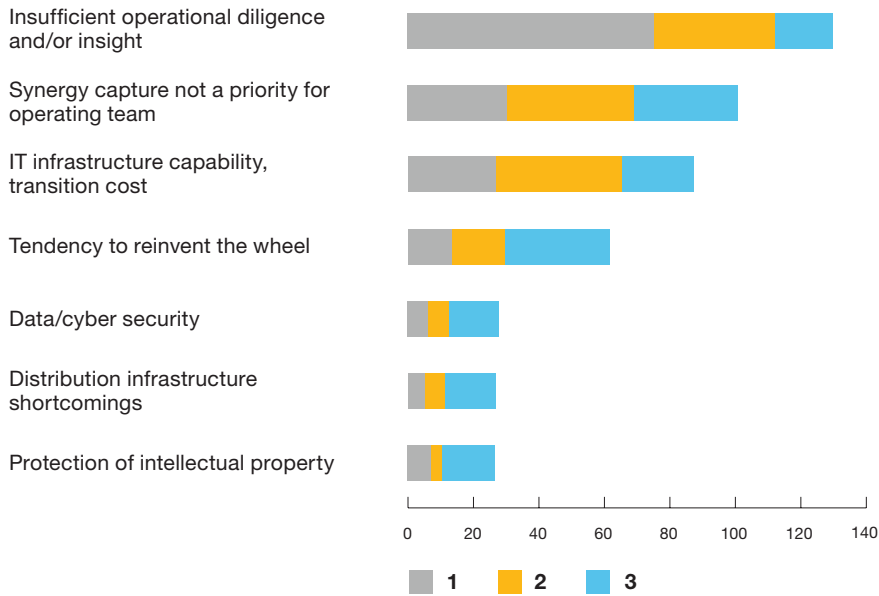
Today, strategic acquisitions seem to be more common than deals done to increase capacity or optimize costs, yet these types of deals have traditionally been difficult. Acquirers are challenged to assess, value, manage, and realize the commercial synergies in a transaction. Unlike many of the more traditional “cost stack” synergies such as G&A expenses, SKU rationalization, facility consolidation, or supply chain benefits, the commercial area often involves elements that can be outside the acquirer’s control. This could include considerations such as customer stickiness (versus vendor diversification), market dynamics, and competitor response.

Given this environment, companies are increasingly attempting to “de-risk” deals by not including commercial synergies in their models. Boards and operating executives want deals to be justified without the benefit of incremental commercial synergies.



## Risks by Category – Operational Transition/ Synergies Risks

### Exhibit 9



In considering key operational transition/synergies risks, the leading risk by far for respondents was “insufficient operational diligence and/or insight,” as shown in Exhibit 9.

Throughout the survey, respondents cited a lack of involvement, commitment, and accountability from the operating team as a major concern. This reported shortage of operating team involvement is doubly problematic considering:

- An increasingly competitive M&A market that limits purely financial arbitrage opportunities and necessitates true operational value optimization to justify deal premiums
- The “limited access to target company (management, facilities, data, etc.)” highlighted in the due diligence risks section, which necessitates increased involvement by an experienced operating team to yield quality insights

“Most of the clients we work with actually have fairly strong internal operating capability. However, it’s important to remember that most of the internal operating people also have “a day job,” running the existing business. When you layer an acquisition on top of that, many companies struggle with simple bandwidth issues. The fact that most companies run fairly lean is, I believe, one simple, but important reason why companies continue to struggle to realize the full value of their M&A deals.”

– Ron Melcher  
Principal, Advisory Services  
Crowe Horwath LLP

The second risk, “synergy capture not a priority for operating team,” is also problematic given the fact that, based on our experience, synergy capture becomes exponentially more difficult, more expensive, and more disruptive as time elapses post-close. There is usually a small window of opportunity to make changes quickly when the deal closes; however, if companies are not willing or able to capitalize on this, the opportunity passes and making the necessary changes becomes increasingly difficult.

We’ve heard many explanations and/or justifications for delaying synergy projects, such as:

- “We just need to take our time and learn the business.”
- “We don’t want to disrupt the customers.”
- “They’ll come around to our way of operating over time.”
- “We don’t want to cloud the earn-out metrics.”
- “We want the personnel from the acquired entity to think that nothing is changing.”

And yet, invariably we find that the companies would have benefitted from accelerating the synergy capture and integration transition. We’ve seen that this translates to superior performance, not only with respect to financial metrics, but also operational transition metrics, key employee retention, and key customer retention. That is not to say that there aren’t some specific circumstances that necessitate a slower transition. But these should be the exception, not the rule.

### Risks by Category – People/ Cultural Transition Risks

Survey respondents indicated that the leading people/cultural transition risk involves “culture assimilation challenges,” as shown in Exhibit 10. The item “unclear how to define/measure ‘culture’ effectively” was seen as much less of a risk factor, which is particularly interesting given that:

- Strong values alignment and cultural fit are referred to as key value drivers for virtually every M&A transaction, as evidenced by many M&A-related deal announcements.

