Expanding global reach:
Overcoming the challenges Japanese corporates face and realizing value in cross-border M&A

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Japanese corporate acquirers continue to make waves in the international market. From Suntory’s multibillion dollar acquisition of US distiller Beam Inc to more modest transactions in the middle market, outbound M&A showcases the resilience of Japanese companies as they search abroad for new points of growth. Indeed, this search is necessary for them to remain competitive in an increasingly complex and challenging global business environment. As new regional and global corporates enter the market, Japan’s corporate community will have to rethink its approach to M&A to succeed in completing cross-border transactions and achieving synergies.

It was for this reason that we set out to assess the challenges facing corporate Japan in its cross-border M&A endeavors. Through an extensive survey of 100 Japanese corporate leaders and managers that recently completed an outbound acquisition, we sought to gain insight into their deal motivations and the obstacles that almost derailed their transactions or added unnecessary headaches to post-close integration.

What we found paints an interesting picture of perceived challenges among Japanese acquirers and areas during the M&A process where they met both internal and external obstacles. In short, the traditional approach to acquiring a foreign target that Japanese acquirers have been taking – while one that has seen great financial reward and realized synergies for some of Japan’s corporates – is quickly becoming outdated as the complexities of completing a cross-border transaction reach new levels.

In completing this report, we would like to thank participants in our survey for their insights and commentary. We also greatly appreciate commentary from Gerard Adams, senior manager with the investment strategy team at Kirin Holdings, for providing a glimpse into the Kirin acquisition of Brazilian beverage maker Schincariol, a deal which provides a number of best practice lessons for prospective Japanese acquirers. Their involvement and support has been most valuable in adding context and an added level of expertise to our research.

The aim of our analysis within is to show Japanese acquirers where they can improve upon established practices in M&A to increase the odds of deal success. We hope with this information, Japanese businesses can continue to maintain their place at the fore as leaders in their respective industries as they globalize their companies and reach toward the future.
Completing a cross-border deal presents a unique set of challenges that Japanese companies may not run into when pursuing a domestic transaction. These challenges are fluid, constantly changing within target markets and geographies that Japanese acquirers seek to enter while adding to the complexities already inherent in cross-border M&A.

In our survey of Japanese corporates, we sought to uncover what the biggest perceived challenges were for these acquirers. The results have helped us understand where the largest obstacles lie and the measures Japan’s corporations can take to remain sharp competitors for quality assets abroad.

Our analysis dissected each of the major steps acquirers take throughout the M&A process and gauged the perceived obstacles Japanese corporates said they faced. Some key points that emerged from our research in each step include:

- **M&A strategy**: Corporates considering M&A should develop a solid rationale before venturing abroad, taking into consideration the benefits of the deal, the target market being entered, as well as the investment options to be pursued. Development of an effective M&A strategy takes time and effort, requiring both ongoing senior management involvement and the delegation of responsibility and decision-making authority to drive execution;

- **Sourcing a deal**: As a strategy is being developed, it is important to adopt an approach to the identification and pursuit of potential counterparts that is opportunistic as well as systematic. Relationships are key, and so too is a commitment to spending time and resources to unlock main priority targets;

- **Due diligence**: Finding accurate, reliable information on the target company is difficult no matter the market. Understanding local business practices, and how to control associated risks, is also challenging. However, consulting specialist advisors can help alleviate stress and streamline resources throughout the deal;

- **Deal negotiations**: Know the challenges to both exclusive deals and M&A auctions, and develop a way of making your company stand out when competing against other bidders. Consider how best to convey your aspirations and make plans to couple the buildup of consensus with an ability to act with speed. However, retain the ability to walk away, even at an advanced stage. If the deal is not right, wasted deal costs will be much less than the cost of doing the wrong deal; and

- **Post-close**: Be aware of the intricacies of merging corporate and national cultures once integration begins. Build plans as to how the acquired company will fit in to your organization, as well as who will have accountability for managing the investment and ensure that plans are communicated and embedded. This process should start as early as possible — ideally as soon as the target is identified.

While intimidating to new acquirers, these obstacles are far from insurmountable. And while these points are not necessarily comprehensive, they do provide an excellent starting point for Japanese acquirers looking to expand abroad. To improve their success rates, especially as the focus on emerging markets accelerates, Japanese acquirers must realize that experience counts and that the road to success will require an adoption of carefully thought out M&A approach and methodology.
Survey and Report Methodology

From April to May 2014, PwC and Allen & Overy commissioned Remark, the research and publications division of Mergermarket, to survey 100 Japanese corporate leaders and managers at companies that had recently completed a cross-border transaction. These respondents were asked a series of questions related to the deal challenges they faced and were encouraged to provide additional feedback where applicable to shed light on issues facing Japanese acquirers.

Respondents had a variety of deal experience, with about half falling in the one- to five-year range. Likewise, many came from different industry backgrounds, with most involved in the industrial, consumer, and technology sectors. In terms of their recent deals, respondents completed transactions predominantly in Asia-Pacific, although large percentages said they also targeted the United States and Europe.

Question types that respondents answered included rate and rank questions where respondents provided feedback on the degree of challenges faced during certain stages in their M&A transactions. In this report, we highlight what respondents chose as the top challenges, that is, those that were either "very challenging" or "somewhat challenging." When rating options within each question, only those with the most respondent comments are presented. In cases where percent figures within charts or graphs add up to more than 100%, respondents were given the option of choosing more than one answer.

Respondent industry background

Respondent deal experience

Respondent target geographies for recent transactions
While various market forces and external factors are behind corporate Japan’s cross-border acquisitions, the underlying cause of this outbound push remains rooted in the domestic market. A dramatic demographic shift is unfolding, one where Japan’s population is growing older and shrinking. Already, Japanese aged 65 or older account for 22% of the population, and the general population is expected to decline from 127 million in 2014 to less than 90 million by 2060. This reality means a historically strong consumer base is slowly contracting, taking with it demand that Japanese companies rely on for growth.

“The Japanese market is starting to lose momentum considering population changes. The decision to venture abroad was made after several board meetings and several high-level discussions, but we eventually determined that M&A – specifically accessing new sales channels and intellectual property – would not only help us expand in a foreign market but also help us sustain operations at home,” says the director of corporate development at a Japanese pharmaceutical enterprise.

An increasingly competitive domestic commercial environment, likewise, means domestic businesses are seeing profits dwindle. Japanese executives, managers, and other business leaders note this trend, with the head of strategy at a Japanese consumer goods enterprise saying “the already overcrowded Japanese market means competition is fierce, especially when it comes to M&A. Looking for new deal opportunities abroad and completing market entries into untapped geographies was an important influence in our recent deals.”

**Business drivers for outbound M&A**

To balance these changing dynamics, successful Japanese acquirers have numerous options to explore. Foremost among these is looking abroad for new growth opportunities. In our survey, when asked to identify their primary reason to pursue cross-border transactions in the future, some 21% of Japanese respondents indicated that international expansion to access new sources of revenue is the top driver (FIGURE 1). An additional 12% of those surveyed noted that offsetting the stagnant domestic market was behind the decision to venture abroad. Aside from entering new markets or expanding existing operations...
abroad, cross-border M&A can also provide access to new technology and innovations – both tangible and intangible in nature – in addition to reputable brands with strong customer bases.

Changes in global and local economic conditions and diversifying the business were also noted.

Consider the target market
The challenges of a cross-border transaction start with selecting the target market. Questions about the geography in which Japanese corporates will be operating in include:

- What are the regulatory requirements for foreign investors? Are there any restrictions, particularly in relation to foreign direct investment or repatriation of funds?
- How stable is the local political, social, and economic climate?
- How easily will I be able to enforce my rights?
- What is standard practice in that market and what will sellers’ expectations be?

For some of these reasons, Japanese corporate acquirers have shown a heavy bias for developed markets, such as the United States and Western Europe. Aside from hosting a large population of quality businesses with good governance standards, the regulatory environments in these jurisdictions are sound, reliable, and reasonably well defined – in addition to being well enforced.

It comes as something of a surprise that survey participants said China is the preferred destination for outbound M&A in the year ahead, according to 72% of our respondents who ranked the country in their top three destinations [FIGURE 2]. From a growth standpoint, marking China for investment makes sense. The country boasts one of the largest expanding middle classes in the world with growing consumer demand for quality goods, healthcare, TMT, and other consumables – all of which Japanese corporations can supply. Rising political tensions, however, mean that uncertainty runs high as public protests can disrupt supply chains and pose a threat to hard assets like factories, storage facilities, and commercial outlets.

