KPMG FAS Newsletter

Driver

Vol. 06 February 2020

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KPMG FAS Newsletter

Driver

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The growing importance of ESG due diligence

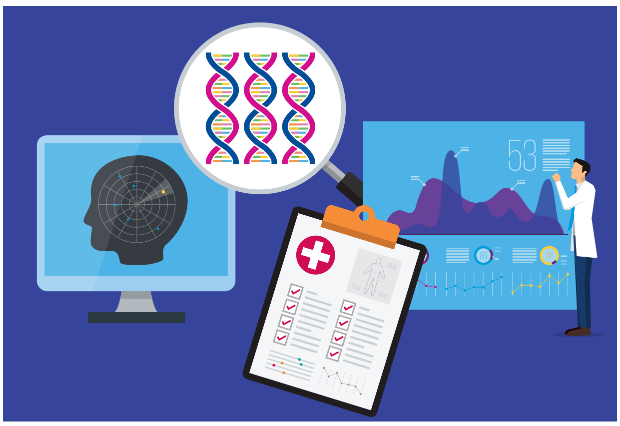
The verdict is out that ESG investment, which takes into account non-financial information such as environmental, social and governance initiatives, is on the rise in the mainstream global investment community. For institutional investors, what's most important is a company's mid- to long-term value creation capabilities, and non-financial information is beginning to play an important role in the forecasting of such capabilities.

The same is true with M&A. From an ESG perspective, performing due diligence helps us to gain a grasp of the value creation potential and also the latent risks of a company, while reducing uncertainties surrounding a transaction. For example, in terms of the "E" for "environment," it is considered crucial to understand the risks associated with greenhouse gas emissions, both from the perspective of strengthening regulations and in regard to pre-emptively understanding both financial and non-financial consequences. Also, in terms of the "S" for "society," it is essential that companies make sure their supply chains pose zero risk to the protection of human rights. In any case, it is vital that companies prioritize proper evaluations based on the business structures of the companies they seek to acquire.

The digital healthcare revolution taking place in Japan

If you look at humans as products of biochemical algorithms, the penetration of digital technology into the healthcare field seems inevitable. As ethical issues are increasingly debated, we expect to see rapid progress in the healthcare field throughout the 2020s. To take full advantage of digitalization, it will be essential to model the profitability of research results. In this sense, 2019 was a milestone year.

Last year, Japan saw a number of medical breakthroughs, including its first officially approved AI medical device, insurance coverage for cancer gene panel testing, approval for the anonymized repurposing of medical information as based on the Next Generation Medical Infrastructure Act, and the launch of data scientist development projects at several universities. In addition, companies pioneering in the data analytics, online diagnosis and PHR domains went public one after another, signaling the upscaling of the digital field. Now, at the head of a new decade, we want to reaffirm three points that will be key for profit modeling: finding new approaches to address industry issues, assessing the maturity of institutional environments, and the co-creation of healthcare ecosystems.



The post-2020 inbound market

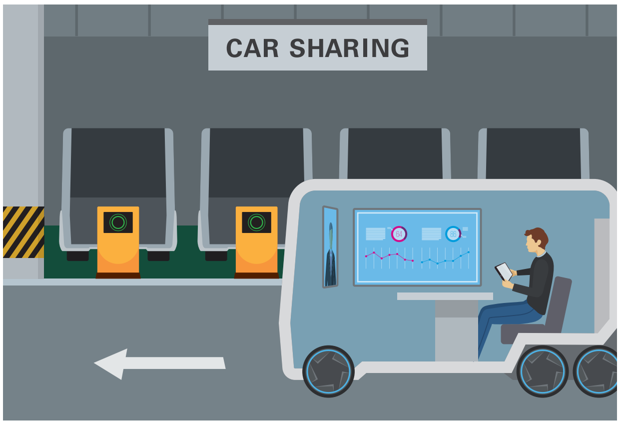
While the number of foreign visitors to Japan has continued to grow in recent years, the rate of growth has started to slow as a result of such factors as deteriorating Japanese-Korean relations and the impact of natural disasters. In 2019 we saw a 2.2% increase, with an annual total of 32 million visitors. Travel styles are becoming increasingly diversified, influenced by an increase in personal travel as well as a shift from consuming objects to consuming experiences, and amid such trends, digital transformation initiatives that enhance the convenience of travel will be a key part of capturing ongoing demand for inbound tourism.

In order to respond to travelers' diverse needs in terms of transportation, merchandise, food and drink, lodging and even experience-based content and services, there is demand for tourism industry operators to accelerate business alliances and data linkages with companies from different industries so that they can provide personalized solutions and travel services that individuals can freely design. In this way, the post-Olympic inbound market is shifting from a focus on the quantity of inbound tourists to business models that emphasize the quality of services as based on the individuality of each traveler. Accordingly, an era of dynamic transformations that transcend industry boundaries, such as the construction of cross-industry digital platforms, is expected to take place.

Boxes that move and boxes that don't: Using digitalization to combine the two and create value

Real estate and cars actually have some things in common. Real estate is equipped with electricity and water supply and drainage facilities, and cars are equipped with modules (assemblies of parts), such as engines. The advancement of IoT technology is enabling the collection and analysis of operating data from each of these facilities and modules to ensure efficient maintenance. While real estate can be viewed as a box, within which activities like manufacturing, sales and lodging take place, as autonomous driving becomes a possibility, cars too will be viewed as spaces for activities rather than just as sources of transportation. As a result, the interchangeability of real estate and automobiles is expected come to the fore.

Advances in digitalization will produce further linkage between non-moving boxes – real estate – and moving boxes – automobiles. Initiatives such as creating car-sharing bases in underutilized underground parking lots of urban offices, or using ride-sharing to support residential areas with poor access to public transportation are some examples of how new value can be created through the digital linkage of moving and non-moving boxes.



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As Japan's domestic market shrinks, Japanese companies are continuing to pursue opportunities in new markets by acquiring overseas businesses aiming for future growth. However, as buyers, they continue to face a range of post-acquisition challenges associated with management, human resources, corporate systems and corporate culture. Key to successful overseas M&A is to ensure an individual understanding of the local characteristics in the country or region of the acquisition.
How do you balance the risks and benefits associated with successful overseas market entry? Over the course of three consecutive issues, we will cover eight major global markets and explain the market characteristics that should be understood in order to link M&A to subsequent value creation, as well as points to be mindful of at the execution stage of investment.

