Strengthening Due Diligence In Cross Border M&A

Although the pace of global M&A slowed during the past two quarters, overall deal count is up in 2011.

During 2012, M&A activity is expected to increase as firms shop for bargains, the global economy edges toward recovery, and cross-border acquisitions by companies in China, India and Brazil continue to rise. Yet, for businesses in both developed and emerging markets there remains slim margin for error in doing deals, raising the bar on due diligence, particularly in cross-border M&A.

To help get transaction pricing right and enhance the likelihood that the combination will achieve its aims, effective due diligence calls for understanding and quantifying the spectrum of potential risks associated with the target company. That starts with assembling a multi-disciplinary team, keeping them informed and engaged, and project managing each element of the due diligence process, according to a panel of M&A experts who participated in a live video webcast – "Strengthening Cross-Border M&A Due Diligence" – presented by Zurich and hosted by *Global Finance*.

While composition of due diligence teams varies by the target company's industry, size, geographic footprint and other factors, team members typically come from multiple disciplines and functions. It's important to manage the process effectively—both vertically within specific disciplines and countries, and horizontally, to get people communicating outside of traditional silos, according to the panel. Buyers lacking a presence in countries where the target firm operates need outside advisors who know local regulations and business practices.

From left to right: Joseph Giarraputo of *Global Finance*, Michael Kerner of Zurich, Duncan Smithson of Mercer, Robert Masella of Clifford Chance and John Marra of PwC

Despite the proliferation of international accounting standards, for businesses making acquisitions in emerging markets, accounting issues can be thorny. Additionally, challenges related to the integrity of financial data cannot be underestimated.

"How good are the numbers?" asked John Marra, partner, Transaction Services practice, PwC. "It's important that the trail the seller provides to represent historic activity is really indicative of the business being acquired, and that due diligence assets and liabilities are indeed those to be acquired or assumed."

While a myriad of legal, regulatory, and political risk issues confront dealmakers targeting acquisitions in emerging countries, compliance with the US Foreign Corrupt Practices Act and the UK Anti-Bribery Act calls for an "intense due diligence process," said Robert Masella, partner, Clifford Chance. "Talk to the company. Ask about business practices. Identify what government officials are involved—and how they're involved." Also, firms should "determine if there are unusual payments or structures used for payments, such as shell companies."

The succession of natural catastrophes in all parts of the world underscores the importance of including a thorough evaluation of hazard risks and their potential impacts as part of due diligence. "Supply chains are relevant in context of M&A transactions," said Michael Kerner, CEO of Zurich Global Corporate in North America. Buyers must identify "catastrophes likely to cause a supply chain to break," how to address the risk and make a supply chain more resilient, he said. Firms also must evaluate construction quality of a target's facilities to assess potential vulnerability to natural disasters.

Among the human capital risks are challenges associated with underfunded or unfunded pensions, regulatory restrictions that might impede workforce synergies, and cultural issues, which can cause a deal to fail.

"While the value created through deals is measured on a financial basis, success ultimately comes down to whether or not you meet your key performance indicators," said Duncan Smithson, partner at Mercer. "And value is created through your people."