- A whole industry of experts is focused on defining culture using tools such as culture models and diagnostic instruments.

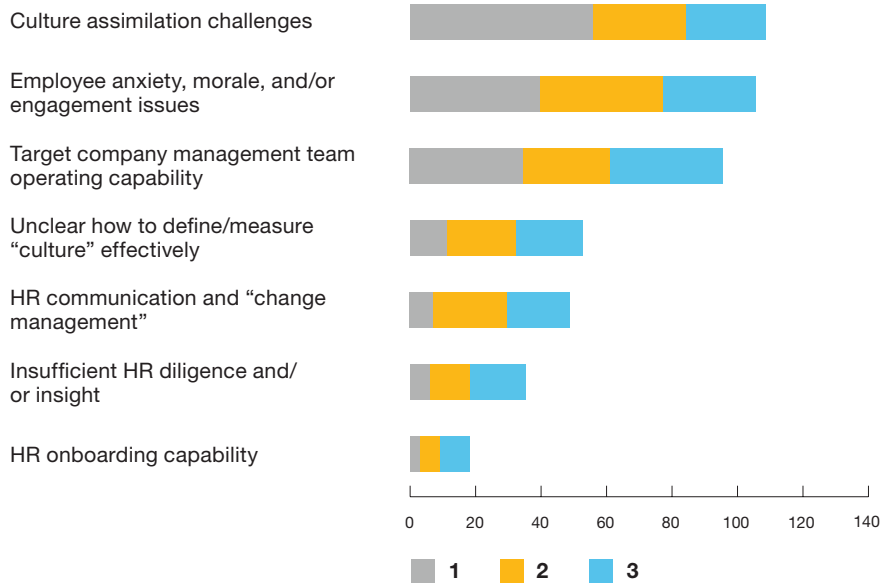
The issues underlying cultural assimilation are very pragmatic and tangible, including issues related to:

- Organization structure and reporting relationships
- Compensation changes
- Benefits changes
- Title changes
- Decision-making protocols
- Risk appetite
- Reliance on hierarchy

These considerations are far more tactical than simply comparing vision and values statements. Ironically, the longer it takes the acquiring company to define and communicate M&A-specific cultural assimilation issues – leaving the acquired and the buyer’s workforce to wrestle with ambiguity – the more detrimental it is for their “anxiety, morale, and engagement,” which is the second most significant risk related to people/cultural transition risks.

# Understand which cultural differences matter.

## Exhibit 10



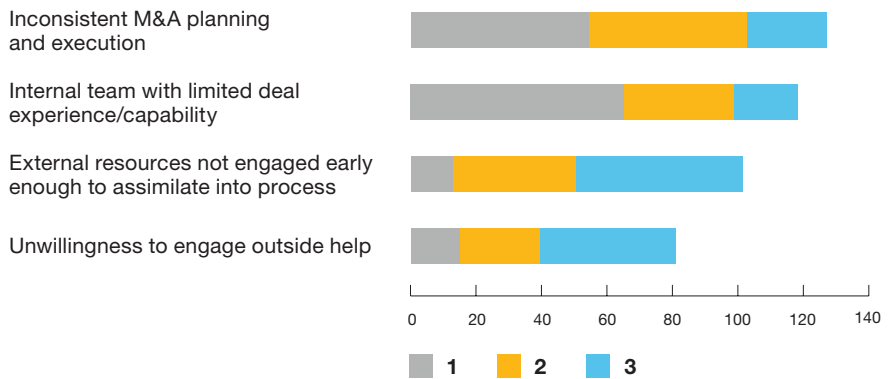
Culture clash – essentially the differences between employee behaviors, attitudes, and values – can derail deal synergy and integration objectives. Therefore, understanding the cultures of both the acquirer and the target is useful to determine which cultural differences matter and must be addressed in the integration change management plan.

“As you probably know or have experienced, there are a myriad of challenges with respect to people and culture in an M&A deal. In addition to the more transactional issues around compensation, benefits, and general employee onboarding, there are a series of strategic issues surrounding ‘how to win the hearts and minds’ of the acquired company’s employees. And, in transactions that are cross-border in nature, these issues become exponentially more complex.”

– Mark Walztoni  
Advisory Services  
Crowe Horwath LLP

## Risks by Category – Internal Resources Risks

### Exhibit 11



Respondents identified a typical conundrum, which is that, although companies could benefit from outside resources when their internal resources are strapped and have mixed levels of practical M&A experience, they struggle with how and when to seek outside help.

In our experience, some consultants also do little to help their own cause in this regard. All too often they only show up once a deal has been announced. If they primarily provide junior-level resources with little practical experience of their own, they do not strengthen the company's capabilities. Instead, they often create even more work for the internal team.



## **Strengthening Internal Capability**

“As someone who’s been on the operating side of the table, I’d ask companies to consider two simple things to help deliver the best M&A execution capability when and where you need it.