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Close-up 1

Accelerating overseas M&A

Challenges facing Japanese companies and keys to success

Author:
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The CEOs of global companies today are tasked with setting “double-digit growth” targets. Single-digit growth is hardly recognized. Even more difficult, double-digit growth is expected to be achieved while maintaining high profitability. This being the case, how exactly are CEOs meeting their targets? There are two key approaches to this. The first is to do business in growth markets, and the second is to achieve growth through M&A. For Japanese companies, engaging in overseas M&A is a way to apply both of these approaches simultaneously. However, from the perspective of corporate systems and human resources, realizing corporate value creation through overseas M&A is still easier said than done for many Japanese companies. It is unlikely that Japanese companies seeking overseas M&A will achieve double-digit growth without the following: a solid vision toward corporate management and company structure, and a preparedness to tackle unique challenges that present themselves in every region of operation.

Challenges facing Japanese companies considering overseas M&A

In recent years, M&A has been recognized as an effective tool for Japanese companies to achieve growth in the global market, and many Japanese companies have come to accelerate their overseas M&A efforts. But overseas M&A does come with its own set of challenges, and in not a few cases the expected results failed to be achieved. According to the results of a Ministry of Economy, Trade and Industry (METI) survey published in April 2019 on the topic of overseas M&A undertaken by Japanese companies, many Japanese companies have experienced the following issues:

These issues were identified by METI through interviews, group discussions and workshops involving companies and investment funds with experience in M&A, and by listening firsthand to individuals who have played a front-line role in the M&A process.

Shortage of global management skills

Let's begin by considering the critical issue of effective communication. Demonstrating an ability to communicate is impossible unless the content being conveyed is as clear and precise as possible. Of particular importance is "M&A objectives" – that is, the subtle sharpening of one's message to express what is hoped to be gained from the M&A. M&A objectives must be clarified – not just from the buyer's perspective but from that of the target company, too. This is because the objectives of the M&A is of more interest to the management and employees of the target company than it is to the buyer. Target companies must be able to clearly understand the benefits that they stand to reap from buyers, such as technology, know-how, brand value, economies of scale, access to new markets and networks, financial support and so forth. Such criteria are even more crucial to consider at the very onset of a deal than they are during the PMI (post-merger integration) phase because they influence the target company or seller when they are choosing a buyer. Demonstrating the critical ability to communicate requires that companies refine the quality of the content they will be using to convey their messages.

Another element that underpins the ability to communicate is the presence of global managerial talent. For buyer companies, the biggest post-M&A topic is the execution of their own corporate strategy and creation of value through the improvement of target companies' competitive viability and performance. To achieve this, a buyer company must first earn the trust of target company management teams and employees, foster understanding of the buyer's

Challenges facing Japanese companies conducting overseas M&A

Lack of global management skills

- The ability to clearly communicate your company's management philosophy, vision and strengths, as well as the positioning of M&A within your overall strategy
- The language skills required to clearly communicate the above
- The ability to adapt to different corporate cultures as a means for effectively promoting post-acquisition management

Inadequate global management systems and structures

- The implementation of corporate governance that embodies both responsibility and accountability
- A compensation system that conforms to global standards, including incentives

Insufficient preparation of M&A process frameworks

- Clarification of important points for every relevant M&A process - from strategy and execution to PMIs
- Formation of M&A-related units within companies

Source: METI's "Report on Survey for Current Situations of Japanese Companies' Cross-border M&A Compiled" (published April 2019) own strategies and make use of human resources that can contribute to the competitive viability and performance of the target company. Effectively promoting the fulfillment of these goals requires the presence of highly skilled and experienced global managerial talent who, on top of having strong language skills, can facilitate tasks such as the reconciling of disparate corporate cultures. Especially important is the ability to grasp the movements of various markets (e.g. for products and services, procurement and human resources) and business environments (competitive, regulatory, social) impacting target companies, identify opportunities and issues to be addressed, and then harness the ability to work with target company management teams and employees to speedily implement whatever measures are deemed necessary.

Key points regarding “management delegation”

Japanese companies have a limited number of global managers with the kind of communication abilities and experience described above. To account for this, Japanese companies have come to rely on a method known as “management delegation.” As is the practice of many European and U.S. companies, this method does not involve post-acquisition deployment of new managers, but rather relies on existing managers at the target company, who remain in place and are entrusted with implementing the buyer company’s corporate strategy. This approach makes sense from a business standpoint – but there are some important points to keep in mind.

First, since existing managers continue to have considerable clout at target companies, buyer companies must rely on them to realize the effects that the M&A is intended to achieve. However, existing managers may not relinquish their discretionary powers so easily, and this resistance can lead to conflicts of interest and time-consuming efforts to rectify the situation. Therefore, it is important for buyer companies to determine whether existing managers at the target company are positively inclined toward the strategies they wish to implement.

Second, if existing managers are to be entrusted with post-acquisition management responsibilities, governance of the target company must be planned and implemented even more precisely than before. Beginning with the task of designating scopes of authority, discussions must be held with existing managers to build consensus around performance, risk management and systems for setting and evaluating targets, among other things. Managers dispatched by buyer companies to take care of such tasks must possess a certain degree of global management expertise.

Setting patterns for success

The key point of the METI report’s observation regarding “insufficient preparation of M&A process frameworks” relates to development of the processes and systems that are fundamental to the success of a merger or acquisition. The implication is that many Japanese companies still have room to improve their handling of M&A processes. In recent years, the popularity of M&A as a tool has led to an increase in the level of knowledge about M&A-related processes, such as corporate valuation, due diligence, contract negotiation and PMI. However, few companies have taken the step of clearly defining a “pattern for success” based on their experience with M&A. Companies such as Japan Tobacco, Nidec, Dentsu, Asahi Kasei and Recruit have been working on “framework-making” to promote more effective use of the experience garnered from the many M&A deals in which they’ve been involved. As an example, these companies have developed frameworks for consideration of the following items:

- Consistency between business strategy and M&A
- Acquisition criteria (including price) and negotiating position
- Post-acquisition management-related human resource requirements and their procurement
- Commitment of resources (technology/know-how, networks, tools, etc.) to improve target company competitivity and performance and anticipated outcomes
- Retention plan for managers, key personnel
- Objective evaluation systems for target company management/employees and compensation/incentives
- Basic approach to governance at target companies
- Performance assessment and risk-management systems to be introduced at target companies

