CROSSBORDER
PMI ADVISORS

How to be successful in cross-border deals

Introduction 3

New Deals
1. Choosing the Right Deal..6
2. Paying the Right Price..9
3. Managing Your Investment
   i. Realizing Planned Synergies.................................14
   ii. Introducing Governance and Controls.................16
   iii. Managing People across Cultures..........................22
   iv. Leadership..25

Past Deals
1. Continuous Review...29
2. Remediation Diagnostic...30
3. Transformation...31

In Conclusion...33

How we can help...34

Introduction

An analysis of corporate Japan reveals two interesting characteristics. Firstly, in many sectors, there are a large number of participants and the market share of the top three players combined is little more than 50%. Secondly, in many more sectors, if not close to all, the size of the entire Japanese industry is smaller than the global top three or so players. With a gradually decline of the Japanese market place, and the emergence of new lower cost competitors from developing countries like Korea, China, Taiwan etc, this can only mean one thing: change is going to come. This change may manifest itself in the consolidation of the domestic market, or in a trend of globalization to reduce the dependence on home base. Which, will vary sector by sector and depend on the strategies of each company, but all of this will without doubt see the continuation or even acceleration of the waves of M&A.

It is often globally reported that over 75% of Deals fail to meet expectations due to insufficient PMI. Is this also the case in Japan? The answer is probably yes, as in our experience extensive PMI is only undertaken in around 10-20% of cases that we see. However the uniqueness of the Japanese M&A market needs to be considered. The market is typified by a large number of small deals (compared to mature markets). For larger deals (say exceeding JPY10 billion), in recent years, around 70% have been overseas investments, so called In-Out deals, which present greater complexity, but also are cases where the meaning of PMI is even less clear (there is no merger, there is nothing to integrate into). Such deals touch upon the biggest challenge of Japanese businesses, management of foreign management, resulting in the most common 'omakase' (leave to you) approach or other delays in the integration process. In many cases, such businesses never really get integrated and never really truly perform well, leading to a growing dilemma facing companies of whether they should close or sell such operations or undergo a restructuring process.

But this doesn't explain the full reason behind the reduced levels of PMI at the time of a deal. In the US, a great deal of literature explains the importance of PMI in capturing synergies in an accelerated time frame in order to protect value and deliver the business performance used to evaluate the business, and which was often reported to shareholders at the time of the original deal. Japanese deals often differ from US counterparts as the business plan most frequently used for business valuation purposes is that of the target management. US deals would also consider some of the synergies from the deal in coming up with an aggressive valuation, meaning that after the deal "business as usual" is not an option, pressure is on to

deliver the synergies and quickly, otherwise the investment will soon be seen to underperform. This means greater urgency on PMI. Japanese deals more consider such synergies much less, especially in early years, leading to a “buy and hold” tendency.

If globally, over 75% of Deals fail to meet expectations, then at least this %, or maybe even higher, fail for Japanese companies. Recently, this has seen a lot of publicity, with significant impairments being recorded on high profile big ticket Deals. There has also probably been many other smaller impairments, which have failed to make the headlines, and if not impaired, there is a common acceptance that expectations were not met, and that the companies are becoming burdened with heavy investments made earning little or no returns, “the Zombie Deals”, which are eating up corporate capital and not adding value to the group.

It is unfair however to blame PMI on the root cause of all issues, it is not. PMI is just the end of the M&A process, and the PMI may fail because of mistakes being made earlier in the deal, setting unsurmountable hurdles. We discuss in this analysis the key to success in cross-border deals, and provide tips on how to best avoid impairment. While cross-border deals are referenced, most are also commonly applicable to domestic M&A. The whole concept can be summarized in that to be successful in cross-border M&A, you should focus on 3 key areas:

i) Do the right deal
ii) Pay the right price
iii) Properly manage and integrate your investment

As the last area (iii) involves the broad, and often misunderstood area of PMI, it is also probably better to subdivide this into four sub-themes:

a) Taking action to realize synergies
b) Introducing appropriate governance, controls and incentives
c) Managing people, which in the case of cross-border deals means managing across cultures.
d) Leadership

In the following sections, we will examine each of these, firstly from the point of view of new M&A, but then to also consider deals already completed, and what actions can still be taken (or must be taken) to improve success and at least reducing the risk of future impairment.

New Deals

Choosing the right Deal

Choosing the right deal sounds easy to say, but in practice is one of the most difficult challenges to face. Embarking on the M&A process requires consideration of your corporate strategy, and the approach to deal origination. There is no right answer, but both have risk components which should be assessed against each other such that there is a full understanding of the undertaking being proposed.

It is often said that it is unclear whether companies have a bad strategy or bad strategy execution until after the result. Bad strategies arise from not understanding the environment, being unwilling or unable to change, or ignoring reality or facts which lead to misjudging the strategic shifts or other disrupting factors in the market, which in today's day and age are occurring at a rapid pace and in ways never previously imagined.