“First, I’d suggest developing and maintaining a simple M&A playbook, essentially the baseline manual for how you and your company execute an M&A transaction, from targeting to diligence through integration. It doesn’t need to be intricate or complicated – I’d say that an overly complex playbook is often worse than no playbook at all. With that said, though, a live M&A transaction is not the time to figure things out on the fly or to reinvent the wheel.

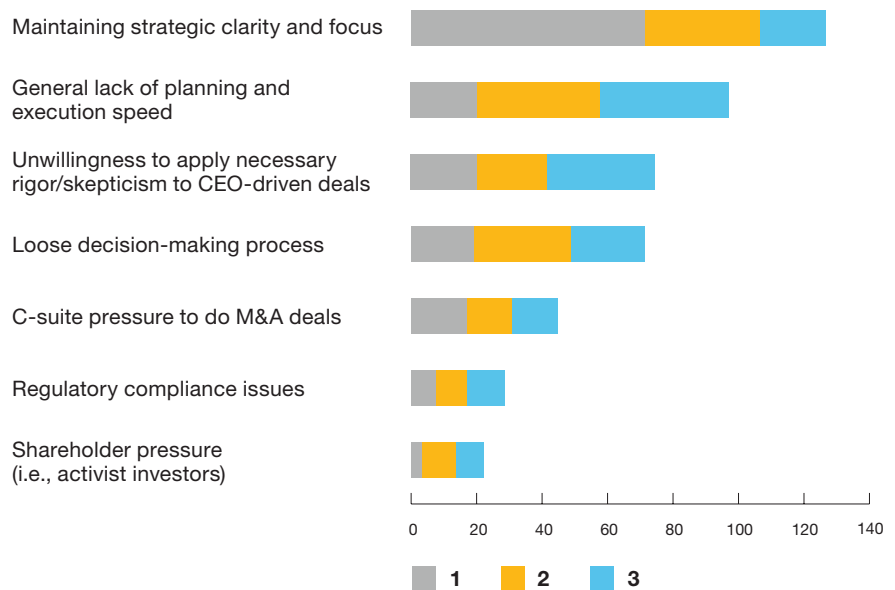
“Second, I’d suggest using the time between deals to identify and properly vet the potential set of external service providers you can turn to for M&A support. Just like anything, there’s a wide range of consultants and so-called experts. Advisers are only as good as the people who will actually work for you, so take time to meet them. What real experience do they have? How well will they interface with your company? They should be able to give you solid, demonstrable evidence of their experience and the kind of incremental value they’ll bring. If they can’t do that or are somehow reluctant to do it to your satisfaction, then just move on. When you are pursuing an M&A deal, it is not the time to have doubts about the people you’re taking the field with.”

– Chris Nemeth



## Risks by Category – Governance and Decision-Making Risks

### Exhibit 12



The top risk in governance and decision-making relates not only to the earlier targeting risk of “fuzzy growth strategy or specific deal rationale,” but also to the integration risk “lack of follow-through and post-close accountability.” In fact, those two risks arguably set the stage for maintaining strategic clarity and focus.

One of the well-documented, inherent challenges of M&A is that it takes a tremendous amount of work and perseverance just to close, and once the deal is consummated, many companies breathe a sigh of relief and are ready to retreat to business as usual. And yet, just like when one buys a house, experienced homeowners know that closing day is when all the home’s problems become theirs. The close day for an M&A transaction is not the end of the adventure – it is truly just the beginning.

The governance and decision-making risk rankings can be grouped with the top two risks considered M&A strategy issues that the acquirer’s deal team can control. The middle three risks may be not controllable by the deal team, but can be addressed through good organizational governance procedures. Finally, the last two risks are more environmental in nature, assuming you accept the argument that activist shareholders are an external factor, not an internal one.