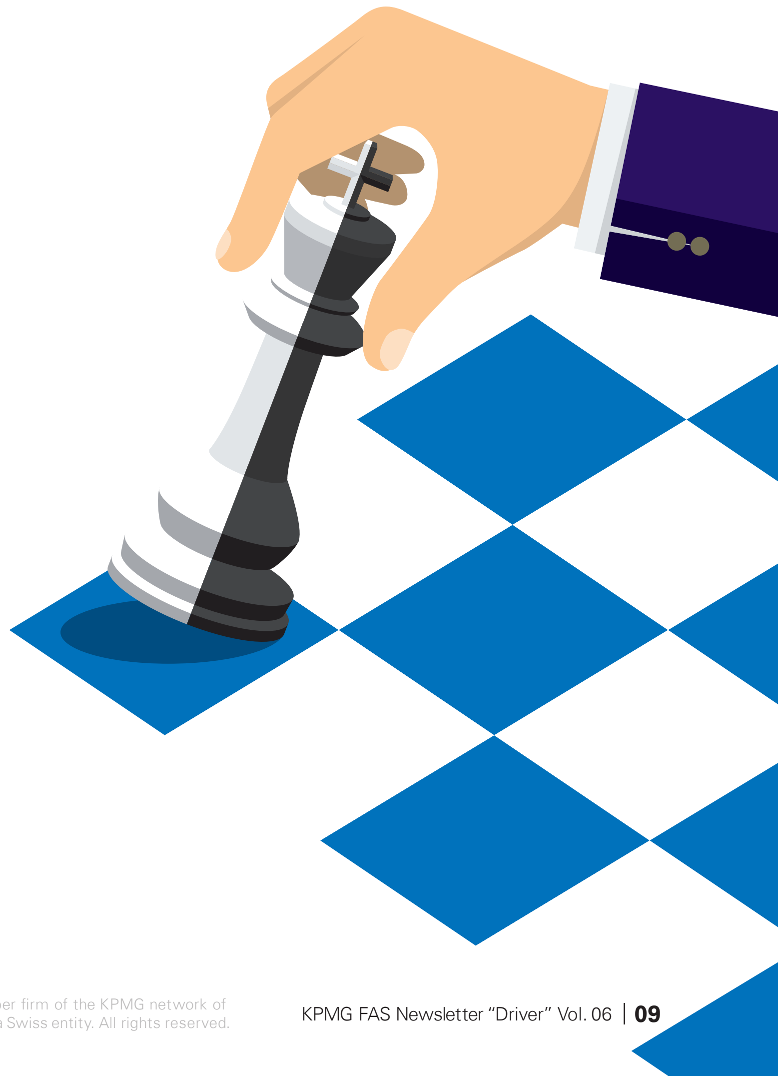
Setting up frameworks and defining approaches for these important issues should be done well before kicking off an M&A transaction because everyone involved will soon become bogged down with day-to-day activities. These frameworks and approaches should also be updated after every new M&A experience to further refine your patterns for success and allow your team to approach new opportunities with confidence.

Considering the uniqueness of each country/region

Without a doubt, overseas M&A can be a powerful tool for building global business models that make good use of the strengths that a company has cultivated. However, overseas M&A can involve a broad spectrum of target countries and regions. The unique nature of each country and region makes it crucial that opportunities and issues stemming from a wide array of factors are taken into consideration, exposing all potential risks. Such factors include population demographics, market size, standard of living, customer characteristics, business practices, laws and regulations, infrastructure, value systems and so forth.

To recap, in addition to establishing patterns for success that can be applied to M&A cases in a general sense, you must also understand the regional characteristics that are unique to each market from both macro and micro perspectives in order to be well prepared for any challenges that may arise from them. Countless M&As have failed due to a less-than-thorough grasp of and insufficient preparation for regional and market characteristics.

This issue is the first in a three-issue series taking a look at eight key countries and regions – the United States, India, China, ASEAN, Australia, the United Kingdom, continental Europe and South America – for overseas M&A by Japanese companies. Based on the characteristics of each market, KPMG deal advisory experts will highlight issues that are commonly faced by Japanese companies when conducting M&A investment and subsequent value creation and provide recommendations for how best to confront such issues.



Close-up 2

Navigating the U.S. M&A market

Authors:
Shinichi Yoshino / Partner (photo left)
Donald L Zambarano / Partner (photo right)

The U.S. ranks as the world's largest M&A market. For the past decade it has been the top M&A destination for Japanese companies, receiving about 3.5 times more Japanese investment than the UK - their next favorite M&A destination. Looking at cumulative totals of the past 5 years, Japan is the world's largest investor in Silicon Valley, with China a distant second. The U.S. is clearly an important market for the future growth of Japanese companies seeking to expand globally, and while the history of Japanese M&A activity in the U.S. dates back to the 1980s, it remains to be a market with inherent challenges that require careful attention. In recent years there are signs of a shift in the reputation of Japanese companies as buyers in the U.S. Below we uncover some of the unique characteristics and challenges of M&A in the U.S., as well as offering some advice for achieving success.

Uncertainties and political risks in the U.S. market

While the US-China trade war began to take hold from summer 2018, it took until January 2020 for the U.S. and China to finally form an agreement - after imposing various sanctions and tariffs on each other - helping avoid further turmoil for the time being. Nonetheless, the first phase of their agreement clearly specified numerical targets for the export of goods and services from the U.S. to China, including more than doubling U.S. agricultural products to China, and with time limits for each item. Depending on how things progress going forward, it is quite possible that dark clouds could appear above U.S.-China relations once again.

Since taking office in 2017, the Trump administration has focused on its "America First" policy. Aside from trade with China, the administration has repeatedly invoked policies that affect how business is carried out in the U.S., including sanctions and tariffs on Mexico stemming from the illegal immigration issue. Japanese companies operating in the U.S. need to continually monitor the effects of such administrative policies and seek the advice of experts in related fields.