There are probably four types of companies:

a) Those with a superficial or no strategy towards market changes
b) Those with a clear strategy, which can be validated and proven to be right by detailed market analysis, but with no clear underlying plans as to how to execute against the strategy
c) Those with a clear strategy, but which embark on poor execution; and
d) Those with both a clear strategy, and strong strategy execution

It is often said that it is unclear whether companies have a bad strategy or bad strategy execution until after the result.

A good strategy requires validation. Validation involves varies aspects. Firstly, it includes detailed market analysis, either in house or by professionals, analyzing the market and related drivers of product demand, substitutes, pricing trends, technology, customer trends, delivery trends, and marketing. The analysis should not just include market factors, but also the underlying operating model and operating cost changes, and the cost to fulfil that market demand. This requires information and an organization built with an ability to channel information quickly to where the decisions are being made.

A good strategy should incorporate a vision, but also flexibility. Rigidly following a planned vision will often lead to a lower level of success than a flexible strategy and open mind to identify and build in new things along the way. Similarly in execution, many companies are tied to rigid processes and timelines, whereas greater success can be enjoyed with agility.

Validating the market side of the strategy though is only part of the story. Validation should also include leadership and the ability to execute. Is the leadership team aligned and committed with the strategy, is it working cross functionally to drive all critical success factors in execution, are leadership incentives all aligned to the same goals. These are all difficult questions, but above all of these is to test if strategy being followed is for corporate success or is it based on the number one cause of failure: 'Ego'.

Ego has the impact of blinding leadership to the true results of the validation, and the ignoring of reality or facts, so the deal teams set off on deals, which are not aligned to strategy, and the hurdles to achieving success begin rising.

Next to consider is the source of deal. Here there are both demand side and supply sides to consider, as well as the cost benefit analysis of pursuing a deal origination initiative, or proceeding with a deal to the next stage. A pragmatic approach is recommended. Deals can come about from a number of sources. Firstly, many deals and often the most successful come from existing relationships, trading partners, distributors, suppliers, licensees or licensors. The reason for the success is that you have extensive existing knowledge and, through the relationship, the fit with your existing operations is to a large extent proven, and extending the operating model is controllable. However, these cases of horizontal or vertical integration offer lower opportunities to generate synergies (they may offer changes to extend your overall profits, but you pay for these through the deal, and these profit increases should not be confused with true incremental synergies).

Another route to a deal is through strategic planning, carefully analyzing capability gaps, market trends and drivers, and then ultimately long list to short list targets. This approach has the benefit, if well executed, of self -validating along the way. The downside of this approach adopted in isolation, however, is twofold. First, a huge amount of time and cost can be expended without sufficient consideration of the availability for sale, so when door knocking begins all effort can be in vain. Where possible, testing availability for sale at an earlier stage pays rewards. The other downside, which applies commonly to all sources except for those existing relationships, is the analysis of cultural fit. Culture can apply equally to both national and organizational cultures, and in cross-border M&A expeditions some of these cultural gaps can be substantial. Cultural differences will become a very significant factor in the later stages of deal execution, and these should be considered at the strategy phase too. While it may be unheard of for deals to be abandoned at the strategy phase because of lack of cultural alignment, this may be a naïve mistake, as many deals undertaken fail to perform because of this very reason.

Now enter investment bankers, who sometimes have an image of pushing deals on their clients and to have some level of conflict of interest between their own fees and their clients. Many are rewarded based on success fees, which in reality are success that the deal has closed, and not that the deals are themselves successful and live up to expectations. This risk of the latter is left up to their clients and their other post deal advisors. Does this mean it is not a good idea to involve investment bankers? Absolutely not. Use of investment bankers in deal origination is to be encouraged. They have large networks and huge amounts of market intelligence, and in many sectors they have analyses as deep as you would be trying to go by your own research, but above all they can bring you a wide variety of deals for you to review and to pick and choose from which are either known to be or have a high probability of being available for sale. The challenge then for you is to assess or validate the pros and cons of each, selecting which are closest to your strategy to proceed with.

The final source of deals, which most definitely have passed the availability for sale test are those which are brought to you by investment bankers working for the sellers who are soliciting bids. This type of deal can be very common, but the biggest challenge is there are likely to be many competing companies looking to buy the company in an auction process. In a very short space of time, you will be required to assess the targets strategic and cultural fit to your group, and to develop an offer based upon a controlled flow of incomplete and insufficient information. This in itself is very challenging indeed, but in addition you will have to deal with the uncertainties regarding why is the company up for sale, is management really committed to the business or to the sale itself, are the financial plans really those of management or those of the seller, and how should you respond to the deal strategy issues given the competition in the deal. All of these matters put pressure on you to overpay, or pay a premium to secure the deal, which also may have come at a time outside of your internal plans.

All in all, choosing the right deal is your first obstacle. Engaging bankers certainly facilitates the potential deal flow, but strong and pragmatic internal capabilities are essential to decipher the opportunities being brought and validating them against you strategy. Again, having a clear strategy in the first place against which to rapidly validate is a must, as is the flexibility to recognize new opportunities not previously envisioned and to take controlled risks if appropriate.