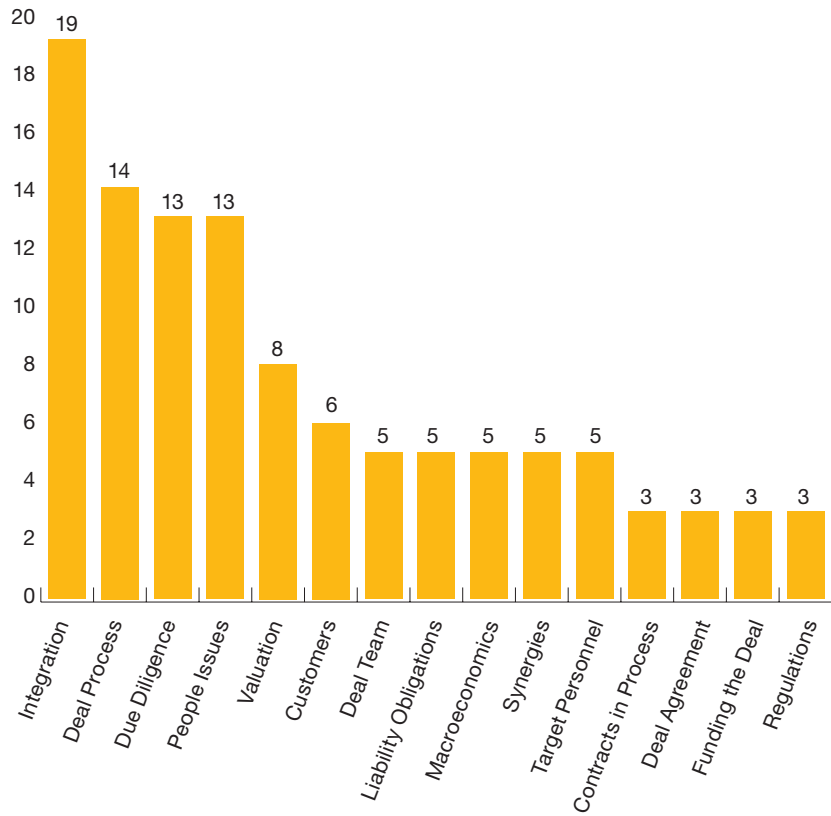


# Most Overlooked Risks

In addition to ranking the risks within each category, respondents were asked to use their own words to identify risks that they considered to be the most overlooked risks in M&A execution. Some of their choices mirrored the risks that we, as the survey developers, selected for respondents to rank within each category.

The 110 respondent quotes were organized into risk groups by Crowe. Based on the respondents' experiences, the issue of integration ranked as the top most-overlooked risk area in M&A execution. This finding is consistent with the findings from our previous strategic buyer M&A process research projects. Three other notable areas follow integration issues: process challenges, diligence risks, and people and culture transition issues.

**Exhibit 13**





Respondents provided key insights into these overlooked risk areas in the following quotes:

**Integration issues:**

1. *"Disconnect between C-suite and integration team on timeline to integrate"*
2. *"Commercial & product detail planning"*
3. *"Availability of internal resources to manage integration"*
4. *"Lack of a clear integration plan prepared before the deal closes"*
5. *"IT application system integration underestimated"*

**Process challenges:**

1. *"Not enough access to management on the ground"*
2. *"Companies fall in love with the deal before due diligence is complete and lose independent viewpoint"*
3. *"Difficult internal governance process where there are many internal stakeholders"*
4. *"Process is too protracted and loss of traction and clarity"*

**Diligence risks:**

1. *"Understanding the drivers of revenue and profitability requires an understanding of markets generally not available during due diligence"*
2. *"Ability to meet projected revenues, projected synergies, and projected bottom line"*
3. *"Biggest risk overall is inadequate financial and operational due diligence"*

**People and culture transition issues:**

1. *"Resource impact to organizations without dedicated M&A resources"*
2. *"Clear means of articulating culture and its relationship to the business"*
3. *"Risk of executive ego clashes"*
4. *"Instilling your culture"*

Note that the risks above are all essentially execution risks (as opposed to the conceptual side of M&A deals). Most experienced deal-makers and operating executives say that, even though many (if not most) deals are readily understood, quickly valued, and conceptually sound on paper, executing and realizing the value of these deals is harder to pull off. Despite this basic understanding, companies are still surprised by the enormity and sheer complexity of the execution challenges.

## Spotlight on International (Cross-Border) M&A Transactions

To gain a broader perspective on M&A transactions, we asked survey respondents about their international or cross-border M&A experience.

For those 55 percent of respondents with international experience, additional questions focused on pre-close and post-close deal risks for cross-border transactions.

In order to better examine and interpret the survey results concerning international deal execution, we assembled a panel of experts from member firms of Crowe Horwath International. The panel members were:



Marc de Prémare  
Partner, Audit Services  
HAF Audit & Conseil, France



Vijay Thacker  
Director, Advisory Services  
Crowe Horwath India



Aymeric Stievenart  
Partner, Corporate Finance  
Rsa Corporate Finance, France



Peter Varley  
Partner, Corporate Finance  
Crowe Clark Whitehill, U.K.



Franklin Bendoraytes  
Partner  
Crowe Horwath Brasil



James Swan  
Corporate Finance  
Crowe Clark Whitehill, U.K.



Justin Audcent  
Partner, Corporate Finance  
Crowe Horwath Australia



Michael Krüger  
Managing Partner  
Platinum Partners GmbH, Germany

## Pre-deal International Risks

In considering this data, Marc de Prémare (France), Franklin Bendoraytes (Brazil), and Justin Audcent (Australia) agreed that identifying the right opportunity is the highest risk for a global market participant. Aymeric Stievenart (France) added that it is even more difficult to find a “pépité” (“jewel”) in a niche market. De Prémare noted that there is such high risk in cross-border acquisitions that even if a company provides the best offer, it may not be selected because alternative buyers may come from better-regarded countries. It is important to know how your company will be perceived based on your headquarters location. For companies without an existing presence in the region, the difficulty of finding a local target is often compounded by having very limited knowledge of the market dynamics and competitive environment. Spending time in a jurisdiction to understand the culture and environment will help to support relationship building; this can be especially important in a high-context region where nonverbal messages are the object of heightened focus.