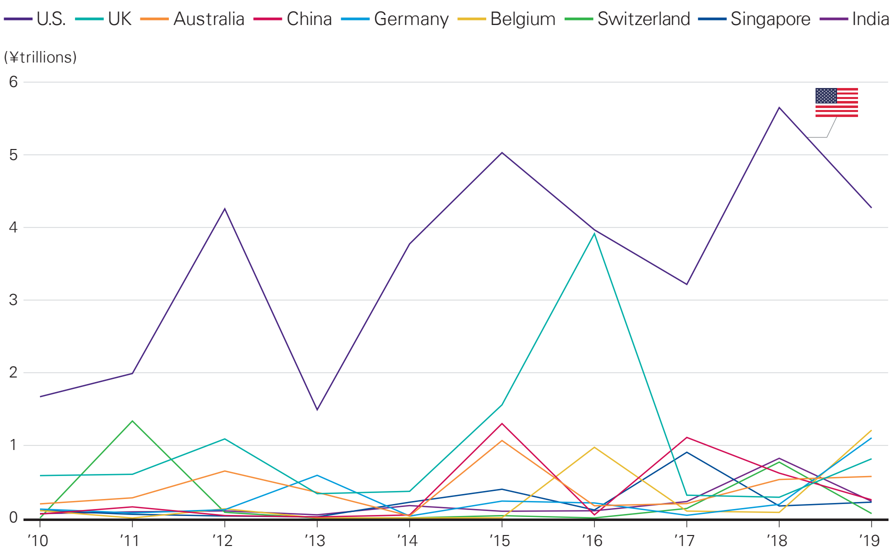
As a foreign company considering investing in a U.S. company, one law that requires particular attention is the Foreign Investment Risk Review Modernization Act (FIRRMA). FIRRMA gives the Committee on Foreign Investment in the United States (CFIUS) the authority to review and regulate investment in the U.S. from the perspective of U.S. security. FIRRMA regulates foreign investment in U.S. companies with significant technology and industrial bases. In the past, there have been cases where CFIUS pre-screening has prevented foreign companies from conducting large-scale M&A deals with U.S. companies. As shown by the U.S. government ban on Chinese telecommunications giant Huawei, the essential target of FIRRMA is said to be Chinese companies, but Japanese companies also need to consider the impact.

New FIRRMA rules being introduced in February 2020 bring an expanded scope to CIFUS screening, and the definition of technologies important to the U.S. is left unclear, triggering concerns that their interpretation may be expanded. In the future, it is highly probable that this will impact Japanese companies with a presence in China, limiting their ability to conduct free investment activities in the U.S. market. If a company goes to sell a U.S. subsidiary as part of restructuring, there is a chance they could have a deal blocked, depending on who the buyer is.

Speed in decision making

Overseas M&A by Japanese companies has significantly exceeded the volume of M&A carried out domestically in Japan over the past decade. The U.S. has continued to be the largest foreign investment destination for Japanese companies, including during the early 2000s when investment in emerging markets such as India and China became popular. Japan also has the highest track record of any country for investing in startups, with activity mainly centered around Silicon Valley. From 2015 to 2018, the total investment by Japanese companies in Silicon Valley was $24.9 billion, well above China in second with $16.0 billion.

M&A investments by Japanese companies (by country)

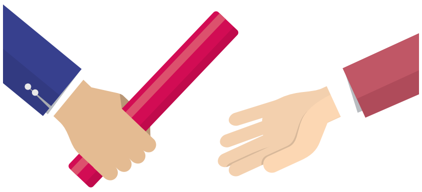


Source: RECOF M&A Database
Note: Excludes Takeda Pharmaceutical's acquisition of Shire (Ireland) in 2018 (approximately ¥6.8 trillion)

Behind this record of investment in Silicon Valley, is a strategy of many Japanese companies to incorporate innovation to strengthen or develop their existing businesses, or to bridge the development of new businesses that will become earnings pillars in the future. While Japanese companies generally seek out startups with innovative technologies and business models in Silicon Valley, they often face various barriers before reaching the point of actually investing. One of the major obstacles is the difference in corporate culture. Startup founders and their shareholders place high value on the speed of operations, and usually maintain clearly defined decision-making criteria. In contrast, Japanese companies take time to make decisions, and in many cases, the person in charge of on-the-ground negotiations is not authorized to make the final investment decision.

It is common for Japanese companies to have locally based staff gathering information without being given a clear investment strategy from their head office. The plan may be to collect some information before deciding the direction and strategy of the investment, but this is inefficient and time consuming.

It is important to clearly define the positioning of M&A within the overall company strategy and to clearly explain the purpose of any acquisition both inside and outside the company. Based on this premise, in order to succeed at M&A in Silicon Valley and in the U.S. as a whole, Japanese companies must utilize their best human resources directly from head office, give them final decision-making power on investment, and have them directly negotiate with sellers of the target company. Since they will be working in partnership with U.S. managers and shareholders who demand a sense of speed in operations, it is vital to proceed with the M&A process efficiently and effectively, while maintaining an unwavering focus on your final goal.



Addressing high valuations and impairment risks

The U.S. is the world's largest M&A market, with an annual scale that has surpassed $2 trillion in three out of the last five years. While it may be the largest overseas M&A destination for Japanese companies, it tends to have high M&A valuations due to the fierce competitive environment. A portion of the premium paid in acquisition price may be recorded as goodwill on the acquiring company's balance sheet, and is subject to impairment risk.

However, in the current business environment, where markets are globalizing and industries are becoming increasingly oligopolized by certain top-tier companies, there is an undeniable strategic risk in not doing M&A in the U.S., in the sense that it would be a missed opportunity to secure a U.S. firm with a well-established brand in the largest economy in the world.

Post-acquisition impairment risk should be considered as part of the overall future growth strategy of the company as an individual entity. The ultimate investment decision is a judgement based on the envisaged value that will be created over the mid to long term as a result of integrating the target company into your own group.

The first step a company should take in M&A to manage the risk of goodwill impairment after an acquisition is to carry out a valuation of the target company based on thorough due diligence (DD). A thorough valuation of the target company based on DD, including its brand power and intellectual property, should be carried out across its business, finance, legal affairs, human resources and IT divisions. While things may be different if the acquiring company has a long-standing business relationship with the target company, for many acquiring companies DD is a process that will need to be carried out on repeated occasions—before and during the M&A negotiations, and even after the acquisition. Based on the results, it is important to establish governance

systems including an appropriate organizational structure and allocation of personnel, and also to continuously implement and review the synergy plan in order to achieve strategic value creation goals.

Retaining key people

Following the acquisition of a U.S. company, maintaining the motivation of its managers and other key people in the company is vital to achieving success with early integration and realizing synergies.

Average annual incomes across the U.S. are generally higher than those in Japan, and depending on the industry and job title they can sometimes be several times the Japan average. It is not uncommon for managers and executives to have exceptionally high income. At a relatively early stage in the M&A process, it is important to gain an understanding of the employment conditions and salary levels of the managers and employees of the target company, and launch a new post-acquisition HR and compensation system, as well as a directive system that incorporates the head office.

Japanese companies carrying out M&A deals often shift the target company to the acquiring company's own employment standards, or they establish a global standard after the acquisition. A change in employment standards may trigger a key person to leave the company, which could not only jeopardize your ability to achieve the original synergy plan but may also affect the performance of existing businesses.

This is an extremely important point, and the head office needs to be prepared to transform itself to match global management standards.