Survey respondents also favored the United States (43%) and India (25%). Interest is also shown for European target geographies such as Germany (22%), the United Kingdom (17%), and Switzerland (8%).

FIGURE 2
What countries are you most interested in as a target geography for M&A?

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<tr>
<th>Country</th>
<th>Rank 1</th>
<th>Rank 2</th>
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<tr>
<td>China</td>
<td>31%</td>
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<td>14%</td>
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<td>USA</td>
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<td>India</td>
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<td>Germany</td>
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Respondents were asked to select up to three options in order of importance.
Likewise, countries in Southeast Asia – Indonesia leading the sub-region with 16% of respondent sentiment – will see Japanese buyers entering the market.

Data analysis: Respondent expectations vs. transaction trends Data on completed deals, however, suggests that sentiment toward Chinese investment may be wishful thinking (FIGURE 3). Since 2007, China accounted for only 5% of outbound deal flow from Japan. Value figures were equally insignificant: 0.8% or US$2.8bn.

Deal activity into the United States and Western Europe was more profound. The US accounted for 28% of deal volume in that same time frame, with Europe accounting for one in four Japanese transactions. Respondents noted that these markets offer quality targets that have superior technology and consumer bases, making them ideal for investment.

This growth in M&A activity is likewise true of emerging markets in Southeast Asia. The patchwork of high-growth economies across Southeast Asia boasts a burgeoning consumer class with increasing buying power. The subregion accounted for 14% of Japan’s outbound transactions since 2007. Further trends and challenges of conducting M&A in Southeast Asia are examined in our feature “Preparing to invest in Southeast Asia” on page 10.

Choosing an investment strategy The target market may also influence the type of investment selected by Japanese acquirers. Regulatory controls within the target market must also be considered, as limitations on foreign ownership can come into play in sectors and industries sensitive to local government national interests.

Japanese acquirers with more M&A experience may consider larger stake deals which will increase revenue, but at the cost of increasing risk. These types of acquisitions can give Japanese acquirers greater control over the operations of the companies they buy, whilst also allowing greater flexibility when working out a post-merger integration strategy. At the same time, whilst prices are rising, prevailing valuations of targets in emerging markets still afford Japanese acquirers the opportunity to buy up entire business operations. Supporting these investments, Japanese respondents expected majority stakes (38% of respondents) and full acquisitions (24%) to be the most common structures for outbound M&A activity in the year ahead with many citing successes in their own transactions (FIGURE 4).

Conversely, those unfamiliar with the market may first wish to engage in some form of joint venture with a local business before taking on a larger investment. Japanese corporates will typically embark on a non-control form of transaction if they are seeking to limit risk exposure or test the water when investing in a new market. Investors should consider whether it is riskier to invest in a business they will control or one that someone else controls, especially if their brand or other key intellectual property is involved.

The head of strategy at a Japanese industrials company says, “it’s sometimes easier to pursue a market entry with a joint venture, especially in developing markets. This provides a good base to build operations and yield stronger profits. It also helps in diversifying the business as these deals can oftentimes incorporate new technology and business practices or ideology with our own.”
FIGURE 4
Which of the following investment strategies will be used during cross-border M&A in the next 12 months?

Majority stake acquisition (≥ 50%) 38%
Full acquisition (100%) 24%
Minority stake acquisition (< 50%) 15%
Establishment of a joint venture 12%
New share issuance (i.e., providing capital to the target company) 5%
Strategic alliance 5%

Respondents were asked to select up to three investment types in order of priority. Results reflect those options ranked top priority.

CHALLENGES AND CONSIDERATIONS

- Develop solid deal rationale before venturing abroad
- Identify primary roadblocks—regulatory, political, or social—in the target market, and how you can mitigate risk
- Select an investment approach that you are comfortable with and that will yield the desired returns
- Consider the alternatives, e.g., greenfield investment in the same market
Japan has long been an active investor in Southeast Asia. Wage increases and political tensions with China have made it easy for Japanese investors looking to expand via M&A to accelerate their relocation of operations and supply chains to emerging Southeast Asia. Economies across the ASEAN region of Asia have posted impressive growth figures in recent years, and a burgeoning middle class also presents an increasingly attractive market with significant growth potential.

Deal activity in recent years has continued to reach new records as Japanese business leaders make acquisitions and investments into everything from resources and infrastructure projects to retail outlets and light to heavy manufacturing. Yet even with ample cash reserves, accessing and completing a transaction into Southeast Asia is by no means a simple task. The process of sourcing targets and approaching potential counterparts necessitates a tailored approach to maximize the chances of bringing a deal to close. A number of challenges and case studies illustrate some obstacles to investing in Southeast Asia.

**Deal challenge #1: Sourcing targets**

Searching for deals in Southeast Asia pits Japanese acquirers against not only their peers, but local businesses trying to expand within the region, as well as multinational corporations pursuing similar expansion strategies into emerging markets. This is true as corporations from the United States begin to invest heavily in Southeast Asia’s more developed markets, like Singapore, Thailand, Malaysia, and increasingly Indonesia. International private equity firms have likewise targeted the sub-region, raising funds and opening local offices to search out both minority stakes and buyout opportunities.

Another bottleneck to sourcing deals is the limited number of quality targets that are available. While Singapore, Thailand, and Malaysia are populated with a rich mix of mature companies with higher governance standards than those in frontier markets, potential deal targets are far fewer than in more developed jurisdictions.

**Deal challenge #2: Family-run companies**

The stage of development in most Southeast Asian economies means that increasingly, a wide cross section of attractive and well positioned family run businesses present themselves as acquisition targets or potential joint venture partners. Whilst it is often difficult to establish relationships and access such companies, once connected owners can frequently be motivated towards a transaction as a means of addressing succession issues, facilitating market or technological expansion or simply releasing capital locked-up in the business.

Companies need to access or build deal sourcing, target assessment and strategic planning capabilities which, when coupled with the right relationships and focus, will provide the ability to compete successfully for a limited pool of attractive targets in Southeast Asia.

Masaji Hamanoue, Partner, Deal Advisory, PwC
Most Southeast Asian economies are underpinned by a wide range of market leading and high quality family businesses. Identifying and approaching such companies in the right way, supported by solid diligence and careful business planning, can enable access to some really exciting growth opportunities.

Matthew Wyborn, Partner, Deal Advisory, PwC

However, the existing operating and organizational structures at many family companies can present challenges for an investor. It is important to obtain an understanding of the controls in place over compliance and governance matters, while also ensuring that related parties and other key relationships or connections are identified. Diligence also needs to focus on gaining an understanding of the quality, timeliness and reliability of financial and regulatory reporting.

With individual sellers, extra thought needs to be given to post-transaction remedies. It can be difficult to pursue individuals in the courts and they may not always have the financial resources to meet any claims brought against them. If the sellers are to remain involved the business it becomes even more difficult - it is a very difficult decision to sue a business partner.

**Deal challenge #3: Quality of information**

Accessing reliable, up to date information is crucial to pre-deal processes, yet it also tends to be one of the more stressful and tedious challenges of completing a transaction in Southeast Asia. Gathering intelligence on targets and owners is best done by developing a network of contacts within the target’s community. While acquirers can accomplish this on their own, utilizing local advisors can help provide a clearer picture, as well as a fresh perspective on the transaction.

Yasuhiro Hirabayashi, Partner, Deal Advisory, PwC

The quality of information often comes into question when conducting due diligence in many Southeast Asian countries. While the authenticity of such information can never be guaranteed, using external advisors who understand the local business environment can help provide a clearer image of a target’s condition and business practices.

Yasuhiro Hirabayashi, Partner, Deal Advisory, PwC
Case study #1: Myanmar
Sweeping reforms in Myanmar have seen the state opening to the outside world in recent years, attracting a new cohort of investors. It was for this reason that a Japanese consumer goods company began sourcing deal opportunities in Myanmar, a relatively untapped market but one where deal opportunities were incredibly scarce.