### Exhibit 14



Audcent raised the point that restrictions on foreign ownership can also present a challenge for international deals. In many countries, certain acquisitions require foreign investment approvals, which can be time-consuming and introduce uncertainty into the deal process. This can place overseas buyers at a disadvantage to domestic suitors, particularly in sensitive industries such as defense, resources, and agribusiness, where there is a greater risk that a company will be found to be “not in the national interest.”

In addition, some countries do not allow an overseas investor to hold a controlling interest in an entity. This restriction on foreign ownership can lead to a requirement to co-invest

with a local partner. In such cases, identifying a suitable local partner can itself be a significant transaction risk.

Vijay Thacker (India) indicated that negotiation processes in cross-border deals tend to be lengthy, particularly for first-time investors from outside of the country. The timelines, approach to negotiations, and administrative processes for deal closures can be time-consuming and even frustrating to a first-timer. Thacker stated that when doing business in India, for instance, one key aspect that must be learned is patience. A quick deal process with an Indian counterpart, whom you are not familiar with, likely could lead to a bad deal or an early breakdown.

Peter Varley (U.K.) and Michael Krüger (Germany) both expressed that when looking for a proper global target, it is advisable to engage buy-side specialists located in the overseas territory. Those specialists can identify potential targets based on a clear strategic vision and help avoid opportunities that might not be perfect in terms of fit or timing.

Stievenart commented that the best source of buy-side specialists is international networks such as audit and tax firms, banks, legal firms, and state or public services who are known by the acquirer in its home country but who also have a local presence in the main countries considered for an investment. Local knowledge and hand-holding through the process will help overcome the challenges posed by differing cultures, business environments, time zones, and language barriers. Also, target companies are usually smaller than the buyer, and it may be necessary to get relevant information about the target from a local presence should data not be available in the public domain.

James Swan (U.K.) supports this idea and adds that spending time in the jurisdiction of a potential acquisition target to understand the culture and competitive environment can be as important as doing effective due diligence.

The second ranked pre-deal risk concerned different accounting rules. Bendoraytes noted that the adoption of International Financial Reporting Standards (IFRS) in various countries has benefitted financial reporting on a global level. U.S. generally accepted accounting principles (GAAP) and IFRS are similar frameworks, and differences may be reconciled without great effort. In the U.K., the recent introduction of Financial Reporting Standard (FRS) 102 has brought reporting for the majority of private U.K. companies closer to full IFRS.

Bendoraytes confirmed that understanding the culture in target countries is critical for transaction success. Consumer habits and business mindset need to be deeply investigated before spending time and energy on a deal opportunity in a foreign country. The deal strategy must include an assessment of the ability and cost to adapt your products to local tastes while being sold globally.

Another local market risk that U.S. acquirers buying domestically rarely need to consider is the consequences of consumer activism. For example, a target company acquired in Brazil that manufactures parts for the bus industry was subject to a ripple-effect of a student protest against a 30-cent price increase on bus passes. The government reacted by canceling the increase,

causing transportation companies to postpone their fleet renewals, which caused bus makers to cancel production, all of which significantly impacted the acquired company.

The last major point of the panel discussion was that antitrust laws need to be considered in the early stages of a potential deal, with voluntary disclosure helping to avoid hurdles in the latter stages of the process. For companies operating within the European Union, consideration must be given to antitrust laws in the individual countries as well as laws set by the European Commission.

Antitrust regulation, of course, differs widely among jurisdictions and can present challenges for companies with a sizable existing market share. For instance, Audcent noted that in Australia regulators consider competition not only on a national market share basis, but also at a state and local level. Certain sectors – such as print, broadcast, and digital media – have particularly stringent regulations to limit the concentration of ownership.

Another regulatory challenge faced in some countries by overseas companies making acquisitions is recognizing the differences in legislation between individual states within a country, an M&A hurdle that also exists in the U.S.

