M&A Views

Deloitte M&A Views podcast:
Exploring deals abroad: Cross-border considerations (part one)

Transcript

Greg Jarrett: Welcome to Deloitte M&A Views, a Deloitte podcast series exploring the latest trends and topics in mergers and acquisitions (M&A). I’m Greg Jarrett. Today, part one of a two-part discussion of cross-border M&A deals, as they are expected to play a huge role as companies choose to expand beyond their local markets. We are joined today by Jack Koenigsknecht, a partner with Deloitte & Touche LLP and the US consumer industry leader for the M&A practice, Nik Chickermane, a principal with Deloitte Consulting LLP and part of the technology & media industry M&A practice. They both have tremendous experience in complex cross-border transactions and are here to share their insights with us.

Gentlemen, first let me say thanks for coming on with us today.

I realize that cross-border transactions make up close to a third of the overall deal activity that’s going on. What I need to understand, or what I’m sure our listeners would like to understand, what are some of the drivers behind all of this cross-border activity with transactions? Jack, if you could answer first, please.

Jack Koenigsknecht: I mean, there could be many, many reasons for companies to explore deals outside of their home or core markets. You know, one is saturation in those existing home and adjacent markets, and thus a need to go and find those new markets, diversify the customer base through those inorganic pursuits.

Another is managing regulatory or tax exposures, or uncertainties in one’s home market while tapping overseas customers. And thus buying overseas operations can help avoid some of the high repatriation costs, for example, of those overseas earnings.

Another is technology. You know, sometimes you have to go chase that technology wherever you can get it, and it’s often in another market, so that can be another reason to go abroad.

But perhaps the biggest advantage of a cross-border deal is the reduction in the time to market. For example, we've seen a lot of these with the US and European companies entering each other's markets to gain that immediate customer access, and this is one of the reasons why that particular deal corridor, between the US and Europe, has been so strong over the years. There's often a ready-made market on the other side of the pond that perhaps would be too expensive or time-consuming, or cumbersome to navigate or recreate those distribution channels, or access those channels from back home, so an acquisition is the immediate solution.

Greg Jarrett: Nik, could you jump in here?

Nik Chickermane: Yeah, thanks, Greg. And I agree completely with Jack. Just to add a couple of points here, there has been a continued focus here on investing in emerging markets. As we all know, I think they're growing at a much faster pace, average growth rates around 5 percent or so. And as a result of that, cross-border M&A has been just a preferred medium, a preferred channel, for companies to get out there, get access to customers, technology, and just to capture positive demographics, right? Driving just access to customer bases and diverse markets, primarily to gain access and accelerate speed to market.

Greg Jarrett: For some people, just traveling across the border into a foreign land is a, a very, well, concerning experience. They prepare for it. So, Jack, in your experience, what are some of the factors the management team should consider while looking at cross-border deals, and is there any sort of secret sauce that makes these deals, gives them a better chance of being successful??

Jack Koenigsknecht: Yeah, so there are a lot of common risk factors and pitfalls, Greg, that buyers often stumble into and need to explore and get comfortable with to close a deal in a foreign territory. And those include understanding the national tax laws, what does this deal look like in a post-US tax reform era and what's the optimal structure for it now, versus before, getting comfortable with the political stability, both at the country and regional level.

For example, you have Germany coming out of a really tough year of national elections and challenges and in forming a coalition government and what does the impact look like on those tax rules and regulations, trade restrictions, import/export controls. For example, what's my anticipated exchange rate stability? You know, and then I go down and look at the individual company, or the entity level, and what are the factors, such as the accuracy and reliability of the target's financial statement, controls and preparation, practices. Are they compliant with anti-bribery, anti-money laundering, SEPA, ITAR, other industry-specific regulations, and what's their history of compliance, and can we get comfortable with it?

And then of course the overall growth prospects of the target's home country and market broadly, as that can play into the opportunity for that business to flourish and grow. So I mean, in terms of secret sauce, to me it's really about being disciplined, doing all of those things, in terms of your homework, to be diligent and understand really all of the potential pitfalls and blind spots and really no silver bullet to shortcut or replace a thorough and disciplined approach.

Greg Jarrett: Nik, doing business all the way on the other side of the world seems like it would be quite a bit different than doing business within your own borders, next county, next state or whatever. Do you really have to be a lot more careful when you're doing something in a foreign land?

Nik Chickermane: Absolutely, Greg. So in terms of our experience with cross-border deals, right, we feel that diligence is absolutely critical. So we recommend that most companies should conduct a thorough due diligence early in the deal lifecycle to identify pitfalls, and make sure that the diligence findings are well connected with integration planning activities. I mean, almost always, we recommend that you should complete all of your decisions and plans before the deal is closed. So the moment the deal is closed, you can start executing and driving value early in the process, right after the deal.