Paying the right price

In M&A, there is never truly a right price, all depends on the situation. All deals are concluded between a willing buyer and a willing seller, at a price which the seller is willing to accept, and that the buyer is willing to pay. To determine if this is "right" or makes sense or not for prospective acquirers, requires a look at the expected returns from the investment made, and whether these are accretive to your cost of capital. If not you will soon begin to have an impairment risk.

There is a common myth, that undertaking a comprehensive discounted cash flow analysis of the management business plan is the key to paying the right price. Of course the DCF is important, but valuing businesses in such a way is insufficient, as it supports a deal, which in most parts results in an exchange of assets which have a determinable value, such as cash, with a whole business which is based on a plan of unknown accuracy, and risk assessments, which are by definition, estimates.

The alternative approach is to look at what you need to pay to succeed in negotiating this deal, and to compare to what you get and what returns you can reasonably expect to achieve. The differentiation of what you need to pay, and what you should be willing to pay requires a careful balance.

What you need to pay depends on the market at the time of the deal and the competitive factors in the deal itself. The base information for this in all cases is the management plan, and if possible applying a degree of skepticism, either generic or taking in the specific assessments from your due diligence (see below). With this information you can undertake a discounted cash flow analysis, apply market multiples, or compare to similar transactions to derive an indicative value. This is straightforward enough, but then the hard work begins, the qualitative assessment of whether such a value will win the day. Some of the questions you need to ask, may include the following:

- What are the sellers expectations?
- Who are the competitors on the deal, and what are their likely assumptions (eg. Will PE players offer greater value through their leverage model?; Do other trade buyers have a more obvious synergy expectation?)
- How far are you likely to "bend" or change your risk position or other hypotheses?
- How badly do you want the deal, and what is the impact to you existing business portfolio if you do not do the deal
- A potential question could also be how much damage you could do to your competitors if you did the deal instead of them.

Each of these, can drive your thinking around the price you need to pay to secure that deal, and the amount in excess of the DCF valuation is called the deal premium. In addition to the premiums you should not under-estimate the one-time costs you will incur in the execution of the deal from investment banking fees, debt raising fees if applicable, due diligence and integration costs, which combined could add anything from 3-10% to your deal costs, maybe more in cases of complex carve-out deals.

So is the deal worth it? That all depends on your returns from the deal both directly and indirectly. The starting point is the value of the business you have acquired, and this is where thorough due diligence of the target and detailed deal modelling is important. In our experience, most deals get presented with famous "hockey stick" growth in their business plans, meaning that after showing some instability or a flat business in recent years, immediately following the deal there is expectation of sales and earnings growth. All of this will be no doubt eloquently explained, by the vendor and often Target management, with various data in evidence presented to persuade you.

Our Recommendation: Validate, Validate, Validate

You should begin with a well thought through commercial diligence, through using your market analysis, or gathering independent new data, looking at movers, competitors, pricing trends, and technology disruptions. This will enable to assess the potential for achieving management plans, but in addition you will need to assess the Targets strategies to see if the path or activities being undertaken by the target form a reasonable basis for achievement. Validating assumptions using market experts or independent interviews are a good way of corroborating or not as the case may be, managements apparent unbridled passion to their plans.

It isn't just the top line, an insightful operational due diligence will not only confirm the current state of operations of the target, but will provide a basis to confirm the readiness for the growth platform, and the level of incremental investment in facilities, marketing, people etc to achieve the top line plan. A focused financial due diligence, will provide a basis for baselining the current recurring income levels, and also provide perspectives on working capital, and liabilities assumed, and capex, all of which effective the discounted cash flow. Your DCF should ideally be broken down into value drivers, and be able to run sensitivity analysis on which valuation parameters have the most sensitive impact on the valuation. And it goes without saying, you should apply a sense check to all those factors, making sure each assumption passes the smell test (eg in most cases a hotel cannot have more guest groups than rooms!).

Another source of validation comes from structure. The underlying premise of a discounted cash flow model is that the income of the business can be accessed by the shareholders. This hypothesis will need validation against the tax and interest leakage, and also the FX risk associated with those flows.

In valuation in addition to the cashflows, we need to consider the risk. Do not forget about the denominator. We will not go into to the complex theory of discount rates, but it should reflect all risk. Most valuations include a lot of theory followed by a risk premium, from some reference source, such as Ibbotson for example, and then go on to consider "control premiums" or "minority discounts". For all read: fudge factors. With all the intricate analysis and emphasis or theory, and the often great sensitivity of value to choice of discount rates, at the end of the day there is often resort to significant "standard market practice" adjustments.

One Risk which is often overlooked, is your own and target management's capability to deliver the plan,

Risk has many components, but the one that is unique, is often overlooked, and the most difficult to assess. This is your own and target management's ability to deliver the plan, do you have the right capabilities and skill sets required, and are these proven. Whether internal delivery risk is a discount rate adjustment, or a sensitivity run in your model is irrelevant, but such risks are ever present.

On top of the business value comes the returns expected either upstream or downstream from synergies. A joke in the M&A community reads that a synergy like a Yeti, it is something often talked about but very rarely seen!. The moral of the joke is that in addition to the business plan, the synergies used to evaluate the returns from the deal and to support the premiums you are proposing to pay should also be thoroughly validated.