The target was a logical choice. It was a top brand in the market. The deal would also provide access to a low cost labor force to expand production capabilities and new distribution channels for the parent company’s products. An intricate team of employees from Japan and advisors was formed to review information of the target and conduct interviews with the target management, conduct due diligence, and bring the deal to a successful close.

During the due diligence exercise, the team faced various issues relating to unusual commercial practices. As is typical of some emerging markets, the target maintained two sets books. An unusual business practice due to foreign currency restrictions was also discovered.

As seen in many emerging markets, in Myanmar, there are still local business practices which are very different from the global standard. The challenge for the Japanese buyer conducting a deal in Myanmar is to correctly understand such local practice and carefully assess the associated risk factors during due diligence. In order to close the deal, it is critical to find pragmatic solutions if the risk is manageable.

Case study #2: Vietnam
A Japanese chemicals company was keen to expand and diversify its operations into Southeast Asia. The company – through advisors – was approached by a major foreign resources operator to acquire one of its subsidiary companies in Vietnam. The transaction would add another link to the Japanese party with an already existing value chain of assets in the region.

The Japanese company was invited to participate in a competitive auction, a process that required quick action and analysis of financial, tax, HR, environmental, and legal documents of the asset. While a data room was established by the owner, an advisory team was used to lead the project management and due diligence. Additional support was given by senior management, which, realizing the importance of the deal, helped drive the transaction forward to a successful signing. But in Vietnam, that’s only half of the path. The final step of a typical Vietnamese M&A deal process is that the parties submit the transaction application to the licensing authority for issuance of an investment certificate or certificate of enterprise registration as the case may be registering the change of ownership in the target company. This stage likely involves the opening of an escrow account for the benefit of the seller and may take up to several months to complete.

Innovative solutions, risk-taking, and determination are key ingredients to compete successfully in an auction under significant time pressure and in a situation where one has to cope with incomplete information not only related to the target but also relative to the dynamics of the process.

Gregory Bournet, Director, Corporate Finance, PwC
SETTING THE STRATEGY

Developing an acquisition strategy – one that aligns with an organization’s corporate development efforts – is that critical first step in the M&A process. While a seemingly obvious initial move, sometimes insufficient resources are spent outlining short- and long-term objectives, considering the optimal business fit, identifying risks and challenges, or delegating responsibilities and assigning resources. A good strategy should cover the target geography/markets, deal sourcing and execution and how any acquired businesses will be managed and integrated. Underestimating certain aspects of strategy formation can spell disaster for negotiations or post-close integration efforts, a trend noted by several Japanese executives in their recent cross-border transactions.

Japanese corporates had the following to say about strategy in their recent cross-border transactions:

- “Determining the strategy and using that to select potential targets during previous cross-border transactions was a daunting task, requiring much more time than anticipated. Considerable time, research and analysis went into this process so that we had solid groundwork for the deal and could make some predictions about how that deal would play out.” – Director of Strategy at a chemical manufacturing company

- “The M&A strategy was one piece of our overall corporate strategy, however, it was a very critical piece and presented numerous challenges as we put the plan together. While we had experience from previous deals and several best practices to utilize, ultimately we had to tailor a specific approach to our transaction.” – Director of Finance at an optical equipment manufacturer

- “Preparing the acquisition strategy was just the first step – next we had to get it approved. This required another layer of high-level internal discussions between management and the board. Their differing views and opinions turned this into a drawn out process, but it was a time commitment that was absolutely necessary before we were ready to take the next steps.” – Chief Financial Officer at a pharmaceutical solutions provider
These respondents also highlight a series of questions that should be answered during the strategy phase. These include everything from fundamental deal rationale (Is the company looking to diversify within an industry or market, or penetrate new ones?) to how the process will be effectively communicated to employees, customers, and other stakeholders at the acquired organization.

**Committing time and resources**

The need for M&A strategy to be as comprehensive and forward looking as possible also means it is one of the most challenging aspects in the acquisition process. Perhaps, realizing the importance of this part of the M&A process, Japanese acquirers also spent the most time and resources on this review and approval process (FIGURE 5). Respondents also noted other strong correlations between their perception of challenges and the corresponding time allocated to the different steps of strategy formation.

While these difficulties affect each aspect of plotting a course for the deal, perceptions among Japanese acquirers focus on target selection (FIGURE 6). Finding an appropriate target often presents one of the greater difficulties in M&A. One in four respondents in our survey support this notion, saying that developing an acquisition candidate list was highly challenging.

Developing lists and then rating and ranking candidates are areas found to be challenging and can become an even more complicated procedure depending on the market. While targeting the North American market, the director of corporate development at a medical equipment manufacturer says of his previous deal: “Because the United States market is so huge, our list of potential candidates was equally large. While this gave us more options, it also required that we research each individual company...”
FIGURE 5
Rank the following tasks according to the amount of time and resources spent during the strategic planning phase.

- Reviewing and approving acquisition strategy: 21%
- Determining attractive markets: 18%
- Developing acquisition candidate lists: 17%
- Building preliminary valuation and return models: 13%
- Determining acquisition financing constraints: 11%
- Rating and ranking acquisition candidates: 9%
- Consulting with advisors: 6%
- Determining business plan drivers: 3%

Results reflect those options ranked top priority in terms of time and resources spent.

Respondents were asked to rate each on a scale from “very challenging” to “least challenging.”
and customize our strategy to each respective target. Filtering the list and making cuts to candidates was a lengthy, but necessary, process.”

The strategic planning process is also a focus area, with 63% of respondents highlighting challenges in determining business plan drivers and 62% identifying the review and approval of the acquisition strategy as a challenge.

Reviewing and approving the strategy
Reviewing and approving the acquisition strategy also proved to be one of the most challenging aspects of the strategy assessment process. The head of strategy at a consumer retailer said, “getting the strategy right is the most important part of the deal and can actually shape the rest of the transaction.”

Sentiment in this vein was especially true of respondents with fewer than four years of deal-making experience. The director of strategy at a Japanese pharmaceutical company said “research time when forming a strategy for M&A is where our organization doesn’t like to compromise. Management and decision-makers don’t mind spending the resources on this since doing so will often produce the desired results we were looking for.”

Sourcing: Finding the right acquisition
Identifying targets and M&A opportunities that fit the corporate growth strategy is often slowed by numerous factors. Distance from the target’s home market puts these acquirers at a disadvantage when screening candidates and competing against bidders in the target market. As illustrated in Figure 6, almost two out of three Japanese acquirers note that rating and ranking acquisition candidates is seen as a challenging element of the strategy development.

These respondents also said a lack of local knowledge and on-the-ground perspective on the target market often obstructed the search for targets. Most of this sentiment was shared among Japanese acquirers with more than six years of M&A experience.

Determining drivers and building models
Figuring out what will drive the corporate development plan, in addition to the geographical focus, requires an analysis of influencing factors such as supply chain and logistics. Various other considerations include the people, skills, and general experience that will be required. While only 12% of respondents said determining business plan drivers was the top challenge, a full 63% noted that this step was either “very” or “somewhat” challenging.

Additionally, making accurate financial forecasts is never easy, but trying to do so amid macroeconomic uncertainties or without adequate information on a target market can only complicate an already difficult task. At this early stage in the acquisition, these models tend to be high level and preliminary in nature, with the overall intention being to provide an indication of potential costs and value. Definitive figures will be easier to address once the wheels of the deal are in motion and more information is accessed on targets and target markets. However, there is also benefit to investing time in a focused deal specific financial model that is dynamic, identifies key value drivers, and can be used to assess various scenarios or sensitivities.

Who drives the strategy?
In planning and executing the strategy, responsibility is often tasked to various parties within the acquiring organization. However, clear lines must be drawn in terms of who has authority in the decision-making process.
While various parties have a voice in rolling out the strategy, for the most part responsibility for planning and execution falls on the shoulders of the upper level of the company’s management. This includes members of the company’s executives, according to 52% of respondents (FIGURE 7). Years of experience and business acumen have armed this group with the power and insight to compose and execute a blueprint for the acquisition. Also, as the regarded leaders of the organization they were seen as being best placed for the task of driving the strategy and acquisition.

An equally large cross section of Japanese respondents (42% of those surveyed) said a corporate development and planning team was at the center of developing the corporate M&A strategy. These teams included a dedicated group of individuals with expertise in various corporate practices. In some cases, they were used to conduct ground-level research and strategy development, while upper management took responsibility for vetting and approving the deal strategy.