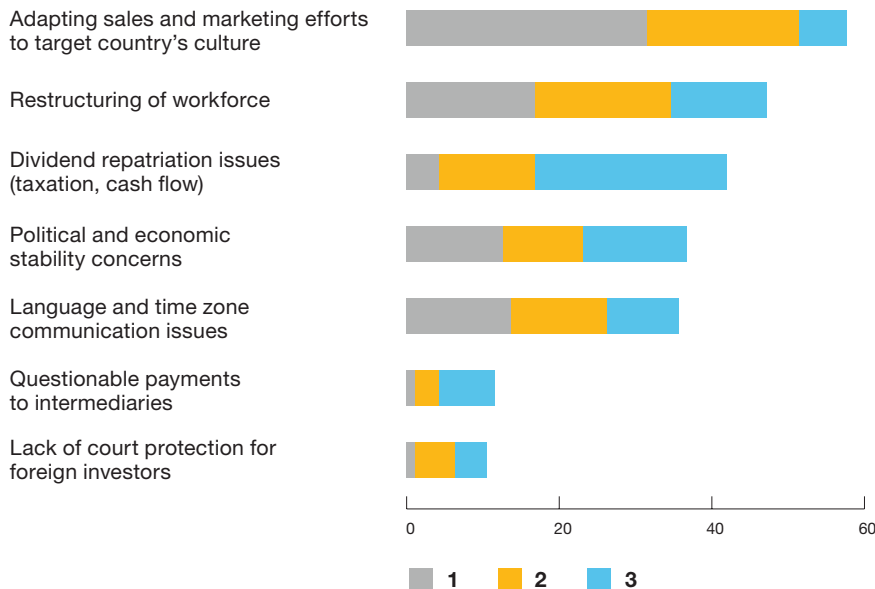
## Post-deal International Risks

The top post-deal international risk was “adapting sales and marketing efforts to the target country’s culture,” a critical point given that many international deals are strategic. This concern was followed by “restructuring of workforce.”

Regarding post-deal international risks, de Prémare commented that synergy capture is much more difficult in a cross-border deal due to the need to adapt sales and marketing strategies, language differences, and cultural nuances. He further agreed with the most overlooked risks results that integration is the highest, and most often overlooked, risk. A cross-border merger requires a longer and more intense integration plan.

Similarly, Bendoraytes observed that the lack of integration between operations may prevent a buyer from harvesting the transaction’s full potential. Integration may look like an expensive proposition at first; however, after the hard work is done, the combined companies

### Exhibit 15



will run on a much more nimble and lean platform and may realize gains not only in operational savings, but in production scale, quality, and brand recognition.

Swan noted that sales and marketing tactics can vary significantly by jurisdiction depending on the country’s culture and regional advertising

laws. Understanding the culture, competitive environment, and advertising laws will help with more swiftly adapting to effective sales and marketing techniques. At an initial stage, the appointment of in-region branding and marketing advisers may help to ease the transition.

Survey respondents consistently highlighted the importance of robust and effective due diligence. To mitigate the risk of a poor deal result, international acquirers are often far more likely to undertake commercial due diligence in order to understand the market and validate the positioning, reputation, and growth prospects of the target, all of which help properly plan for the combined company's market approach.

Cultural assimilation challenges were ranked as the most challenging risk by respondents from companies conducting international transactions. Despite this ranking, this risk often gets insufficient attention, especially when a closely held private business is acquired by a large, global company. Many companies regard their culture as a key to their success, and international buyers often find it challenging to implement change while keeping management and employees engaged. Employee loyalty is often a risk in an M&A transaction, and due to the uncertainty of how the companies will be combined, staff may decide to "jump before they are pushed." Effective early communication with staff can help

ease uncertainty and encourage loyalty. Establishing effective in-region incentive plans also helps retain key personnel.

The second highest international deal post-close execution risk was "restructuring of workforce," which Thacker and de Prémare say can be a challenge in India and France, respectively, with timelines and costs being a surprise to first-time acquirers. On the other hand, Thacker maintained that investors in India need not be concerned about courts favoring a domestic party or joint venture partner in a dispute because Indian courts tend to judge transactions on commercial merit rather than from a nationalist bias. Of course, formal, legal processes and arbitration to settle disputes may take longer to close than in the Western world.

The panel believes that accomplishing the integration process in a cross-border deal is a high risk due to differences in time zones, language, and the operations and regulatory environments. In some cases, target businesses struggle to meet new management reporting requirements, which are often in different formats and have much tighter timeframes.

As is true with many domestic deals, international purchasers often overestimate cost synergies. Because the acquirer is headquartered in another country, accessing and executing cost synergies can be difficult. A well-considered integration plan, which commences before the deal closes, is key for any transaction to achieve the full value of the synergies it expects.

Our panel was surprised by how low the survey respondents ranked "questionable payments to intermediaries" as an international deal risk. Thacker believes the need to rush the implementation of international ethics policies to comply with the U.S. *Foreign Corrupt Practices Act (FCPA)* and the U.K. *Bribery Act* when dealing with various in-country agencies and commercial partners of the old company is a high risk. For example, agents and service providers of an acquired entity may not have complied with the FCPA in the past, but will need to do so on behalf of the newly combined business.



## Country-Specific Risks

Our international panel also identified some country-specific risks that the survey structure did not address. A summary follows:

### France

In France, it is important to inform the workforce of the target company of the deal and to ask for their opinion before signing the deal. France has very protective labor laws, as do many Western European countries.

### Brazil

In Brazil, private companies are rarely audited, except for those companies that are in an investment fund portfolio. The accounting practices adopted by Brazilian middle-market companies have always been driven by tax priorities. In particular, manufacturing and distribution companies adopt an arbitrary method for measuring their inventories, which the Brazilian IRS has always accepted. Because of this, few companies have invested resources in systems and training to have more detailed and precise inventory information

The top Brazilian M&A risk is related to the famous Brazilian tax complexity. The dizzying array of tax codes and requirements can be overwhelming, increasing the chance of error. Tax inconsistencies result in penalties that increase over time, because the delinquent tax and any fines are indexed by one of the highest interest rates on the globe.