A synergy can be defined as an operational factor arising during the deal process where the integrated result is greater than the sum of the underlying parts. In Japanese M&A, synergies are often not included in deal valuations, helping to reduce the pressure on delivery to avoid investment write down, but they are often discussed as vague upsides to deals and form part of the long term investment strategy. The synergies most commonly discussed are sales increases through cross selling of products and overhead cost reduction. In reality these represent only a selection of synergies available and operational and cash flow improvements can be found across the value chain by considering 8 drivers, which are described below.

Site performance: This relates to the efficiency of any facility in an organization, often a manufacturing location, but in principle could be considered to be any facility in the group. The synergies to be had would include optimizing of asset utilization and plant capacities across the expanded portfolio of sites, potentially redesigning the processes across plants (such as sub-assembly and final completion), and rolling our best practices across all plants including quality improvement programs.

Asset Footprint: Asset footprint improvements relate to the potential reduction of the number of sites within the expanded groups. Just as one would consider the elimination of duplicate back-office departments, while more complex to execute great savings can be obtained from rationalization of facilities, from either economies of scale, or through the reduction of logistics costs from complete integration of the supply chain with that of the acquired company

Commercial Optimization: Commercial optimization is more of a philosophy than a synergy, and relates to trade-offs to optimize profits. This could include accepting the costs of a higher product return rate, versus the additional cost required to maintain quality to achieve lower returns. This could also relate to price point decisions, inventory, lead time and delivery practices. Synergies can most often be found either from the rolling out of best practices across the group, or through changes in brand position or portfolio strategies.

Revenue Enhancement: Revenue enhancement is the most visible and most common synergy. Acquiring a company with a new sales force and a new distribution channel, in many case opens up the opportunities to cross sell products through the different channels either as straight exchanges or through the increase ability to combine complimentary offering of products and or services. Many deals are undertaken to acquire new technologies or the get access to new R&D programs. These too enable the opportunity to gain significant revenue increases, or conversely help protect from revenue threats to your existing business from technological changes.

Strategic Sourcing and Supply Chain Improvement: Logistic cost synergies from warehouse footprint changes are considered above. In addition to these acquisition provides an opportunity to revisit your sourcing strategy and value chain. Synergies gained can be moving to the best of both worlds, but in addition the increases purchase and logistics volumes provide for greater purchasing power, volume discounts and often greater efficiency.

Overhead Reduction: Overhead cost reduction is probably the most common synergy considered, and certainly the subject on the minds of most management in an acquired company. While there may be legal restrictions in some countries, practical considerations, and difficult talent selection and retention decisions, it goes without saying that a group wants to minimize the duplicate infrastructure and overheads. Cost reductions can be found in many places such as streamlining reporting lines, reducing legal entities, and moving to in-country, regional or global shared service centers. Cost reduction should not just consider organization and functions, as while it may sound unusual it is not uncommon especially following a deal for duplicate payments to build up (eg. Two or more corporate memberships to the same organization.)

Working Capital Improvement: While many companies consider cost synergies, fewer go as far as considering cash flow synergies, yet opportunities exist. Working capital improvements may be had by first harmonizing existing practices, but then going on to consider improvements from being part of an enlarged group, your ability to extend payable settlement, or demand short receivable collection. Inventory reductions follow your asset footprint and supply chain changes. Additionally, in an enlarge group you have greater flexibility to drive efficient intercompany settlement and treasury practices. Remember, cash flow also includes group interest and tax leakages.

Sales Channel Rationalization: Again sharing of best practices and harmonization provides the potential for synergies across the sales channel. These are likely to fall into one of four categories. Firstly there is the opportunity to revisit your strategy and focus, this is likely to have already be considered as part of your deal rational and your sales growth blue-print. Synergies are possible in process and skills and your combined approach to key account management. Similarly there could be structure and organization changes to rationalize the in-house channel to market, the leveraging of third party channels by enhancing support and management tools, and identifying effective pull strategies to expand into small and medium size accounts.

Synergy identification can begin even before the due diligence phase, when you can start building hypotheses for testing during due diligence. Again a rigorous commercial and operational due diligence process will support the identification of other synergies and validate assumptions, enabling a prioritized synergy plan considering size, risk and ease/cost of implementation, for incorporation into you growth blueprint and your overall integration plan. The key to success is not to try to do everything but to follow a well-planned and structured execution schedule.

Managing your investment

When the deal is complete, your attention should be focused on managing the investment. It is strange to think that many companies put a huge amount of effort into getting the deal signed and closed, but then fail to properly manage company post deal. Taking the approach of business as usual might seem a safe course avoiding disruption, but in many cases the target companies management and employees are often expecting something different. They have just be sold off by their former owner, and if previous were a non-core business, are likely to have been ignored by their former parent, and potential starved of funds to help them develop the business. A miscommunication that nothing will change starts your relationship off on the wrong footing. Even with top management, a "omakase" (leave it to you) approach, suggesting local management know the business much better than you do, and that you wish leave management to them, immediately leads to setting off on a path which is difficult to divert from. Previously the business was managed under the previous owners strategy, with KPIs and incentives aligned to that strategy, so if no changes in direction are made it is highly unlikely that your strategic objectives will be met, and management are being incentivized to do the wrong things.