**CHALLENGES AND CONSIDERATIONS**

- Allocate enough time and resources to strategy formation
- Find targets that fit the broader corporate strategy and prepare a concise list of potential companies to acquire (including identification of the merits and risks of each)
- Numerous voices will need to be heard during strategy formation: be sure to clearly define responsibility of who will drive the deal strategy
FEATURE: The Start of M&A

Numerous variables can delay or derail the deal, yet ultimately, the outcome of any cross-border venture depends on key decisions before the transaction is executed. M&A practitioners and advisors at PwC and Allen & Overy discuss these issues and others.

**Q:** What are some of the key questions that Japanese corporations need to be asking internally before they start formulating their cross-border M&A strategies?

**TAIZO IWASHIMA - Partner, Corporate Finance, PwC:** Some of these questions involve markets and technology, geographies, people and experience, and risk. For instance: What markets do you want to be in? Do you have the right technology, and R&D? What geographies do you want to operate in, be it a market entry or expansion? What types of people, skills, and experience will be required to succeed? And how much risk are you willing to take? The problem is that these questions – particularly those around human capital – aren’t getting answered, or worse, aren’t being asked. While Japanese companies are becoming more determined to globalize through acquisition, we’re still not seeing the level of robustness that is really needed to succeed.

Strategies are not always thought through or have gaping holes in their design. These oversights really come out in the integration phase, where communication, people issues, and KPIs are not always tailored, and the question of how to manage the newly acquired business crystallizes.

**Q:** What are some of the approaches to M&A in both the pre- and post-deal phases that Japanese dealmakers typically take that could be hindering the realization of synergies?

**AKANE YOSHIDA - Director, Deal Advisory, PwC:** Japanese M&A over the past 20 years has followed the trend of playing “follow the leader”. There has been a tendency to pursue M&A and follow the activities of competitors and corporate peers instead of developing tailored strategies and short-term goals. One of the other areas where Japanese M&A practitioners have taken a passive approach is in the integration phase. Japanese acquirers have been known to be very hands-off when it comes to combining resources or establishing control, especially personnel, at the target company. Targets are left to continue business as usual, which means pursuing the agenda of the previous owner, not the current controlling entity. Responsibilities for controlling and capturing value from the acquired business are often unclear within the acquiring organization. With no clear expectations set, targets often fail to perform and deliver. While it may seem pre-emptive to start planning for integration before the deal is signed, having a plan that is ready to put in place on Day One, and executives with clear accountability for execution, will help expedite the merger of companies, people, ideas, and overall corporate strategy.
Q: Where are Japanese dealmakers falling short in the early stages of a deal process?

MATTHEW J. WYBORN - Partner, Deal Advisory, PwC: At the outset of a transaction process, the seller and their advisors, are looking to establish a clear picture of potential acquirers and to assess their ability and their rationale to pursue the transaction. Japanese middle management will ordinarily be extremely thorough in gathering intelligence on the target which can put Japanese acquirers at a disadvantage during the early stages of a process. This, matched with a lack of information or the inability to collect adequate information on the target, means that on numerous occasions Japanese acquirers have been known to pass or lose out on strategically well suited deals opportunities. Internal structures have also been known to hold back potential Japanese buyers at the early stage of a transaction process. M&A efforts at Japanese corporates are oftentimes not driven from the top down.

This can mean that deal teams lack the authority to make executive judgments and provide quick responses, often on relatively straightforward matters such as executing confidentiality or non-disclosure agreements. Whilst care, diligence, and consensus are important, it is also necessary to develop some momentum and to demonstrate an ability to keep pace with the seller’s process (especially in an auction). Because deal teams need to revert to higher leadership, this will sometimes see companies left behind by competing bidders who are able to act more rapidly.

Q: Where should insight and deal direction come from in relation to parties involved in the transaction process?

NICK WALL - Partner, Allen & Overy: Involvement and responsibility in any cross-border transaction needs to come from a variety of parties with different perspectives. The four main groups that should be active members of the M&A process include: senior management; M&A deal teams; key functional leads; and an independent advisor, someone with knowledge of the acquiring company but who is detached from the deal and can provide an outsider’s perspective.

The independent is particularly key to these types of transactions. With the other parties who are actively involved, it is easy to get consumed in the deal and lose sight of long-term goals or be unable to see the immediate warning signs that something is amiss. This independent could help answer such key questions as: Is this the price we should be paying? Is it a good cultural fit? Will synergies be realized within the specified timeframe? A non-executive board member or other person with a deep knowledge of the buyer, yet is one step removed from the transaction, would be well placed to fill this role.
Q: Japanese corporates usually acquire directly using the parent entity, but is it worth looking at other options?

SIMON BLACK - Partner, Allen & Overy: Japanese companies are increasingly looking at alternatives to direct acquisitions from the Japanese parent, and I’ve experienced Dutch, UK, Jersey, and Singapore acquisition vehicles on recent deals. Primarily, it is driven by tax aspects and often one can use more favorable tax treatment for profits, dividends, and capital gains than exists if a Japanese entity makes the purchase. Some clients have also used overseas holding companies to own all of their overseas businesses and, beyond any tax advantages, this may make future reorganisations or spin-offs easier to structure. For example, a UK style corporate scheme of arrangement is a very flexible means of structuring internal reorganisations or external mergers and is possible in some of these jurisdictions.

However, the decision on the most appropriate structure is complex, requiring tax, accounting and legal advice in the target jurisdictions and Japan. For example, the Japanese tax rules relating to tax havens need careful consideration. Getting experienced external advice early on in the transaction is vital; it shouldn’t be left as an afterthought.

Q: What should potential acquirers be thinking about in terms of communication programs upfront?

OSAMU ITO - Partner, Allen & Overy: Merger control filings under competitions laws are something that parties may underestimate. Prior filings or approvals may be required in jurisdictions other than the country in which the target is located, and the analysis becomes more complex in a joint venture or where the seller retains a certain stake in the target; the parties may not have the requisite information readily available to make an assessment on the necessity of filings or to put together the filings; the parties may need to take a view whether or not to file in a particular jurisdiction where a filing appears theoretically necessary but is of little relevance to the target’s business or the acquirer. As merger control filings can significantly affect the schedule to closing, and can also impose a heavy burden on the deal teams in putting together the facts and figures to be reported, it would always be advisable to address this and seek expert advice well upfront.

Another issue is communication to the target’s employees and to the public. Certain jurisdictions have mandatory rules on employee communication and consultation, including the timing or period therefor. This should be taken into account in discussing and agreeing on the timing and schedule for the deal, and should be addressed early on. If the target or the potential acquirer is listed, the parties will usually agree on the timing and contents of a public announcement, but they would also need to be prepared for a leak, as they may be required to make an announcement in the event of a leak.
CONDUCTING DUE DILIGENCE

Due diligence is a time intensive part of the M&A process, and one that is critical in validating the strategy being pursued by top management and decision-makers. A well-structured approach to due diligence will help alleviate concerns, clarify understanding, and pave the way for better informed negotiations and post-deal processes.

During due diligence, acquirers will set out on fact-finding missions to uncover details on the target companies. Does the target have sound financials? Is the company exposed to any significant risk or liabilities? What legal, tax, or environmental issues will arise, and what cross cultural challenges can be anticipated? These and many other questions will need to be answered, often within a condensed timeframe.

Priorities when evaluating the deal
Accessing information vital to the deal is by no means an easy task. This matter is made more difficult as borders and oceans separate Japanese corporations from target markets. In varying degrees, Japanese acquirers highlighted focus areas for their due diligence in recent transactions (FIGURE 8).

Understanding the acquired business through due diligence is important in managing risk in M&A. If satisfactory due diligence cannot be completed, buyers will need to focus greater attention on other ways of mitigating risk, including contractual protections, third party support (eg insurance) or hold-backs of the amount to be paid for the business, e.g. earn-outs or other forms of deferred consideration.

Financial due diligence
Unsurprisingly, analyzing the target’s financials arose as the most necessary area for due diligence in cross-border M&A. Financial due diligence is mandatory in any transaction. While a deep analysis of the target’s financial condition may be difficult to perform, even a standard performance check and review of financial statements can establish a clearer picture of stability or instability at the target company.