Japanese companies as buyers in the market

In the 2000s when we saw rapid growth in emerging economies, Chinese companies became more active in the U.S. At that time, Japanese companies gained an unfavorable reputation in the U.S. for being slow to make decisions and more likely to engage in prolonged negotiations. Contrastingly, Chinese companies were seen to have comparatively quick decision making and strong financial resources. However, this reputation in the U.S. has recently been changing. Due to the recent sanctions and tariffs and an overall deterioration of U.S.-China relations, Chinese companies have been facing a headwind, and there has been an increase in cases of Chinese companies in the U.S. breaching investment contracts and causing negotiation issues. Despite being cautious in negotiations and investment decisions, Japanese companies are starting to gain a reputation as buyers who respond in good faith once the terms of the contract are determined.

With its world-leading and continuously growing economy, the U.S. attracts talent from around the world, not only to Silicon Valley but across all its centers. The U.S. will remain a center of global business, and a core target for Japanese companies seeking to fulfill their growth strategies and global business goals. Despite some uncertainty about the business environment, both U.S. and overseas companies are essentially on a level playing field. Our hope is that many Japanese companies can successfully overcome the unique challenges of M&A in the U.S., surpass global competition, and build a sustainable growth base for the future.

Close-up 3

M&A in India

Current challenges and possibilities

Authors:
Seiji Ota / Partner (photo right)
Fumiyoshi Yamaguchi / Director (photo left)

India is in the running to be one of the top two most promising investment destinations for Japanese companies. As another wave of economic growth appears poised to lift the world's developing economies, India is a prime destination for Japanese companies that have already broken through in China and Southeast Asia. And yet the pace of entry into the Indian market has been slow.

While it has long been said that the keys to success in India are favorable relationships with local partners, thorough localization efforts, proper delegation of authority and quick decision-making systems, the fact is that many Japanese companies continue to struggle there. In the following, we consider ways for Japanese companies to succeed at M&A in the Indian market – where it can take up to five years to turn a profit.

The Indian market is hot ... but challenging

The Indian economy, described as being more than a decade behind that of China, is developing steadily and expected to surpass Japan in GDP terms by 2029. Domestic demand in a huge market boasting a population of 1.3 billion, combined with expectations for high growth and the realization of latent potential, have led to a gradual increase in the number and size of investments made by Japanese companies in India. Japanese companies that have already entered the Indian market are beginning to see results. But many others say that Japanese companies face significant difficulties when seeking to conduct M&As involving Indian companies.

The context for this statement is that, first and foremost, investing in Indian companies can constitute a long-term ordeal requiring significant patience and effort. In terms of negotiations, not only have pricing discussions necessitated fierce talks with target companies, but there have been instances in which target companies have requested retroactive changes to key contract documents such as memorandum of understanding and share purchase agreements. In terms of due diligence, information management at Indian companies tends to be poor, with desired information being hard to obtain and the process subject to delay. Indian authorities have failed on numerous occasions to grant timely approvals for various closing requirements related to licensing and so forth even after share purchase agreements had been signed.

Furthermore, even after investing so much time and despite expectations of being able to capitalize on domestic demand in the Indian market, companies have come to realize that the Indian market is much more cost-conscious than previously anticipated. Since the expected quality and pricing of products and services differ from region to region based on income levels and other characteristics, the investor faces difficulty in swiftly achieving profit plans envisaged at the onset of investments and also confronts impairment risks. The most worrisome topic for Japanese companies has been the question, "To whom can we entrust management of our Indian company?" Most companies end up leaving management in the hands of the existing Indian team, or appointing Japanese management personnel from within their own ranks. Few opt to look outside of their organizations to recruit executive talent.

However, these are common issues to be found in any developing market and are not necessarily unique to India. What, then, are the real difficulties facing Japanese companies investing in the Indian market?

Key issues that arise during Indian M&A

Valuation

- In accordance with the Foreign Exchange and Management Act, M&A deals involving the transfer of Indian corporate stock to a foreign corporation are subject to pricing guidelines set by the Reserve Bank of India (RBI) and require the RBI's prior approval
- Foreign companies can only acquire shares from Indian companies at prices equivalent to or above the fair value (FV) set by specially licensed experts in India
- If a foreign company sells its business to an Indian resident, the business can only be transferred at a price equivalent to or lower than the applicable FV (resulting in the risk that put options may be impeded)

Due diligence

- Profit-inflation by target companies
  - Increased sales and reduced costs via related-party transactions with seller-side promoter affiliates
  - Unallocated and unamortized receivables despite un-collectibility
  - Unlawful underpayment of wages to factory workers and contract employees, unlawfully low rates of salary increment
- Insufficient registration of land ownership, inadequate maintenance of license and permits including Consent to Operate (CTO) various operations and procedures

Laws and financial regulations

- When acquiring part of a listed Indian company's business via corporate carve-out, permission must be granted by Indian judicial authorities (time-consuming process)
- When a foreign company receives damages from an Indian company, prior approval by the RBI may be required under the Foreign Exchange and Management Act
- When a foreign company seeks to acquire a stake in an Indian company, it must provide proof of the trading value via an AD Category-I Bank (and payment must be conducted before the acquisition of shares is completed)

“Hot” top management, “cold” middle management

Few top management teams have given up on the Indian market—seeing as it’s the next major market for Japanese companies—and an increasing number of corporations are targeting India as part of their upcoming medium-term management plans. However, if you talk to middle management at any Japanese company targeting India as part of its next mid-term plan and ask them about their impressions of the Indian market, the responses are going to be polarized. No matter whom you ask, it’s likely that everyone apart from the individuals responsible for the India strategy in the first place will be less than enthusiastic. In fact, statistically, it appears that the rate of penetration into the Indian market has been even slower than the rate at which companies penetrated the Chinese market. So, what exactly is the reason for this difference in attitude between top and middle management?

Many Japanese businesspeople seem to hold the prejudiced opinion that Indian people are difficult to work with. From the perspective of businesspeople who are accustomed to Japanese culture and the capacity for individuals to somehow mutually grasp each other’s intentions, there is a sense that Indians are long-winded and audacious. For middle managers at Japanese companies who hold such impressions and who are ordered to participate in M&A projects in India, the pursuit of solutions that minimize investment risk often involves repeated and longform communications – an experience that can turn them off to the idea of engagement with Indian companies. For this reason, middle managers tend not to have such strong feelings and a sense of crisis as their upper management.