In this section we will analyze how to manage your investment, by looking at a number of areas, how to go about realizing synergies; how to take control and what governance to put in place; how to manage people, especially across cultures in cross-border deals; and finally how you should go about leading the new business, and what leadership skills are required.

Realizing planned synergies

As discussed earlier, synergies are an important part of not only bridging the value of the business and the cost of your investment inclusive of all transaction costs but also as a driver of the returns on your investment and creation of value. The returns should be emphasized as your deal will not create value if the DCF of your business plan including synergies is only equal to the price paid, that is merely a like for like exchange of value. To create value you need to exceed the price paid.

We have discussed the nature of the various synergies that you might contemplate or target during the deal, and it is hoped that these have been validated during the execution phase. If not, do it immediately as you will be running blind in the face of impairment.

But identification and validation alone is not enough, synergies need to be realized and for that, rather than a wait and see, action is required. Most global discussion around PMI focusses on the importance of a rapid start integration, and rather than analyzing and focusing on doing everything possible, prioritize your actions and your scare resources to take 20% of the actions required to get 80% of the result. Doing nothing not an option. Realization of synergies requires change, and to begin to make the change you need to start by unlocking status quo and get buy in from management. In a deal environment, there really is no status quo, something has occurred, and people are eagerly waiting to hear and experience what the future holds.

An accelerated integration is much better than a prolonged one. Of course the latter gives people time to acclimatize to the changes taking place, but this should be measured in getting the pain over with quickly, so that results can equally be seen quickly which has a snowball effect on motivation and the willingness to undertake further change. A boring process driven integration with invisible or hidden results, slows down progress, and reduces value.

An accelerated integration is much better than a prolonged one.

So how should you go about realizing synergies? First, you should document the deal rationale and the integration blueprint. This sets out the objectives of the integration and how it will be undertaken. The top down discussion takes your group vision, and philosophy and clearly relates this to your stated strategy. This should have already be done through the deal phase, if not do it, and at least use this as a basis of your next consideration. Next, take you strategy and break this down into measurable components and identifying the touch points within the operations at both HQ and in the target company. Begin to link these touch points with the identified and validated synergies, and the set out the integration landscape function by function as to what is anticipated by day one, by day100, within one year and what is the end state. Of course, this is not a one way discussion, this involves the target management and is an important part of getting their buy in and identifying their respective KPIs
Next work should begin by prioritizing synergies. This is done by documenting business cases for each synergies, with quantifications of each, and execution factors such as the difficulty of realization, the probability of success, and the realizations costs. Consideration should also be given to identifying dependencies between the synergies to determining if an order of implementation is required, and the extent of cross functional teams to be included. Through a deep assessment of synergies, and mapping magnitude and ease of implementation,

the low hanging fruit stands out and you can come to a pragmatic phased approach of wave 1, wave 2, wave 3 synergies to build into your plan. The target is to achieve 80% of the targeted results with only 20% of the effort. In reality, it is never that clear, but you should not be wasting your scarce resources trying to do everything at the same time. Greater damage can be done by taking your eye of the core existing business, which in many cases will make up 80% or more of the value of the business.

To realize synergies you need an actionable plan. While day one readiness activities maybe largely functional with a few dependencies to address, synergies by their nature are likely to require group wide cross-functional effort, and formation of agile cross-functional teams are recommended. The first step to developing a plan is the creation of synergy maps. To take the business case, and to map what activities will be the drivers of change and then down to the actions function by function. This is often best achieved in a workshop forum, which itself helps cement the collaboration required to achieve success. These plans then provide milestones and a clear roadmap for execution.

Overarching these plans will require two other things, robust project management and progress tracking. Project management needs to be pragmatic. Micro-management achieves nothing except for lots of effort and downstream irritation, but being too hands-off risks milestones slipping. Project management should be supported by user friendly reporting tools, to enable clear reporting to senior project owners, and to capture the risks, issues and dependencies for escalation and decision making where necessary. Progress tracking is often sensitive, as it can be seen to report too much accountability, but from a top level perspective it is essential to providing continuous validation of the business case, and indicates the need for countermeasures should any of the previous assumptions prove inaccurate when it comes to execution.

Reducing Risk: Introducing governance and controls

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.

Value creation is a combination of increasing cash flows while at the same time reducing risk.

Your ability to exert control of the acquired company, determines how you will be able to reduce your risk and 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"*

Managing people across cultures

Deals do not underperform or fail by themselves; they underperform or fail because of people. People are responsible for taking the actions necessary to realize the planned synergies and deliver the expected results from the acquired business. Similarly people are also responsible for getting in the way of change, for deserting their position, and for all being the root cause of all integration problems. While during the deal number one priority may be the agreement of valuation, completion of due diligence and negotiation of legal terms and conditions, post-deal all this paperwork has little meaning without the people being onside and aligned to achieving a common goal.

