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Fundamentals of Post M&A Control

The success of all your integration initiatives depends on the control you can establish over the acquired entity

An accelerated integration process is important to minimizing disruption and realizing the value of the deal for shareholders. In a combination of businesses close to home the complexities of such an integration are clear, you are familiar with the challenges of business, and integrations issues cannot hide. However, if you are making your first acquisition or are moving into a new geography, then what is meant by integration is often difficult to see. If you have just bought a company in a country in which you currently have no operations then what is there to integrate? Often your deal synergies are the geographic expansion and new markets, or the opportunities to reduce cost by restructuring your home base and migrating functions off shore. As companies globalize, move into developing countries, or those countries move overseas, integration takes on a whole new meaning.

Your ability to exert control of the acquired company, will underpin the success of your acquisition. Alignment of people is difficult enough in a domestic deal, but when cross-border you encounter wide differences in culture, business practice and outlook, religion and language; you will have to live with the fact that your company doesn't speak a common language because simply it cannot. Venturing cross-border exposes you to a list of new practices, regulations or laws that you are unfamiliar with. Conversely, you may require your new subsidiary to comply with your own regulations with which they are unfamiliar and unprepared. Ongoing compliance will come at a price which needs to be kept under control. And finally, we come to delivering the synergies and the integration itself. Exerting control is fundamental to providing you with a foundation to move forward, to taking your next steps in transforming your acquired business.

The Many Dimensions of Integration

In setting the course for your integration you consider various areas, from your vision through to the degree of integration that you wish to undertake. Integration of companies contains many moving parts, and often it is important to understand what comprises an integration. These are the dimensions of integration, non-exclusive but separately identifiable characteristics of the integration process. It is inappropriate to put these dimensions in order, however, and the base, the foundation of all other integration comes exerting control.

After exerting control you are then in a position to realize the Deal Case, to ensure that the business performs at least in line with how you anticipated, and included in your deal valuation model. This would also include taking the actions required to deliver those synergies or savings expected from the deal. You will also want to align processes, policies and procedures of your new subsidiary so that it operates in the same way, timeframe as the rest of your group. Alignment of operations is often associated with realizing the deal case, however, in entering new markets, various aspects of your existing operations, your exports or your procurement from the territory in which you have entered is overlooked and may need to be folded in to the distribution or supply chain. Then there is the embedding of culture. This can take a long time and is also not just one way. In crossborder deals the cultural gap can be so large it can easily jeopardize the entire integration effort. Sadly, many deals also fail to properly recognize the quality of processes and people talent in the acquired companies, and to repatriate those best practices and people into your wider group, but this step can often be a hidden synergy to enhance the performance and value of your group

The Components of Exerting Control

Control can be further broken down into a number of interrelated components. The emphasis on these components will vary on a case-by-case basis and also upon your specific concerns or "hot buttons". In setting the course for the integration and for exerting control, each of these areas would be considered, and built into your integration masterplan.

Ownership Initiation

Taking ownership of your newly acquired entity may be straight forward, in other cases it may be more problematic. Regardless, the obvious should not be overlooked, especially when the vendor is fully exiting the company. In addition to getting the "keys to the door", access requirements to your asset, and accesses granted to other parties should be identified and confirmed. Nothing should be immediately taken for granted if dealing in an unfamiliar territory. Corporate authority mandates, bank mandates, physical and IT security levels should be reviewed. While often a condition precedent to closing of the deal, external registrations, licenses, patents, contracts all may need to be changed, even if just in corporate name or ownership. The identification process may be something built into to your due diligence, but the execution can be complex and prolonged.

Treasury, cash and FX management

After spending a significant amount of money on the acquisition, you will be looking to instantly take control of the cash of your new subsidiary. This is especially so where you have financed all or part of the deal by new borrowing to which there will be repayment schedules and covenants attached. It will be important that you can channel that cash on a timely basis to meet your repayment requirements, which if dealing with a cross-border deal, may involve foreign exchange controls, varying exchange rates, and tax leakage. Other steps such as implementing cash pooling, bank rationalization etc, will be on your early post deal agenda.

Global expansion brings about the often enormous challenge of dealing with foreign exchange. During the deal itself, the foreign exchange profile of the company being acquired should be analyzed to understand what hedging measures should be taken or how you need to modify your existing practice to maintain efficiency post deal. Remember, the cash flows of a company in a foreign country are rarely denominated in the currency of that country, they are just reported as such. Overseas transactions can also lead to knock-on consequences to your entire group which you will quickly need to come to terms with, for example your effective tax rate will change, as will your group borrowing rate and weighted average cost of capital.