However, if a company invests in an Indian enterprise and simply entrusts management of the business to the existing management team, the company will struggle to set the ship right if results begin to sour and the cause of the poor performance is not identified in a timely manner. This being the case, from a long-term perspective it is necessary for companies to internally cultivate human resources who have been fully immersed in Indian projects and business. To accomplish this goal, top managers cannot simply leave this task to middle management. Rather, they must demonstrate that they are serious about the Indian business, and headquarters must implement measures to increase motivation by offering necessary support and feedback.

In fact, many young Japanese have quit their jobs at Japanese companies to pursue personal development in India that they felt was unobtainable in advanced, developed nations. If companies hope to penetrate the Indian market, top management might need to create jobs that offer the same rate and expectations for growth while establishing a work environment that can attract young talent by enticing them with the promise of realizing their Indian dream.

Keys to M&A success in India

It’s often said that corporate Japan’s successful penetration of the Chinese market has not been repeated in India; what isn’t said is that this is because companies are facing distinctly different environmental and historical factors than those found in China during the 2000s. Back then, Japanese companies sought to enter the Chinese market by setting up manufacturing bases from which they could export Japanese goods to developed countries. This was in line with the Chinese government’s policy of furthering economic development by becoming the “factory of the world,” and was easy to implement with government support. Today, however, most Japanese companies seeking to enter the Indian market are doing so with the intention of developing a new market altogether, and from the beginning have been attempting to capitalize on huge domestic demand.

Furthermore, it needs to be noted that India is a country that essentially exercises a policy of non-discrimination in regard to domestic and foreign investors. For example, although one of the main goals of the Indian government’s “Make in India” program is to recruit foreign investment, foreign companies should not assume that they will be given preferential treatment over Indian companies. In other words, whereas foreign companies can also benefit from “Make in India” incentives through the Indian companies in which they invest, they nevertheless must be prepared to compete with domestic companies when investing in key industries designated by the program.

An analysis of foreign companies said to be performing well in India reveals that they have the following characteristics: build healthy relationships with partner companies; promote quick decision-making; ensure thorough localization efforts; carry out large-scale advertising programs; demonstrate cultural understanding in their approach to managing local businesses; and take time to develop local human resources. In summary, many of these companies have focused on achieving success through localization. In addition, these companies typically have upper management teams that exhibit a strong commitment to efforts in India.

M&A is an effective tool when localization efforts require the help of local Indian management personnel. However, the time a company can buy itself through M&A is limited to the time it would have taken to set up an overseas production base and sales network; an M&A can't buy it the time it will need to invest in growing its profitability. In an Indian market comprising a wide variety of territories, anticipating the synergistic effects of introducing Japanese best practices and post-acquisition cross-selling can be difficult, so acquisitions must be tailored to local specifications and companies may need to conduct post-acquisition investment into management resources. Ultimately, the acquiring company has no alternative but to utilize time and management resources gained through M&A, as well as additional post-acquisition support, to set its sights on becoming number one in the local market.

Japanese companies who want to succeed in M&A in the Indian market should consider the following measures:

1 Clarify "definition of success"

Upper management teams must clarify their "definition of success" early on and base discussions with Indian target companies upon that paradigm. They must eliminate all traces of ambiguity, firmly coordinate policies to produce foundational documents, and avoid a scenario in which both parties are operating under different visions. Upper management must build trusting relationships alongside Indian management teams for the realization of mid- to long-term goals.

2 Thorough risk assessment

Companies must thoroughly and pre-emptively investigate potential risk factors, including those associated with management teams at Indian target companies and business partners. India is a surprisingly gossip-oriented society, making it possible to conduct effective reputational research. The past is littered with case after case of investors choosing to ignore the facts and push ahead; the investments have often resulted in unsuccessful outcomes and exit. Needless to say, the cost of research is lower than the cost of exit. In many cases, detected risks can be addressed through consultations with the management teams at target Indian companies. Upper management should acknowledge that they will not be able to remove the risk and should focus instead on "controlling the risk."

3 Maintenance of local support system by main office

Following an M&A, the head office should be responsible for creating the systems that will be used to achieve the business management and compliance performances. To prevent Japanese expats who have been dispatched to India from struggling in isolation, the head office should implement a support system that provides local Indian experts to assist them. Such a system will reduce the psychological burden on dispatched expats and allow them to concentrate on management issues.

As stated above, companies have much to consider when pursuing successful M&A in the Indian market. As one objective of M&A involving Indian companies, firms should also have a view for incorporating competent Indian executives into their own company and developing them as bridgeheads for further expansion into the global market – i.e. from India to Africa and beyond. An aging population, low birth rate and work style reforms are leading to drastic changes in Japan's working population and work environment. In contrast, India is overflowing with human resources who can play an active part in today's global economy, and a company has every reason to use this to their advantage. Making the most of this opportunity, Japanese companies should consider bringing promising Indian personnel to Japanese headquarters for training while fostering a sense of belonging among staff at Indian investee companies.

It is our sincere hope that Japanese companies will make use of M&A involving Indian companies to resolve the issues that they face, and that this in turn will lead to a further deepening and development of their efforts to globalize.

Market Check!