Ranking as the number two risk in Brazil is the labor law, the so-called “CLT,” which has always concerned business owners and corporations. The CLT regulates almost all aspects of the

relationship between employers and employees. Payroll taxes are one of the heaviest corporate costs in Brazil. However, because the CLT role offsets what may be a union role in other countries, unions in Brazil are not as strong as they are in United States.

Ranking right below tax and labor M&A risks in Brazil is the risk of inheriting a business involved in bribery. The development of the Lava-Jato, the law enforcement operation that is investigating the Petrobras corruption case, is giving rise to a new mindset in the country; therefore, the relationship between a corporation and the Brazilian government must be deeply investigated before any M&A transaction.

### Europe

Our British panel members developed the following list of Europe-centric risks to consider:

- Brexit and the future impact on Britain’s trading relationship with Europe
- The European Commission becoming more involved in the tax affairs of individual member states
- Competition restrictions imposed by the European Commission
- Over 30 languages are used across Europe, and less than 50 percent of the population speaks English
- 28 different currencies are used across Europe, causing intra-region currency fluctuations
- Varying tax codes across Europe

- The shift toward the lock box completion mechanism across Europe can pass risk to a buyer
- Cultural differences between jurisdictions within Europe
- Auto-enrollment for compulsory employer pension plans in the U.K.

### India

In India, recent regulatory requirements regarding indemnifications and escrow holdbacks add to the normal commercial challenges and affect the ability to implement a valuation basis for transaction pricing. The regulatory implications primarily concern the need for fair value pricing for any cross-border transaction with implications under tax law and foreign exchange regulations.

In addition, the possibility of unaccounted incomes and profits needs to be factored into valuations in India. While tax laws are being tightened to remove this possibility through income tax and a goods and services tax, the issue will continue to be relevant at least for the medium term.

Lastly, greenfield projects in India could have uncertain completion timelines with frequent delays due to regulatory, environmental, and financing issues. If a greenfield project is an important component to supplement an M&A transaction, this risk must be considered.

“A correlation analysis can provide insight into which issues are likely to become the most critical risk areas. For instance, knowing the target size in relationship to the acquirer or whether the deal has an international component can help an M&A team go into a project armed with the appropriate tools and strategy and increase the probability of a successful outcome.”

– Eric Ference  
Managing Director,  
Advisory Services  
Crowe Horwath LLP

## Correlation Analysis

On their own, the survey results provide some interesting considerations, but we also looked for correlations between some of the highest ranked responses and other deal attributes. For example, the relative importance of certain risks varied based on respondent demographics. Some of those key correlations include:

### Deal Size

- Restructuring the workforce was, on average, twice as big of a risk for respondents whose average deal size was more than \$500 million.
- Underestimating the integration work/challenge was a higher risk for companies doing deals of more than \$500 million.
- Maintaining strategic clarity and focus was a bigger risk for companies transacting deals less than \$500 million.
- A loose decision-making process was more of a risk for respondents involved with deals less than \$10 million.

### Company Size

- Insufficient operational due diligence rigor and oversight was a bigger risk for companies with less than \$1 billion in revenue than for larger companies.

- Complications related to auction processes were considered twice as risky for companies with more than \$1 billion in sales compared to smaller respondents.
- Lack of planning and execution speed was riskier for companies with revenues of less than \$25 million than for their larger counterparts.

### Public vs. Private

- Public companies considered it twice as risky to find the right global opportunity instead of staying in their comfort zone. This may be because private companies tend to undertake fewer international transactions.

### International vs. Domestic

- IT infrastructure capability and transition was riskier for internationally focused companies than for domestic-only companies.

In some cases, demographics of the respondents did not affect responses, including:

- Senior-level decision-makers shared eight of the top 10 risks with other respondents.
- Manufacturing and nonmanufacturing respondents shared eight of the top 10 risks.
- Public and private companies shared eight of the top 10 risks.
- Domestic and international companies shared nine of the top 10 risks.



## Conclusion: Navigating M&A Risks

M&A deal participants, such as the corporate development team and business unit leadership, can often become enamored with the upside potential of a transaction. The successes of M&A transactions, however, are determined by solid risk assessment and mitigation strategies. This is where senior financial executives must remain steadfast in their responsibilities.

The recent survey explored a myriad of M&A execution risks across a number of areas. These risks, while challenging in their own right, are further heightened by a number of factors in today's M&A climate, including:

- A competitive M&A market and higher pricing multiples
- Limited access to and visibility of target company information during due diligence
- The increasing centrality and expense of the IT systems transition
- Internal staff with limited bandwidth and M&A experience
- An increasing prevalence of cross-border international deals

Despite the fact that some of the risks are environmental in nature (such as the prevailing valuation multiples for a specific market), we find that most risks are well within the control of the acquirer to vet pre-deal and subsequently mitigate post-deal. Some of the risk mitigation tactics we've found to be particularly effective include:

- Articulating a clear M&A strategy
- Adhering to a simple deal governance process to maintain targeting and valuation discipline
- Creating expectations for early operating-team involvement, focus, and post-close accountability
- Improving M&A execution readiness for internal resources (e.g., using an M&A playbook) as well as vetting and prequalifying external advisers
- Adhering to a conservative approach with respect to modeling and communicating commercial synergies
- Paying careful attention to people/culture issues, particularly for international deals

Proper preparation is the key in these areas, just as it is in so many areas of M&A execution.