Management of people issues is a broad area. Firstly, there are the differences in culture, which are present in all deals, but can be bewilderingly wide in cross-border transactions. Effective communication requires extensive planning to reduce the wasted productivity from employee speculation and gossip. An effective organization not only needs to be designed, the flows and the processes behind it need to be implemented. Management and people for key positions need to be selected and retained. Measurements and incentives aligned to achieving your goals need to be rolled out, and of course you need the HR infrastructure, and systems to enable your new operation to function. There can be no greater challenge than all of this.

Let's take a look further at each of these issues.

People always make judgements and decisions from their own perspective and understanding. In a cross-border environment that includes different cultures. A persons underlying national culture doesn't really change, it has been embedded in their personal behavior since around the age of seven. Each culture has different attitudes to hierarchy, to individualism, to obsession with achievement, adversity to risk, pragmatism, and restraint. To begin to address culture, it is imperative to understand these differences and how they may impact the integration process. This understanding needs to be shared with the target as such issues are two way. Remember the phrase "when in Rome, do what the Romans do".

Despite overwhelming evidence that cultural issues must be addressed swiftly, many executives believe it is possible to merge cultures gradually through contact and interaction. Unfortunately, cultures cannot be merged my waving a banner proclaiming shared vision and values. Cultural change does not come from

newsletters, logos, or posters. Cultural acceptance (as opposed to change) comes from deep understanding of the different behavioral characteristics, the gaps and the desired behaviors to support the business strategy. Cultural stereotypes need to be recognized and addressed up front, and turned to be a positive force, rather than left to become a derogatory factor. Of course such behaviors are two sided and not just one, and full inclusion in the behavioral analysis of all stakeholders prevents destructive "us and them" forces from winning.

When asked, management of a US company, which was acquired by a Japanese company and failed to live up expectations, said "head office never told us what they expected us to do". They were told to continue "business as usual", but that was aligned to the vendors overall strategy, following their processes, their KPIs, and their rewards. Take the vendor away and you have a ship without sails. Effective communication and with content which anticipates and addresses the concerns of the target is indispensable and needs to be prepared in advance. And remember in cross border deals, what is normal in your home country is not necessarily the case in another. Japanese companies may have a clear hierarchy and norm, but it the west management need answers to 5 simple questions: Who is my boss, what are my responsibilities, how will I be measured, how much will I be rewarded, and what are my career/promotion opportunities. Without communication on all 5 of these areas, people will begin to speculate about the acquirers intentions, and if you have a business of 1000 people, each gossiping 30 minutes a day about their future, that becomes 2 man years of lost productivity per week. These communications should be made clearly, and often, beginning with a welcome pack to all employees of the newly acquired company on day one addressing their concerns upfront, and introducing a process for feedback

Just as when you mix chickens together you disrupt the hierarchy and status quo leading to chaos and fights, bringing two sets of management together presents similar challenges. Developing and making clear the new organization structure is important, however, organization charts alone are more about authority and power, and not about function and accountability, and how information should flow, how processes should operate and how decisions should be made. These other matters should be the focus of clarification.

Within the new organization you need the best people, and the process of selecting these should begin even before the deal gets consummated. The biggest danger and the most common mistake is either favoring your own people who you are familiar with or trying to be impartial sharing positions between two legacy teams. Management should be analyzed based not just on capabilities but also based on

their operating style and fit. In this respect, a common dilemma faced by Japanese companies is that of sending expats to their overseas acquisitions, which are often for the sole reason for being Japanese or the HQ eyes and ears alone. The lack of clarity of their roles and responsibilities compared with incumbent local management often causes confusion and attrition. These roles should be clearly defined and of course communicated.

Above all, key management are critical to your success and need to be retained. Identification of these key management should begin at the due diligence phase and appropriate retention packages offered. It is often best to identify key management top down with a cascade approach, as your top manager will be quick to tell you who he needs to help him be successful. Packages are generally lump sum, and should be contingent on time alone. Performance factors should be rewarded by a carefully designed KPI and reward structure, aligned to the overall business strategy, as such continuity of same measures as in the past should be a rare alternative. In many cases continuity of previous plans will not be practical and such plans require replacement.

Replacement of employee benefits is a complex process and often the devil is very much in the detail. You will probably not have received sufficient information during your due diligence process to identify all benefits for replacement, and you should prioritize to do so between signing and closing. While insignificant to you, loss of a small benefit, such as a lunch voucher for example, upon change of ownership, is much more concern to an individual giving rise to concern and the onset of negativity. .

It is not just benefits that need replacement, but potentially HR policies, and performance systems, and related infrastructure. Being unable to pay your new employees after change of ownership, spells the onset of disaster.

While all of the above presents a tremendous challenge, careful upfront planning and close attention to such people matters, and related communication can yield great results. After all the employees of a company that you have just acquired, are also the employees of a company that has just been sold off. You represent their immediate future, as much as they may determine yours. Planning, communication, and alignment to your strategy will yield the results you expected.

Leadership

Strong leadership is a pre-requisite to success in cross-border deals. Corporate leadership is really a combination of organization and management structure and the absolute attributes of the leaders (top management) themselves.