Considerations may include:
• Analyzing historical revenue and net income trends
• Gaining comfort on the underlying quality of earnings and assets
• Identifying working capital and capital expenditure needs
• Considering potential revenue and cost synergies
• Ascertaining the projected outlook for the target, in light of planned activity as well as industry and competitor considerations
• Addressing target-specific and industry-wide risks

Legal due diligence
Legal due diligence was selected by 87% of respondents for similar reasons: to expose potential risks and limit exposure. This included examining organizational documents and contracts, as well as potential liabilities.

Considerations may include:
• Understanding the contractual arrangements with lenders, key customers, and suppliers and whether the transaction may have any adverse impacts on such arrangements
• Confirmation that the target owns the key assets (both tangible and intangible assets such as intellectual property) needed to operate its business
• Regulatory issues in the markets in which the target operates, such as licenses, permits, and approvals
• Labour issues, such as violations of employment codes or health and safety violations
• Legal risks such as ongoing litigation or other disputes that could impact the deal
**Environmental due diligence**

Identifying potential environmental pitfalls can help reduce the likelihood of legal actions later in the deal or once an acquisition has been completed. This includes a thorough investigation into pollution issues, land quality, and water contamination, among many others as well as the applicable regulatory regime – could a buyer be responsible for environmental issues caused by previous owners of the business or the relevant property? For prospective Japanese acquirers pursuing cross-border M&A, the challenge can lie in gaining access to certain facilities of the target company. Likewise, conducting adequate tests on the properties owned by the selling entity can prove difficult and the data necessary for desk-top analyses may not be available (or reliable).

Considerations may include:
- Understanding the broad framework of liabilities imposed at various levels of government in the target market
- Anticipate cleanup requirements and related costs
- Managing contaminated property transactions, especially during brownfield development projects and joint ventures
- Negotiations with the seller to allocate costs/risk of any necessary clean-up

In addition, it is becoming increasingly important to gain a full understanding of a range of compliance matters covering areas such as anti-bribery measures. Already 49% of respondents indicated that focus is placed in this area and it is anticipated that due diligence around compliance and business ethics will become ever more common.

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**FIGURE 8**
What type of due diligence did you undertake in your most recent transaction?

- Financial: 91%
- Legal: 87%
- Environmental: 79%
- Tax: 68%
- Compliance/Business ethics: 49%
- Commercial: 65%
- Political (risk): 54%
- Technical: 20%
- HR, Pension: 17%

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**FIGURE 9**
Which type of external advisors were used in your most recent transaction?

- Legal advisor: 92%
- Financial advisor [ie investment bank]: 88%
- Financial & tax due diligence advisor: 68%
- Risk consultant: 53%
- Strategy/management consultant: 49%
- Environmental advisor: 37%
- HR consultant: 29%
- Actuarial advisor: 17%
- Insurance broker: 5%
External advisors: An extra layer of insight

The sheer scale of investigations, volumes of information involved, and distance from the target means due diligence can quickly turn from a minor challenge to a potentially deal-derailing situation. Consulting advisors, preferably those located in the target market or with expertise in certain fields, can lighten the heavy burden on internal staff during a particularly stressful and deadline-intensive time. Overwhelmingly, participants in our survey note the use of such advisors, with 92% saying that outside professionals were consulted.

External advisors can be used to address a variety of issues (FIGURE 9). Recent acquirers said that legal and financial advisors, as well as financial and tax due diligence advisors, were most frequently consulted. These advisors were also hired most frequently at an early stage in the transaction (FIGURE 10). In this way, their early involvement ensured that they were up to speed and informed of developments in the deal and could provide insights and support without having to be continually re-briefed on matters as they unfold.

According to a chief financial officer at a consumer goods company, “Making the most of our investment and reducing the risks involved was a primary concern. To sidestep these risks and mitigate obstacles to the transaction we felt it necessary to consult financial advisors and other due diligence specialists.”

The director of strategic planning at a manufacturing company pointed to new funding related requirements from financial institutions in Japan who are asking for access to better due diligence that necessitates the use of external advisors. The director elaborates, saying: “Banks and other providers of finance in Japan are more than willing to provide companies with the financial resources to pursue M&A. However, they are only taking those companies into consideration that have completed a stringent due diligence check. Do they have adequate predictions and models on returns? Does the organization have the scalability to perform? And maybe more importantly, will they be able to realize enough profits to sustain operations and repay debts?”

FIGURE 10
At which point during your most recent transaction were external advisors hired?

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>65%</td>
<td>Target was introduced by an external advisor</td>
</tr>
<tr>
<td>7%</td>
<td>At a very early stage in the transaction</td>
</tr>
<tr>
<td>26%</td>
<td>After non-binding offer was accepted</td>
</tr>
<tr>
<td>2%</td>
<td>After exclusivity was achieved</td>
</tr>
</tbody>
</table>

CHALLENGES AND CONSIDERATIONS:

- Thorough due diligence can help ensure that negotiations, and even post-deal integration, run smoothly
- Accessing details on the target company will take time and resources – plan accordingly
- Consult advisors early and often to ensure that their insights and experience can be leveraged
- Internal teams, such as IT, HR, and Finance, can provide useful insights. Involving them from an early stage will also help with the post-merger integration process
Navigating the Sales Process

Japanese acquirers unfamiliar or relatively new to the target market will often be at a competitive disadvantage to counterparts in the local corporate community. Without a network of contacts, prospective Japanese acquirers have little chance of uncovering and accessing potential deals. It may be even more unlikely that such companies will be a good fit in terms of aligning with their acquisition or corporate strategy.

When opportunities are discovered, acquirers may face a new set of challenges, depending on the sales process. These sales ordinarily take one of two forms: an exclusive negotiation between buyer and seller, or an auction process with a pool of bidders.

Assessing the likelihoods of success and overall preferences, two out of three respondents completed exclusive negotiations in their recent cross-border acquisition. Unsurprisingly, further 71% said they felt more comfortable with a one-on-one process as opposed to an auction (FIGURE 11).

Exclusive negotiations
The nature of exclusive negotiations makes it easy to understand why Japanese corporates prefer these sales over alternative methods. The lack of a larger bidding group and selection process gives Japanese acquirers more time to build rapport with the seller and to conduct tailored and focused due diligence. Companies that recently completed transactions through exclusive negotiations generally said the process yielded better results for their companies.

However, during exclusive negotiations finding information can still prove problematic (FIGURE 12). When conducting deals in emerging markets, poor governance and lack of transparency often mean record keeping practices may not be up to the Japanese standard.

The study confirms clearly that, typically, Japanese corporates articulate a strong preference for exclusive negotiations as opposed to a competitive auction. However, knowing to have a party ready to sell and to concentrate efforts within a structured process can eliminate frustrations encountered by at times very lengthy deal discussions with business owners who are entertaining a transaction oriented dialogue but ultimately are not committed to a divestment.

Gregory Bournet, Director, Corporate Finance, PwC
In exclusive negotiations, communication issues can also pose significant challenges. Reaching out to sellers, or finding potential sellers in the first place, can prove difficult in cross-border forays and often require the help of third-parties to establish contact or set up an introduction. Price expectations and the seller’s commitment to the transaction were also cited as challenges that could result in a deal’s collapse.

**M&A Auctions**

Auction sales can be a much more intense process than an exclusive deal. The often fast pace of auctions means prospective acquirers must be willing to act decisively within a timetable they have little control over. The speed with which an auction is carried out had many respondents questioning the quality of information they were receiving. Relatively short timelines during the preliminary stages of an auction also means that only a limited amount of due diligence can be carried out.