Governance and Compliance

Your new deal brings about various governance and compliance challenges which may be new to you. It will be important to analyze the governance structure of your new company, and ensure that you are properly embedded. Board representation may not be sufficient if it serves as just a rubber stamping body. You will need to evaluate your expatriate deployment strategy, how will they be effective and to what levels should they be deployed. Alignment management with your group visions and targets, and implementing incentives is one step. However, again in new countries make no assumptions. Corporate governance priorities and norms can differ from your home country, and shareholders may find themselves ranked far down on the priority list. Crazy as it may seem, direct financial incentives do not often achieve the desired results, and indirect motivators also need to be considered.

In today's world, the spectre of compliance looms large over every company. Entering a new territory just adds to this, bringing unfamiliar requirements in the

local territory sometimes which conflict with your own. Information requirements can appear onerous. However, the need for compliance is there, and this should be planned from very early in the deal, especially where there is a day one requirement to ensure compliance requirements can be met in a cost effective way. Delaying closing by a matter of days, can sometimes impact the first date to become compliant by months or a year, which significantly reduces the burden and hence cost.

Financial and Management Reporting

How is your new subsidiary going to report to you, in the method and format you require, to the level of detail you require, and in the timeframe your require? These may seem like simple questions, but they underpin an enormous challenge to taking control. In some cases, the deal itself will have external reporting requirements, which should be identified early in the deal process and embedded into documentation. Then comes your purchase price allocation, your first quarterly reported results post-deal, and the list goes on. You do not have much time, to get financial reporting up and running. You will want to establish KPIs for your new subsidiary, and receive management reports, all of which may be new to the company. Even in today's international world with growing use of international reporting standards, we are not there yet, and there remain many different local reporting methods, and you will need to implement and train staff in your new requirements.

The challenges of financial and management reporting when going into new territories can be massive, but begin on closing. Careful planning during the deal is a must, as is a pragmatic approach to temporary and permanent solutions.

Validating your Due Diligence

Each deal is different, as is the level of access that you can get in performing your pre-deal due diligence. It is important to move as quickly as possible to complete a detailed due diligence of the company, even if it means continuing post deal. If there are skeletons to be found, it is better to find these now rather than later. During your due diligence process, even if it is comprehensive, you make assumptions and rely on representations of the vendor and management, not all of which can be captured by legal documentation. You will also develop your analysis on synergies available from the deal either from revenue growth or cost reduction. Were these right? As soon as possible you should move to validate these

assumptions, and build plans for their realization in the integration process, or take appropriate countermeasures. Above all, in assuming control do not hand over responsibility for validating assumptions to those who made the representations in the first place

Effective management of people and cultural differences

Finally, we come to the issue of people. However, people issues come at the beginning, middle and end of the control process. You can take all the processes, implement all the systems, but without the alignment of people, few if any of these will operate. As you set the course for your integration, you should understand and plan for the organization of your new subsidiary, and carefully plan communications. In all integrations, these are complex and important steps to get the buy-in and cooperation of management. However, in cross-border deals, you have different languages and cultures to deal with. Choosing words carefully is one thing, but ensuring they are translated properly, and delivered in the right way can often be beyond your control. Additionally, people always judge things and make decisions from their own perspective. What drives and motivates employees in your own country, or how you operate, is likely to be completely different. Early on, you should identify these differences, and begin the long and uphill task to bridge them, and turn the differences into positive attributes rather than negative forces. Communication is vital here and opening up a two-way communication process indispensable to mutual understanding and respect. Have you ever had emails ignored? Calls not returned? Sometimes it can be simply do the lack of understanding, or insecurity of language.

In Summary

Integration is often talked about in terms of value to shareholders leading to an obsession with delivering synergies. However, this approach is flawed from two perspectives. Firstly, in most cases synergies represent only a small proportion of the value compared with that of the existing business of the target the continued performance of which depends on the smooth transition of ownership. Secondly, and more importantly is control. Value is derived by the formula of cash flows discounted by risk, failure to exert control over your investment goes to increase your risk position thereby reducing value derived. While fundamental exerting control quickly helps to de-risk your investment, and potential could help create value. There is wisdom in the phrase “Don’t forget the Denominator”

How we can help

Crossborder expansion is an inevitable part of globalization and brings with it exposure to unfamiliar rules and regulations, different languages, and people from different cultures who think and act much differently than yourself. Crossborder PMI Advisors helps our clients navigate these challenges and to engineer success.

Crossborder PMI Advisors offers a wide range advisory services on both the buyside and sellside of cross-border deals. All services are specifically tailored to working in a multicultural crossborder environment, and range from cultural and overall PMI advisory services, to a modular approach to PMI, Carve-outs, Joint ventures and alliances, and other related areas. As such we offer a flexible approach to working with our clients, including working with your other PMI advisors in a cross-border SME capacity.

At Crossborder PMI advisors, our mission is simple: To help our clients succeed in cross border M&A. The key to crossborder success is to do the right deal, to pay the right price, and to manage your investment through realizing synergies, reducing risk through effective governance, managing people across cultures, and global leadership.

We look forward to working with you on your global journey. Please contact us any time for further information and to discuss your needs at: **info@xbpmi.jp**

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