To begin with the management structure, as you expand, so will your global governance model and organization need to evolve. Initially, you may have an HQ organization, with an autonomous country management. As your overseas operations become more significant, you may begin to deploy expatriates to manage on behalf of HQ. The challenge with expatriates however is twofold, firstly to define their roles and responsibilities which are understood by all and are complimentary to the activities of incumbent local management; and secondly, to determine how they will be effective within the local governance model without introducing parallel management. Expatriate deployment also comes with a cost, which should be evaluated from a cost – benefit perspective.

As you expand even more, you may regionalize, or globalize, certain corporate functions, or take the alternative route to organize globally across business unit lines, or even both. There is no right answer to the right organization structure, and much depends on management style and strategic objectives. The two most common structures are the pyramidal structure and the matrix structure. The former promotes hierarchy and also becomes less effective in handling competing priorities (eg. Business group, function, or geography) as these will have been embedded in the structure at the outset. The latter, which could be two dimensional, or multi-dimension achieves additional focus, but can quickly become overwhelming and confusing, with anarchic competition, silos, and excess cost. Which structure you follow will depend on the nature of your business, your growth strategy, and quite often the predominant culture nationally and organizationally.

Your final metamorphosis will be to break down the barriers of nationality and location, and implement a management structure which draws on your full capabilities regardless of nationality, regardless of where they entered your group, and regardless of where they are currently located. Drawing on your best talent is encouraged long before you are branded a Transnational Corporation, as this ensures you fully utilize the capabilities you have within your group, and moreso break those actual or perceived glass ceilings motivating subsidiary management. In reality, differences in culture and language, physical and time difference, and

simple xenophobia creates high hurdles to fully realizing this final step.

Whatever the organization structure, success will not come without strong management and leadership at an individual level. Both are important and distinct. It is said that leaders are the people who do the right thing, while managers are the people who do things right. In a global organization the greatest challenge to leadership is culture, which varies country by country. Each country has different levels of accepted hierarchy, and different levels of individualism as opposed to collectivism. This will determine the management style which will work well, and those which will not work well in each country.

Leadership styles can be broken down into 5 types. First, is the Authoritarian type where decision making is made top down, which is found in hierarchical societies such as Russia or South America. Here there is the expectation of an authoritative but benevolent boss. Next is Participative leadership where managers are involved in the decision making process. Another level is the Free-Rein style of leadership where decisions are fully delegated down within management who operate within a clear KPI framework. Within western countries which are strongly individualistic, leadership tends to follow the Participative or the Free-rein style. Then there are the Leaders which are Task Oriented, and those which are Relationship Oriented. The former focuses on getting the job done, with lesser regard to the feelings of the team, where the latter focuses on harmony within the team to work together. These styles are said to aligned to male and female leaders respective, and found in German/Japanese management and Nordic management respectively.

With these different styles the challenge of leadership of MNCs or TNCs are evident. Not only is the leader influenced by his own inherent culture, he is managing people from many different cultures each with their own expectations of leadership. Giving too much free rein in countries with an expectation of authority, is going to lead to loss of respect, and inaction.

Irrespective of country, however, a good leader is one that is proactive and creates a clear vision; one that motivates management to share in that vision with a philosophy of hard work produces good results which in turn provided good incentives or rewards; a leader which manages delivery through the setting of clear KPIs aligned to strategy; and a leader which coaches and builds a team, including the development of future leaders. It has been said that the qualities which are required of a strong leader are passion, integrity, strong communication, loyalty, decisiveness, competence, empowerment and charisma.

However, in a global environment the biggest quality of all is the ability to distinguish between global solutions and local solutions, and to exert leadership without hinderance of language differences between himself and local management teams. This does not mean necessarily speaking the same language, but exerting the same level of leadership as if they did.

Past deals

Let us now assume that you have developed your strategy, and found the right deal, you have paid what is considered the right price, you have undertaken a PMI exercise and realized synergies, you have put in strong governance and controls, and you have managed to overcome the cultural issues. Things are going well, but its probably still to early to call a success. Your overseas investments are part of a continually evolving strategy and this means a continuous review process. It also means following up promptly when things seem to be going off track, diagnosing the root causes and remediating or moving on with the next chapter of your strategic development

Continuous Review

There are many areas of continuous review following your overseas investment. The first comes as an extension of your PMI process and the review if synergy realization. In the same way as PMI is broad and cannot be defined as a consistent set of activities, the duration of the PMI phase cannot be defined. Textbooks refer to 100 day plans, but in reality integration efforts and with them the realization of synergies continue for months if not years after the first 100 days. During the PMI phase, you will have implemented a process for tracking the achievement of synergies, and this should continue while the synergies continue to be realized especially if there remains continual reporting to shareholders. This will vary on a case by case basis but probably for at least one full year budget cycle, and eventually synergy reporting will become embedded in regular management and financial reporting.

It goes without saying that your businesses will be subject to continuous review from financial and management reporting, but the degree to which your original investment is specifically reviewed will depend on the overall degree of integration, and sometimes may become indistinguishable from your other businesses. There will however, need to be some tracking for impairment review purposes, but operationally the legacy business may lose its identity over time.