When engaged in an auction, corporates stated that compressed process timelines

**FIGURE 12**

Rate the following in terms of the challenges they presented during exclusive negotiations

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Very Challenging (%)</th>
<th>Somewhat Challenging (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Communication with seller or its advisors</td>
<td>7%</td>
<td>29%</td>
</tr>
<tr>
<td>Seller’s commitment to the transaction</td>
<td>10%</td>
<td>25%</td>
</tr>
<tr>
<td>Price expectations</td>
<td>9%</td>
<td>26%</td>
</tr>
<tr>
<td>Information availability</td>
<td>16%</td>
<td>18%</td>
</tr>
<tr>
<td>Extent of due diligence</td>
<td>9%</td>
<td>24%</td>
</tr>
<tr>
<td>Flexibility of deal structure</td>
<td>13%</td>
<td>18%</td>
</tr>
<tr>
<td>Final documentation</td>
<td>11%</td>
<td>19%</td>
</tr>
<tr>
<td>Lack of deal certainty</td>
<td>8%</td>
<td>20%</td>
</tr>
<tr>
<td>Compressed process timelines</td>
<td>10%</td>
<td>17%</td>
</tr>
<tr>
<td>Negotiation of deal terms</td>
<td>7%</td>
<td>20%</td>
</tr>
</tbody>
</table>

Respondents were asked to rate each on a scale from “very challenging” to “least challenging.”
create the greatest hindrance to their acquisitions. The expedited process and time element pressures present challenges for organizations in executing quickly enough [FIGURE 13].

“In an auction process because of time constraints and the seller’s attitude, the deal can turn sour much more quickly. Rushing through the process often leaves little time for due diligence. Also, the participation of additional bidders in the process adds another layer of uncertainty,” the director of M&A at a financial services company said.

The vice president of strategy at another financial services firm added to this comment, saying the fast-paced nature of auctions “does not allow the buyers enough time to check all the credentials properly which can result in failure to realize synergies after the deal is completed.”

Auctions do, however, mean there is greater certainty that the seller is committed to selling the business – something which may not always be clear in bilateral negotiations.

**FIGURE 13**
Rate the following in terms of the challenges they presented to the M&A auction

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Very Challenging (%)</th>
<th>Somewhat Challenging (%)</th>
<th>Least Challenging (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compressed process timelines</td>
<td></td>
<td></td>
<td>32%</td>
</tr>
<tr>
<td>Extent of due diligence</td>
<td></td>
<td></td>
<td>42%</td>
</tr>
<tr>
<td>Communication with seller or its advisors</td>
<td></td>
<td></td>
<td>44%</td>
</tr>
<tr>
<td>Lack of deal certainty</td>
<td></td>
<td></td>
<td>39%</td>
</tr>
<tr>
<td>Seller’s commitment to the transaction</td>
<td></td>
<td></td>
<td>34%</td>
</tr>
<tr>
<td>Information availability</td>
<td>40%</td>
<td></td>
<td>17%</td>
</tr>
<tr>
<td>Price expectations</td>
<td></td>
<td></td>
<td>24%</td>
</tr>
<tr>
<td>Flexibility of deal structure</td>
<td>14%</td>
<td></td>
<td>39%</td>
</tr>
<tr>
<td>Negotiation of deal terms</td>
<td>21%</td>
<td></td>
<td>31%</td>
</tr>
<tr>
<td>Final documentation</td>
<td>12%</td>
<td></td>
<td>38%</td>
</tr>
</tbody>
</table>

Respondents were asked to rate each on a scale from “very challenging” to “least challenging”.

**CHALLENGES AND CONSIDERATIONS:**

- Know the tactics and methods necessary to make your company stand out from other competitors during an M&A auction
- Be prepared to clearly communicate goals and strategy to the selling party
- Lack of information is an inherent part of M&A – be flexible and prepared to complete due diligence at various speeds

Navigating the Sales Process
FEATURE: Understanding representations and warranties in cross-border M&A

During the M&A process, sellers will provide certain information in relation to the business being sold. This is primarily done through the marketing process (for example in the form of an information memorandum), the due diligence process (usually through management presentations and a data room of key documents), and the transaction documents (primarily in the form of representations and warranties).

The representations and warranties are statements included in the transaction documents, given in relation to the state of the business being sold (as well as the seller and buyer) and are designed to give a degree of comfort, and potential remedies, to the counter-party. The difference between a “representation” and a “warranty” is somewhat technical – under English law for example, a “warranty” is a statement that forms part of the contract, which if untrue gives rise to a claim for breach of contract whereas a “representation” is a statement given seeking to induce a party to enter into a transaction, a breach of which gives rise to a claim under the tort of misrepresentation. As a practical matter many practitioners use the terms together when referring to the statements in the transaction documents.

There are two principle ways to think about representations and warranties: first, as statements of fact; second, as a tool to apportion risk between the parties. Understanding how a counter-party views them is important in understanding whether the counter-party may be willing to share the risk in relation to matters outside its knowledge or control. A good example of this is future events, for instance if a seller views the representations and warranties as a method of risk apportionment, then it may be more open to give a representation in a transaction document that as of closing (which could be a few months in the future), the target business is not involved in any litigation.

The list of representations in a purchase agreement varies by deal. In most cases, however, they involve an extensive, complex set of statements that shed light on the condition of the business being sold. Are all assets on the balance sheet currently owned by the business being sold? Are there any upcoming contract expirations with significant customers? Do additional liabilities exist outside those listed on the balance sheet? The extent of the representations and warranties will also be dependent on the level of post-transaction risk that the seller is prepared to take. Many private equity sellers, for example, are required to distribute the proceeds following the sale of a business shortly after receipt of the sale proceeds, which means that they are unable to accept a material degree of post-transaction risk for any period of time.

Whilst the negotiation of the representations and warranties can be a time consuming and difficult process it is often a useful tool to solicit further information on the business being sold.

Nick Wall, Partner, Allen & Overy
Survey insights

In our survey, respondents said warranties on a company’s financials were a top concern during their recent cross-border transactions (FIGURE 14). Generally speaking, a financial statement’s representation is one of the most important representations for the buyer. A buyer will want the seller to stand by the financial information (and ideally projections) provided during the due diligence process. A seller will, however, generally be reluctant to give any representations in respect of financial information which has not been subject to any audit or other formal review process. Normally, they will prefer to limit the warranties to the standard applied in any such audit, for instance the audited accounts give a “true and fair” view under the relevant accounting policies.

Respondents likewise cited warranties on assets as one of their top concerns. While questions surrounding ownership of the assets being sold can arise, these trepidations were mostly qualitative in nature. Assets that do not meet buyer expectations due to misrepresentation from the seller can have a dramatic impact on integration and other aspects of the deal. There

FIGURE 14
What were the top concerns involving representations and warranties?

<table>
<thead>
<tr>
<th>Representation</th>
<th>Concern</th>
</tr>
</thead>
<tbody>
<tr>
<td>Warranties on financials</td>
<td>31%</td>
</tr>
<tr>
<td>Warranties on assets</td>
<td>12%</td>
</tr>
<tr>
<td>Warranties on intellectual property</td>
<td>12%</td>
</tr>
<tr>
<td>Warranties on regulation</td>
<td>10%</td>
</tr>
<tr>
<td>Warranties on tax</td>
<td>9%</td>
</tr>
<tr>
<td>Warranties on title, incorporation, solvency</td>
<td>7%</td>
</tr>
<tr>
<td>Warranties on environmental</td>
<td>6%</td>
</tr>
<tr>
<td>Creditworthiness of the warrantor</td>
<td>5%</td>
</tr>
<tr>
<td>Warranties on contractual arrangements</td>
<td>2%</td>
</tr>
</tbody>
</table>

Only options ranked of top concern are shown here.
can also be differing views on qualitative statements – for example, what in one person’s view may be “good working order” could be “obsolete and in need of replacement” in another’s.

In many cross-border ventures, especially for tech companies, issues involving intellectual property can surface. Buyers must ask if IP rights and patents infringe on anyone else’s rights or claims. As is often the case, it may take time for potential litigants to bring claims against a tech company or patent holder, by which time the company may have come under new ownership through M&A.

**Know the seller**

Unless other mechanics such as parent company guarantees or escrow arrangements are agreed, the value of the representations and warranties is dependent on the financial strength of the person giving them and the ability to enforce any claims against such person.

Again, a series of questions must be asked:
- Who is the seller?
- What will be their approach to warranties?
- Will they have the financial strength to stand behind the warranties they provide?

In particular, care is needed if the seller is in financial difficulty, it is a holding company or special purpose vehicle with no assets other than the business being sold, or an individual (with special care needed for individuals who are to remain involved in the business post-closing).

Additionally, buyers must ask whether an appropriate forum exists to hear any warranty claims and if necessary enforce such claims. For example, Japanese companies conducting business in Southeast Asia must ask if local courts and legal systems will hear their claims and uphold representation and warranty agreements should problems arise.