EV/EBITDA multiples by trends by sector

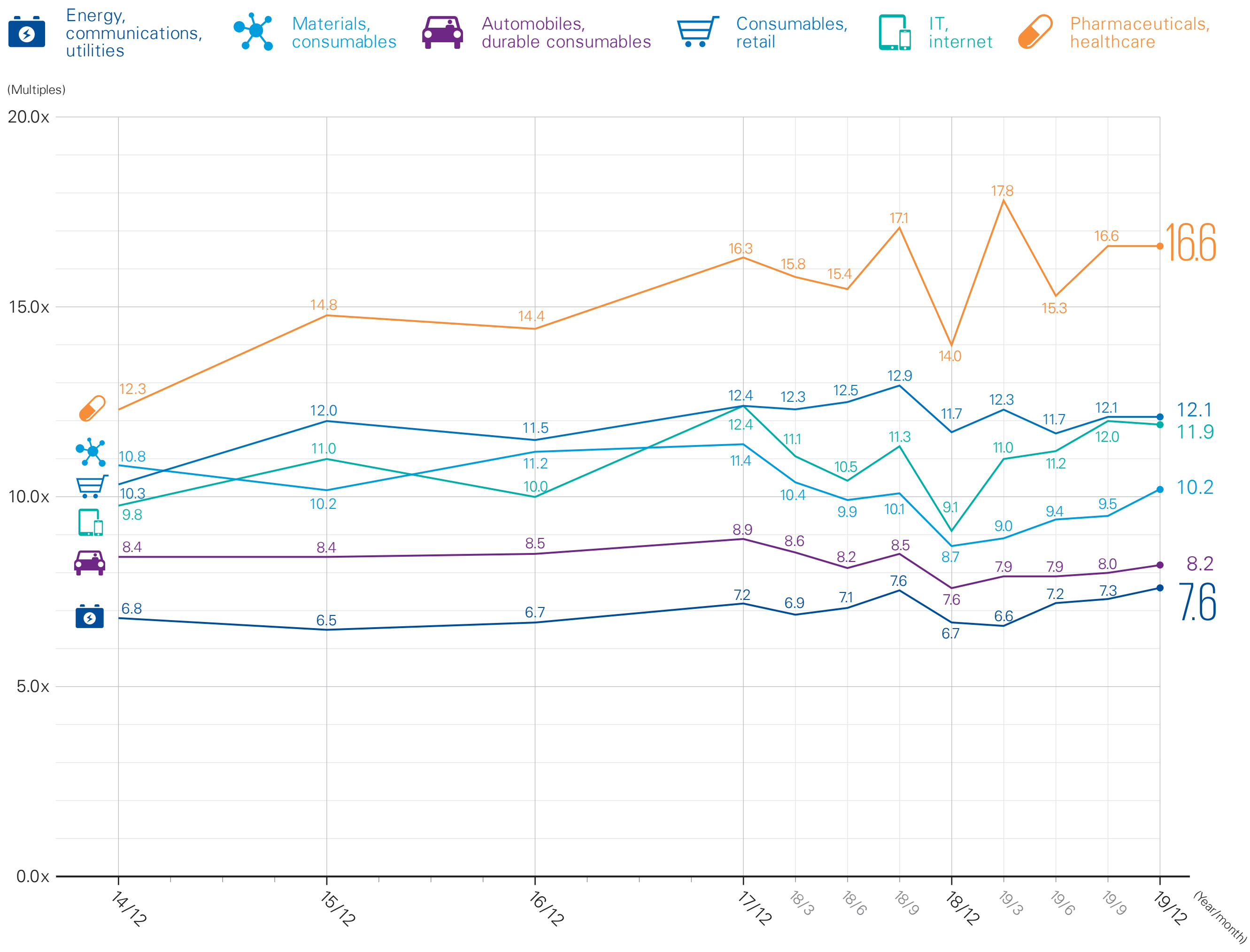
Market multiples trends as an indicator for measuring M&A Markets

Looking at six sectors ranging from hardware centric to software centric, this section provides fixed-point observation data for the market multiples of major markets in Japan, the US, and China.

M&As are defined as an important tool for companies in realizing growth strategies. M&As by Japanese companies both in Japan and overseas continue to increase.

We hope these data will provide you with insight into the M&A transaction trends in the sector to which your company belongs, as well as the recent growing trend of cross-sector M&A transactions.

Changes in EV/EBITDA multiples:
Japan



<Sectors>	<Industry classification>	<Representative companies (as of December 2019, top five of market capitalization)>
Energy, utilities and communications	Energy-related facilities and services / Oil, gas and consumable fuels / Electrical communications, wireless services, independent power generation business / Electric power, gas, tap water / Comprehensive utilities	Japan: NTT / NTT Docomo / Softbank / KDDI / INPEX
Materials and capital goods	Chemical, machinery, semi-conductor, aerospace, defense / Metal, mining / Paper products, wood products, containers, packages / Construction, civil works, electrical equipment, architectural materials / Trading companies, distribution, conglomerate automobile parts / Automobiles	Shin-Etsu Chemical / DAIKIN / NIDEC / Mitsubishi Corporation / FANUC
Automobiles and durable consumables	Durable goods	TOYOTA / Sonny / Honda / DENSO / Bridgestone
Consumer goods and retail	Retail, sales / Beverage / Foods / Tobacco / Home appliances / Personal goods	FAST RETAILING / Kao / JT / Seven & I HD / Shiseido
IT Internet	Internet sales, catalog sales / Interactive media and services / IT services / Software healthcare related	Z HD / Fujitsu / NTT Data / Nomura Research Institute / OBIC
Pharmaceuticals and healthcare	Biotechnologies / Pharmaceuticals / Life science tools	Takeda / CHUGAI / DAIICHI SANKYO / HOYA / Astellas
<Component number (December 2019)>		273

Component issues of the six sectors

EV/EBITDA multiples:

Index indicating the enterprise value (EV) multiples against earnings before income tax and depreciation and amortization (EBITDA)

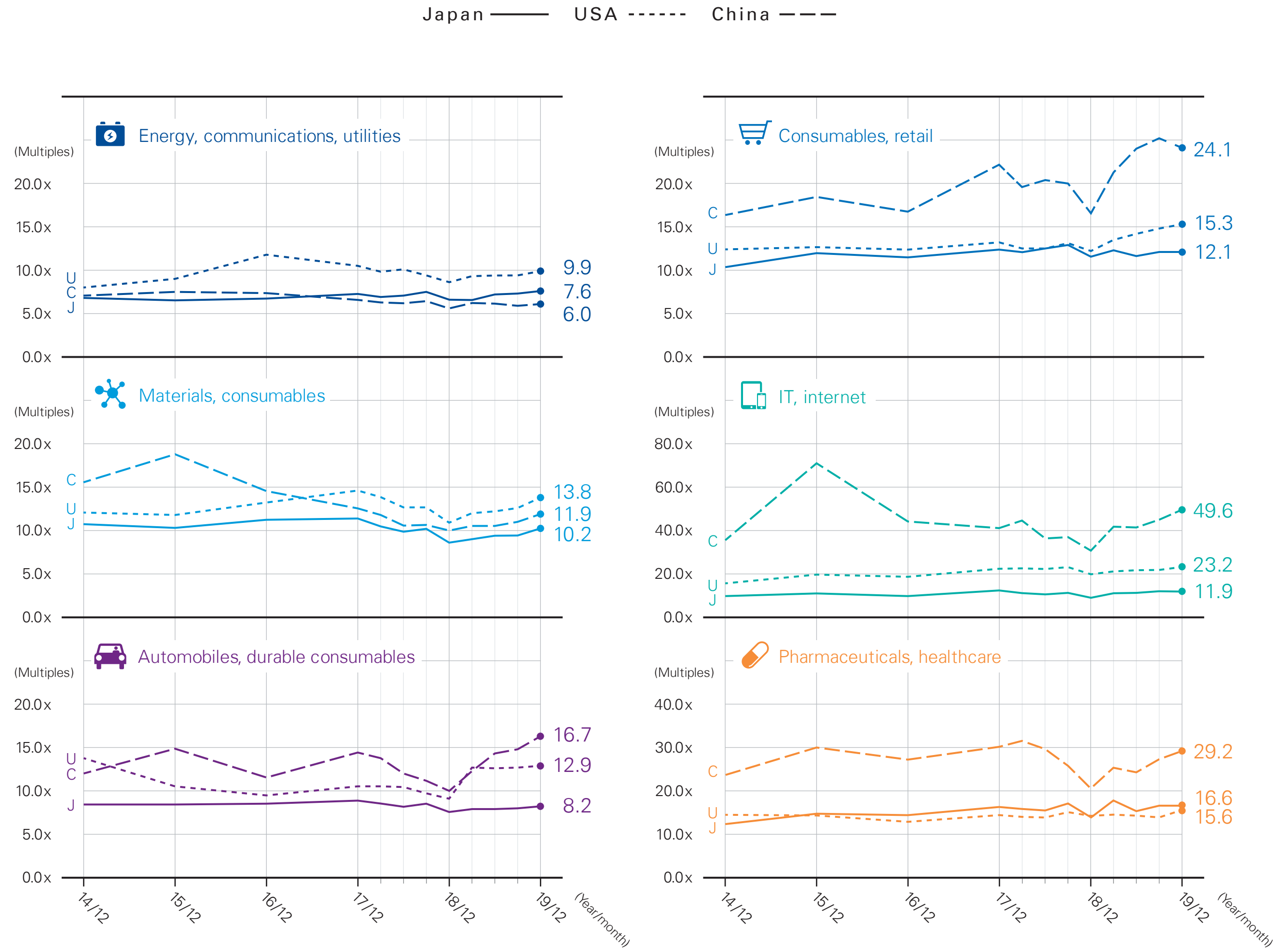
*In this analysis, we determine EV as the total of market capitalization and interest-bearing liabilities. The EBITDA stated is for the most recent 12-month period.