One area of review that is often overlooked but is highly recommended is a post deal review of your M&A process and/or your PMI process. This can be reviewed independently for comparison with best practice, or for compliance with your established internal procedures or play books, or simply from the perspective of achieving objectives. The feedback from such a review is a good way to build in

in your own experience into your procedures and play books and to achieve continual improvement.

Global markets and industries are subject to constant change. In response to this your group strategy will continue to evolve and encapsulated in revised mid-term plans. As part of that change, mature companies will critically review performance from a portfolio perspective. The level of portfolio can be many-fold from division, business unit, sub-unit, entity, geography or even product group or product line. This will show relevant contributions to overall value, and in the case of lower than threshold returns, decisions can be taken on whether to divest, wind-up or to take remediate actions.

Remediation Diagnostic

While it may be sometimes sensitive to acknowledge that a particular deal has not lived up to expectations, such cases happen. It is often said that 75% of deals fail to meet original expectations in some respect or another. In cross-border deals with the challenges arising from distance, language and culture, some symptoms that all is not well include HQ feeling they lack visibility, or cannot understand, or cases of requested action being ignored or mis-followed. In such cases, a review of the position should be undertaken to understand the current situation against original plans and to diagnose the root cause. While there may often be a combination of factors, the cause is likely to arise from one of the following areas:

a) *Strategy*: although the strategy may have been well planned, it is always difficult to confirm if the strategy is aligned to the underlying culture of the target, or target country. With hindsight this may require revisiting.
b) *Operational:* even with a robust PMI process, things might not fully go according to plan, and further changes or continued integration may be required.
c) *Organizational:* The governance model and organization structure over the company acquired may have been misjudged, and changes needed to structure, reporting lines, and KPIs. With this comes the difficult but real issue of people. Despite your key person analysis and retention plans, people do move on, which can leave gaps to be filled. Further, management you though were key and high performers before the deal may be less adapt at performing in your environment. People changes are common, but take care that you do not use people as the scapegoat for a different unidentified root cause.

d. *Governance:* Despite all PMI efforts, your governance model may not be appropriate for the business acquired. It maybe that a greater grip that was planned is required. Alternatively, it could be too tight strangling the targets operations and/or frustrating target management. When considering governance do not forget to examine head office and whether any upstream improvements are also required. Frequently, with Japanese acquirors the slowness of HQ decision making is often cited as a cause of underperformance at the target level.

Transformation

With the root cause or causes known, a plan of action can be developed. If it is a case of remediation of organization, operations or governance, then this should be approached in a similar way to the PMI process. A successful remediation will not just be an HQ action, as with PMI it should involve buy-in and clear communication with the Target. Obviously in cases of underperformance, and when the remediation comes with personnel changes, the approach and related communication needs to be well planned, but the emphasis should be on future success, as opposed to finger pointing as to what or who went wrong.

Of course, if the underperformance is significant and the situation is becoming distressed, then as with any similar situation, immediate action should be taken to identify the root cause and to "stop the blood being spilt". In addition to operational restructuring, there may need to be financial restructuring, refinancing, or in extreme cases resort to the legal remedies possible under the local law of the target.

If the issue is a strategic one, either that original hypotheses were misjudged or simply that things have moved on and the circumstances have changed, then it's time to re-strategize. This new strategy could be a group strategy, local strategy or a combination. Now with the freedom of access to local management and your growing experience of the local market, your revised strategy should be self-validating. The solution again could be by making operational or organizational changes, or it could be more fundamental. Should the target business be divested in whole or in part, or even closed down, or is it time to respond to market environmental changes and use the target as a platform for further M&A expansion. If it is the latter the cycle begins again and you will look to do the right deal, pay the right price, and manage the investment through realizing new synergies, reducing risk through governance, managing people across cultures and continued leadership

In Conclusion

In Conclusion

Cross-border 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.

With shrinking and increasingly competitive home markets, global expansion provides opportunity to alleviate your exposure and to create a platform for continuous growth. Yet the hurdles are high and a disciplined approach required to succeed. This applies to cross-border deals in general irrespective of the country of origin of the head office. However, for Japanese companies, which have lower cultural similarity than two Anglo-Saxon companies coming together would have, the hurdles are even higher. While Japanese risk aversion serves as a protection, it can also mean lost opportunities either in deals themselves or in capturing the full benefits from execution.

The key to success comes from a pragmatic and disciplined approach of doing the right deals in the first place, paying the right price, and managing the investment from maximizing synergies, reducing risk, managing people of different cultures, and leadership.

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**

CROSSBORDER
PMI ADVISORS

CROSSBORDER
PMI ADVISORS

Contact:

Crossborder PMI Advisors

Tokyo Sankei Bldg, 1-7-2 Otemachi, Chiyoda-ku, Tokyo, Japan 100-0004

Tel: +81-80-6626-9525

For further information or RFP, please mail to: **info@xbpmi.jp**

Follow Crossborder PMI Advisors on Social Media
Linkedin: https://www.linkedin.com/company/crossborder-pmi-advisors/
Twitter: https://twitter.com/hashtag/Crossborder_PMI_Advisors?src=hash/