**Reps and warranties insurance (RWI)**

It is not uncommon for a buyer to require that a portion of the sale proceeds are set aside for a period to cover any potential warranty claims. This is often done using an escrow account. Another tool for managing risk is insurance covering the deal’s representations and warranties. Such policies insure buyers and/or sellers against claims arising from inaccuracies or breaches of the agreed upon representations and warranties.

The use of third parties has certain benefits to the deal. Aside from assuming a portion of the risk involved in transactions, it can also help make a bidder’s position more attractive in a competitive auction situation. While broad in their coverage, RWI generally excludes breaches of representations and warranties known prior to the drafting of the policy.
Experienced M&A practitioners know that once the deal closes, the real hard work in M&A begins. Merging the newly acquired asset with the parent company opens up a whole new set of challenges that acquirers must face. In cross-border M&A, these matters are complicated by the nuances of operating in a foreign market, such as language issues, national customs, and the local business environment.

In some ways, the challenges post-close can be more detrimental to the deal than those experienced during negotiations. Failure to manage problems or establish control can lead to runaway loss in momentum and, in worst cases, lost or eroded value.

Post-deal considerations
Reshaping existing supply lines at the acquired company to achieve cost synergies and leverage better negotiating power requires acquirers to firstly maintain and manage existing supplier relationships. This process involves assessing current contracts during the due diligence phase and determining the benefits and repercussions of restructuring these obligations. As such, this challenge topped the list of post-deal challenges among Japanese respondents (FIGURE 15).
Systems and business process integration is another notable challenge. Those surveyed cited differing process management and management styles, in addition to IT issues, as holding up the integration process.

Integrating employees and business cultures also scored highly among the challenges respondents faced. Employees at a business being sold will naturally be nervous about what impact the transaction will have on them and the new owner will need to move quickly to address such concerns. As in any major change process, bringing employees from one company under the umbrella of another creates the basis for a clash in corporate culture. This possibility is magnified in cross-border transactions, where national differences and entrenched cultural norms may not initially sit well alongside the parent company’s established business practices.

Communicating change
While language issues may have arisen or even hindered segments of the deal, Japanese respondents said that during their cross-border transactions structured communication programs were organized to help with the transition of ownership. In varying degrees, these programs included parties and stakeholders within the parent corporation and the newly acquired company (FIGURE 16).

According to the director of finance at an industrials company, “Each and every group associated with the organization was informed about changes unfolding during the acquisition. If these changes are communicated well throughout both organizations it will positively affect the overall investment and eventually help the company thrive.” This opinion was confirmed by another respondent, who said that any changes whether tangible or intangible require an effective communication framework to deliver the message throughout the organization.

FIGURE 16
Did you organize a structured communication program upon announcement of your most recent cross-border deal?

OWN ORGANIZATION
- Employees 52%
- Suppliers 42%
- Customers 71%
- Other stakeholders 72%

TARGET ORGANIZATION
- Employees 85%
- Suppliers 76%
- Customers 91%
- Other stakeholders 83%

CHALLENGES AND CONSIDERATIONS:
- Even greater time and resources may be needed post-close to ensure the deal yields results established in the M&A strategy
- Never underestimate the power of an effective communication program to inform staff at the parent organization and target company of changes and updates
- People and cultural issues can seriously obstruct integration if not addressed appropriately
M&A transactions do not fail on their own, nor will a recently merged company fall short of expectations without cause. Failure and underperformance occur because of people, or more accurately, because of mismanaged people during the post-deal phase of an acquisition. Integrating people and work cultures presents one of the larger stumbling blocks during a transaction. Add to this the hurdles inherent in cross-border M&A – language barriers and cultural incompatibility, to name a few – and companies can quickly see pre-deal victories turn to post-deal headaches.

Post-merger people integration need not be unnecessarily complicated. The obstacles that are sure to arise when two distinctly different corporate cultures meet can be addressed by adhering to a few simple steps. Following a mutually developed integration blueprint can engender a culture of cooperation between employees at the newly minted company. More importantly, it can improve the odds of a successful, well managed integration where value is created and synergy is realized.

Addressing cultural differences
Despite overwhelming evidence that cultural issues must be addressed swiftly, many executives believe it is possible to take a more gradual approach to integrating business cultures. This is a dangerous move. A passive approach of distributing internal material alone will not yield results. Instead, an active campaign to understand the value and ideas of employees at the acquired company must be undertaken, a process that is best implemented before the deal is closed.

Cultural differences and stereotypes must be addressed up front and quickly if they are to be recognized and used as a positive force for change within the organization. Above all else, respect and a willingness to understand these differences will help forge ties between employees. This proactive approach can prevent an “us and them” mentality from forming, a development which left unchecked can rapidly become an entrenched viewpoint and make it difficult for employees from seeing the long-term corporate vision.

Communication is key
Establishing effective lines of communication and anticipating concerns of target employees is indispensable to the integration process and to guaranteeing that corporate initiatives are carried out. The importance of communication is exemplified in several case examples.

In a recent cross-border transaction a Japanese company that had completed a transaction into the United States left decision making authority in the hands of the target’s management, commonly referred to as “omakase”, translated as “we’ll leave it to you”. That approach was taken since the Japanese owners were not familiar enough with the local business environment and operations of the newly acquired company. However, this meant that US managers were carrying out business as usual as required by their former owner instead of aligning with the Japanese acquirer’s long-term strategy.

Communication will also help address office culture and management differences. For instance, corporate Japan has a clearly defined hierarchy and corporate norms. Loyalty among employees leans toward the company, whereas Western employees place greater emphasis on individual development and advancement, typically requiring answers to the following questions: Who is my boss; what are my responsibilities; how will my
performance be measured; how much will I be rewarded; and what are my career advancement opportunities?

A lack of communication also leaves room for speculation among employees at the acquired company about their new owner’s intentions. This stress and uncertainty can lead to lost productivity and in some cases lost talent.

Designing an effective organization: Management selection
Developing a new organizational structure is more than just charts. Charts are about power and authority, whereas an effective organization is also about function and accountability, information flow, and the decision-making process. Within the new organization, the most qualified employees will need to be put into places of authority to govern integration and operation. The process of selecting these people should begin before the deal is consummated.

The biggest danger in this selection process is favoring your own people over prospective candidates at the acquired company or trying to be impartial by sharing positions between two legacy teams. Management should be analyzed based not just on capabilities but also based on their operating style and fit.

A practical approach to employee retention is to first identify top managers within the various functions. These managers can then select other employees for retention based on performance, merit, and necessity.

Employee benefits: Handle with care
Replacing employee benefits is a complex and sensitive process. Since it is unlikely that sufficient information on benefits programs at the target company will have been collected during due diligence, companies should make it a point to familiarize themselves with this part of the deal once the transaction is complete. Changing benefits schemes without adequate consideration can quickly lead to discontent from employees. Potentially, HR policies will need to be evaluated and replaced, along with performance systems and related internal infrastructure.

A common mistake companies often make is sending expats to their overseas acquisitions with no clear purpose or mandates from the parent organization. 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 so as to prevent mismanagement and disorganization at the target company.

Talent retention
Retaining key managers and employees at the acquired company will ensure business continuity and help expedite synergy realization. Identifying these employees should begin during due diligence, and appropriate retention packages should be offered as soon as possible once the transaction is completed. However, not all employees will base their decision to remain at the company based on money alone. In many cases, future prospects and career advancement will need to be offered to retain top managers and high-value employees.
ASSESSING STRENGTHS AND WEAKNESSES

Among respondents in our survey, when reflecting upon past transactions, they identified deal pricing issues, strategic assessments, and post-merger integration as the main challenges that needed to be overcome throughout the transaction (FIGURE 17). However, the survey also yielded a wide range of other challenges that needed to be addressed.

A director of strategy at a financial services firm pointed to due diligence and governance issues as creating the most frustration in his recent transaction into an Asian country. “Governance in Asian countries has yet to reach an international standard. As such, the availability of information in our deal was lack luster, and due diligence was difficult and time consuming. Also the structure of some companies is such that they are able to hide key financial and operational data.”

Overcoming traditional weaknesses
Even as Japanese corporations gain deal experience and develop best practices in their M&A ventures, many who recently completed a transaction noted gaps in deal consistency.

Language capabilities were most often cited as being the key challenge in conveying strategic goals and managing the integration process (FIGURE 18).