In addition to identifying deal-breakers, the diligence process, to us, is just extremely important when you want to assess the deal rationale and the risk and the value that you could get with the deal. We recently just did a $5 billion cross-border transaction and we realized that really planning two interactions between the buyer and the target was critical in understanding competitively sensitive information that was shared, understanding the risk and the value. And we did that in a clean-room format, which placed sensitive information in a setting that was accessible just to a few members of the team.

And these were key in this expanding our post-load integration efforts early on in the process, so by the time we came to deal close, everything was planned and all ready to be executed. And to me, that's really the way to do it.

Greg Jarrett: Nik, let me follow up with you here, at the other end of this spectrum. It's seen that a significant share of cross-border deals fail to achieve the target synergies. According to communique, this rate is more or less 70 percent.[1] In most cases, this is driven by inadequate integration. What are some of the integration issues that companies face specific to cross-border deals?

Nik Chickermane: This is tricky in general. Now if you add the cross-border component, what I think are the primary differences are around the corporate regulations. Every country, there are going to be specific legal issues that need to be addressed. And this just requires highly specialized experts and we've got to factor in long lead times, depending on the country.

Some of these regulations require immediate attention, including like, labor issues, for example, worker time submissions in Europe. We have investment issues, they come up, anti-trust issues, tax reform, changes in different countries, and so forth. So just trying to make sure that there's a good understanding for a company to be, before they go into a different marketplace, I think that's key.

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[1] "Cross-Border Mergers & Acquisitions: Reducing the Risk of Failure," *Communicaid* https://www.communicaid.com/wp-content/uploads/2013/09/Cross-Border-Mergers-Acquisitions_Reducing-the-Risk-of-Failure.pdf, p. 2.

One of the cross-border deals, for example, we did in the health care space, right, the acquirer was delayed, just because we could not get the local authorities in the target country to be compliant with the ownership thresholds. And during that process, our regulator mandated that the acquirer hold a public meeting with the minority shareholders, explaining the benefits of selling their shares as part of the acquisition.

So some of these were just new findings, you know, even for the acquirer to be compliant with some of those regulations. We were able to help the acquirer and the regulators facilitate in that conversation. The second one I would think are just industry-specific regulations, and these require extensive diligence because of the level of intricacies we have from product registrations, certifications, labeling requirements. One example that comes to mind is we did this $60 billion cross-border merger in the tech space. And we had a long product registration timeline to model the markets, right, and most like as a revenue footprint of $2 billion for the acquirer, and that required that both companies separately brand their products at close, and this impacted much of the commercial assumptions we had made to monetize the products. So we found that early on, but that had implications from a product perspective, from a fallout management perspective, as well as from a supply chain perspective, for us to truly go sell into that country. So us knowing that, I think, really helped that planning for it.

Large mergers often result in complicated legal entity structures. You have overlaps. You have redundancies in how the legal entities have been set up. And that just drives up the administrative costs. This also complicates how we go to market.

So some of the common areas of concern include structures, how you simplify, how you register and license, making sure that there is enough of a legal construct in those countries for the combined entity to go to market together, making sure the legal entity is set up right. You have the contract set up right. You want to make sure that the customers are able to transact with you. And we have seen this, you know, in a fair bit of transactions.

And then the fourth one that comes to mind are just the cultural differences that occur when you’re doing cross-border deals. Even, we’ve done deals even in English-speaking countries, and there isn’t quite always the same way that work gets done, and I would say that cultural is perhaps one of the other big components that one should counter as we are trying to do a cross-border deal.

Now what’s really important is that all of these factors manifest themselves in ITHR sales and financial systems that need to be refactored in, to handle these companies, because that really does elongate the time we have to integrate these companies. So what we started doing with many clients is defining tools, accelerator solutions that can truly expedite decision-making, planning, as well as the execution process.

Greg Jarrett: I'm Greg Jarrett. Thanks for listening to Deloitte M&A views, sponsored by Deloitte's M&A Institute. Listen for part two of our discussion on cross-border M&A deals. This podcast is provided by Deloitte and is intended to provide general information only. This podcast is not intended to constitute advice or services of any kind. For additional information about Deloitte, go to www.deloitte.com/about. We also release new podcasts regularly and if you subscribe, you won't miss a single one. To stay connected and receive more information on Deloitte's M&A service offerings, visit www.deloitte.com/us/masubscribe, and follow us on Twitter @DeloitteMnA. Until next time.