How to calculate multiples: We classify the component issues of representative stock indexes (JPX Nikkei 400; S&P 500, CSI 300) into the following six sectors defined by KPMG: "energy, utilities and communications," "materials and capital goods," "automobiles and durable consumables," "consumer goods and retail," "IT Internet," "pharmaceuticals and healthcare." Then we illustrate them with charts.

Sources: Capital IQ / Bloomberg

Country comparisons of changes in EV/EBITDA multiples by sector:

Japan / USA / China



	USA	China
	Exxon Mobil / AT&T / Verizon Communications / Chevron / NextEra Energy	PetroChina / China Petroleum & Chemical / China Yangtze Power / China Shenhua Energy / China United Network Communications
	Intel / The Boeing / NVIDIA / United Technologies / Honeywell	Anhui Conch Cement / China State Construction Engineering / CRRC / Wanhua Chemical Group / Sany Heavy Industry
	General Motors / Ford Motor / Aptiv / D.R. Horton / Garmin	Midea Group / Gree Electric Appliances / SAIC Motor / Haier Smart Home / BYD
	Walmart / The Procter & Gamble / The Home Depot / The Coca-Cola / PepsiCo	Kweichow Moutai / Wuliangye Yibin / Foshan Haitian Flavouring & Food / Muyuan Foods / Inner Mongolia Yili Industrial Group
	Microsoft / Alphabet / Amazon.com / Facebook / Visa	360 Security Technology / iFLYTEK / Yonyou Network Technology / Hundsun Technologies / Aisino
	Johnson & Johnson / UnitedHealth Group / Merck & Co / Pfizer / Abbott Laboratories	Jiangsu Hengrui Medicine / WuXi AppTec / Aier Eye Hospital Group / Yunnan Baiyao Group / Changchun High & New Technology Industry (Group)
	320	167

Publications & Reports

Practical CVC
From the development of strategies
to foundation and investment valuation

Recommended Books

This book elaborates on practical approaches required through all phases of CVC operations by comprehensively discussing the flow of processes from establishment and operational management to exit strategies. The reports closely reflect KPMG's experiences with CVS supports while describing the most sophisticated CVC transactions in the US and Japan.

Editor	: KPMG FAS Co., Ltd.
Publisher	: Chuokeizai-Sha
Publication date	: October 5, 2018
No. of pages	: 252
Price	: ¥2,200

(Available only in Japanese)

Understanding M&As

Recommended Books

This book elaborates on the flow of M&A transactions from the development of a project to due diligence, valuation, the contract, the closing, and project management, while lucidly highlighting key issues in each phase.

Authors	: Masahiko Chino, Hikaru Okada
Publisher	: Nikkei Publishing
Publication date	: June 2018
Price	: ¥1,000

(Available only in Japanese)

★ Other recommendations ★

KPMG FAS Books (Available only in Japanese)

For details of publications, please see "**home.kpmg/jp/publication**". Please order a book directly from the publishing companies.

New	Business Acquisition and Buy-out – 2nd Edition	(Chuokeizai-Sha / November 2019)
—	ASEAN Company Map – Second Edition	(Shoeisha / January 2019)
—	Business Rehabilitation and Buyout	(Chuokeizai-Sha / November 2018)
—	ROIC Management – Development of Power to Generate Profit and Strategic Dialogue	(Nikkei Publishing / November 2017)
—	Corporation and Business Rehabilitation Handbook	(Nikkei Publishing / April 2015)
—	Chart – All about Enterprise Value	(Nippon Jitsugyo Publishing / April 2011)

KPMG Research Reports

If you wish to obtain relevant reports, please see "**home.kpmg/jp**" or contact "**fasmktg@jp.kpmg.com**".

—	Agile or irrelevant: 2019 Global CEO Outlook	https://home.kpmg/xx/en/home/campaigns/2019/05/global-ceo-outlook-2019.html
—	Global Automotive Executive Survey 2019	https://home.kpmg/xx/en/home/insights/2019/01/global-automotive-executive-survey-2019.html
—	REACTION Magazine: Chemicals 26th Edition	https://home.kpmg/xx/en/home/insights/2018/06/reaction-26-magazine.html
—	Me, my life, my wallet, 2nd Edition	https://home.kpmg/xx/en/home/campaigns/2018/09/me-my-life-my-wallet.html
—	Industry 4.0	https://home.kpmg/xx/en/home/campaigns/2018/11/industry-4-0.html
—	2019 Autonomous Vehicles Readiness Index	https://home.kpmg/xx/en/home/insights/2019/02/2019-autonomous-vehicles-readiness-index.html

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KPMG FAS Newsletter

Driver 06

Information

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