Securing on-going financial resources is another area where Japanese buyers have faced obstacles, whilst acquirers were also vocal on the need to improve cross cultural understanding.

The director of finance at a Japanese technology company elaborates on this, saying: “Since Japan is a country that relies...”

FIGURE 17
Rate the following in terms of the challenges it posed throughout the transaction...
on its cultural roots to conduct business, numerous cultural factors and their effect on the deal will make cross-border deal making challenging to Japanese bidders.” Japanese corporates with limited exposure to foreign markets may find themselves in an uncomfortable position when their passive approach to deal making comes head-to-head with more aggressive business environments. Even at the corporate level, company cultures may not align, causing integration efforts to stagnate – in rare circumstances, the deal could collapse altogether.

**Best practice? A tailored approach**

What then can Japanese acquirers do to improve their current methods of conducting M&A? Taking various executed transactions as reference, numerous best practices and case examples can be drawn from in order to provide a blueprint for success. Whilst the best practices of other business leaders can help guide transactions, a well-executed deal that yields the desired results will require a more tailored approach to fit the corporate strategy.

Respondents were asked to rate each on a scale from “very challenging” to “least challenging”:

- Very challenging
- Somewhat challenging

![Graph showing top weaknesses of Japanese bidders compared to international counterparts](image)

**FIGURE 18**

What do you think are the top weaknesses of Japanese bidders compared to their international counterparts?

- Language capabilities: 37%
- On-going financial resources available to support business growth: 16%
- Cultural understanding: 13%
- General perception: 8%
- On-going time and human resources available to support business growth: 4%
- Production development capabilities: 4%
- Flexibility: 4%
- Speed/responsiveness: 4%
- Negotiation skills: 3%
- Ability to offer superior valuations: 3%
- Establishing mutual understanding with sellers/target early on: 2%
- Technology skills: 1%

Only options ranked top weakness are shown here.
FEATURE:  
Kirin case study

At the time of its acquisition of Brazil’s Schincariol in 2011, Japanese beverage giant Kirin Holdings had limited M&A exposure outside Asia-Pacific. Unsurprisingly, the move caused media and investors to question its takeover offer valued at US$2.5bn. Despite skepticism, the case was a success and illustrates how Japanese dealmakers can increase the odds of success through speed and adaptability. These factors are especially crucial to completing deals when faced with competition for limited assets and in dealing with sellers from diverse business backgrounds and cultures.

BACKGROUND

BUYER: Kirin Holdings (JAPAN)

One of several leaders in the Japanese food and beverage industry and maker of popular Ichiban Shibori beer

Forced to search abroad for new profit growth due to intense competition and a shrinking home market

M&A resume included major acquisitions in 2009, including Australia’s largest beermaker Lion Nathan and a 48% stake in Philippines’ San Miguel Brewery

No prior M&A experience in South America

SELLER: Schincariol (BRAZIL)

Founded in 1939, the beverage maker grew from a small town business into Brazil’s second-largest beer producer and third-largest soft drink maker

Family-owned and operated since its founding, with ownership divided between two sides of the family in a 51-49 split

Beer consumption in Brazil jumped 11% in 2010, and is the third-largest beer consuming market after China and the United States
Clandestine negotiations
While it is not unusual for deal negotiations to be conducted under a cloak of confidentiality, the deal to acquire Schincariol required a whole new level of secrecy. The intricate split in shareholders pitted potential acquirers against two parties: a majority group of family members interested in selling and a minority group opposed to a sale. As the deal progressed, meetings between Kirin and Schincariol were held in private to keep details from leaking to the minority group or public.

The covert nature of the deal negotiations forced Kirin to work within a tight timeframe, a factor out of the norm for the typically meticulous Japanese. Within approximately four months from the first due diligence meetings, a deal was signed and completed on the same day in order to preserve confidentiality and avoid the risk of the minority shareholders attempting to block the transaction.

Due diligence and averting litigation
The speed with which the deal was carried out and level of access provided to internal Schincariol documents meant that due diligence was not as broad as typically seen in Japanese deals, but was adequate for the purposes of assessing the company and making an offer. Steps were not skipped, but simply expedited.

The threat of litigation from the minority group forced Kirin to consult legal advisors familiar with Brazilian legal frameworks. These advisors indicated Kirin was in a strong position to complete the deal and that the existing shareholders agreement – which contained limited rights of first refusal – would not be applicable in this case.

Aside from their specialized legal team, Kirin also utilized several local advisors who were plugged into the local business environment. Their insight and understanding of local nuances helped the deal maintain momentum in the late stages of the deal.

Integration and post-merger challenges
Once legal issues between the parties were cleared, a specialized integration team began bringing Schincariol under Kirin’s corporate umbrella. The team established a communication plan and answered employee questions regarding their new owners. Steps taken during negotiations and due diligence ensured that managers stayed on board and that crucial talent was retained. Consulting agreements were also set up with existing shareholders to assist with the transition before their departure.

From day one, the logistical and practical issues of the integration were apparent. Distance, language, and work culture between Kirin as a Japanese public company and Schincariol as a Brazilian family company were different in so many ways. To prevent relations between the employees and new owners from becoming strained, Kirin supplemented its internal integration team with consultants from the local branch of a global advisory firm to assist with and provide a local perspective to the integration process.

Kirin today
In terms of its original strategy – diversifying outside Japan, accessing a growing economy with a strong consumer market – Kirin accomplished its goals while successfully integrating Schincariol (now known as Brasil Kirin) into the group. While macro-economic issues have developed in Brazil in recent years, the Schincariol deal has put Kirin in a position to reap financial reward once the market recovers. It also armed Kirin with a number of best practices in cross-border M&A to use in future transactions into emerging markets.
Despite the challenges and trials faced when completing international deals, cross-border M&A need not be an unsurmountable task. While creating value from these transactions is far from guaranteed, adhering to set of rules and principles can help ensure that deals remain on track and that post-close integration creates an entity where synergies can be more easily realized.

From our survey and research, the following points have emerged. While each deal is unique, drawing from these practices can help Japanese acquirers navigate the deal process in their outbound ventures.

**M&A STRATEGY**

- Establish a concrete set of deal rationale and business drivers before considering cross-border M&A.
- Consider the regulatory, political, and social issues unique to each geography that you plan to enter.
- Select an investment approach that suits your corporate development strategy.
- Undertake a thorough assessment of the risks inherent in various markets, particularly in the emerging world.
- Recognize that strategy formation is a time and resources intensive process and should be treated as such.
- Clearly define who will drive strategy within your company and develop a decision-making hierarchy to expedite each aspect of the deal.

**SOURCING A DEAL**

- Adopt an opportunistic approach to the identification and pursuit of potential counterparts.
- Commit time and resource to building relationships and unlocking your main priority targets.
**CONDUCTING DUE DILIGENCE**

- Emphasize the importance of conducting a thorough investigative process of the target company’s business practices, financials, legal, commercial, environmental, and other liabilities.
- Consult advisors early in the deal process as bringing in these professionals from the start of a cross-border acquisition will allow them to become an integral part of the deal team.
- Invest time to build a tailored financial model that focuses on the value drivers supporting the proposed transaction.
- Evaluate and make plans to control compliance risks and establish strong business practices.
- Involve appropriate internal experts such as IT, HR, Finance, etc. Their input will be valuable and it will help them plan for the integration.

**NEGOTIATING AND THE SALES PROCESS**

- Be prepared to communicate goals and strategy with the selling party and maintain these lines of communication throughout the transaction.
- Know the tactics and methods that will enable your company to stand out from other competitors during M&A auctions.
- Enter the sale process with a degree of flexibility, as unforeseen turns in auctions or exclusive negotiations may force prospective acquirers to act quickly.
- Understand what is market and the concerns your counter party will have.
- Avoid large gaps between signing and closing, unless necessary, to get regulatory approvals – during this period a disinterested seller is managing your new investment.

**POST-MERGER INTEGRATION**

- Plan on the basis that post-merger integration is a resource intensive process requiring a hands-on approach from various parts of the business.
- Develop an effective communication program to relay corporate strategy to employees at the newly acquired firm and to existing staff.
- Ensure that people and cultural issues that arise during integration do not carry over– quickly address employee concerns and establish a joint work force to help drive integration and realize synergies.
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