It is our hope that this report provides readers with insights and suggestions that will help them be more prepared to undertake the challenging – but potentially rewarding – activity of M&A.

# M&A deal risks can be mitigated with proper preparation.

## Respondent Demographics

Our 20-question online survey was conducted from May to July 2016. Respondents included 180 senior-level financial executives – more than half (55 percent) of whom were chief financial officers. More than two-thirds (69 percent) of respondents were from private companies, and the rest were from public companies and not-for-profit organizations. The following tables show the demographic profile of our respondents.

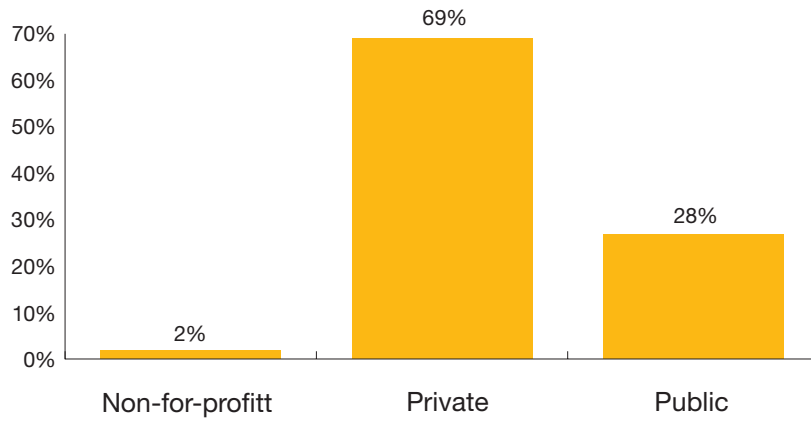
### Job Title

#### Exhibit 16

Current Title	Number of Respondents	Percent
Chief Financial Officer	99	55%
Business Owner, Principal, or Partner	13	7%
Corporate Controller	9	5%
Vice President	9	5%
Other	8	4%
General Manager	6	3%
Manager	6	3%
Vice President of Finance	6	3%
Director	5	3%
Managing Director	4	2%
President and/or CEO	4	2%
Senior Vice President	4	2%
Management Consultant	3	2%
Chief Auditor/VP of Internal Audit	2	1%
Assistant/Divisional Controller	1	1%
Chief Accounting Officer	1	1%
<b>Total</b>	<b>180</b>	<b>100%</b>

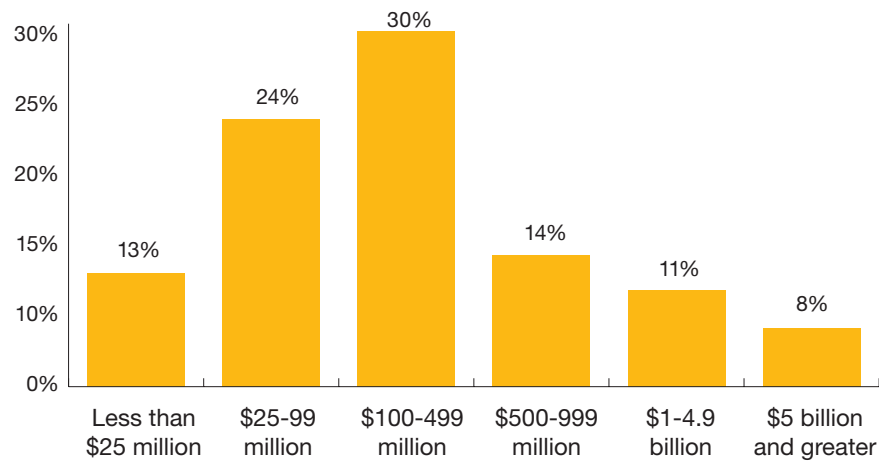
## Company Type

**Exhibit 17**



## Annual Revenue

**Exhibit 18**



## Industry

### Exhibit 19

Company Industry	Number of Respondents	Percent
Manufacturing	69	38%
Professional Services	21	12%
Other	18	10%
Retail	13	7%
Wholesale Trade	11	6%
Construction	9	5%
Technology	8	4%
Natural Resources	5	3%
Transportation	4	2%
Agriculture & Agribusiness	4	2%
Healthcare Provider	3	2%
Property Management and/or Real Estate	3	2%
Banking	2	1%
Insurance	2	1%
Utilities	2	1%
Aerospace & Defense	2	1%
Medical Devices	2	1%
Communications	1	1%
Education	1	1%
<b>Total</b>	<b>180</b>	<b>100%</b>



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