



# KPMG FAS Newsletter

# Driver

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## Close-up 1

# Accelerating overseas M&A

Challenges facing Japanese companies and keys to success

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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.
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### 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.

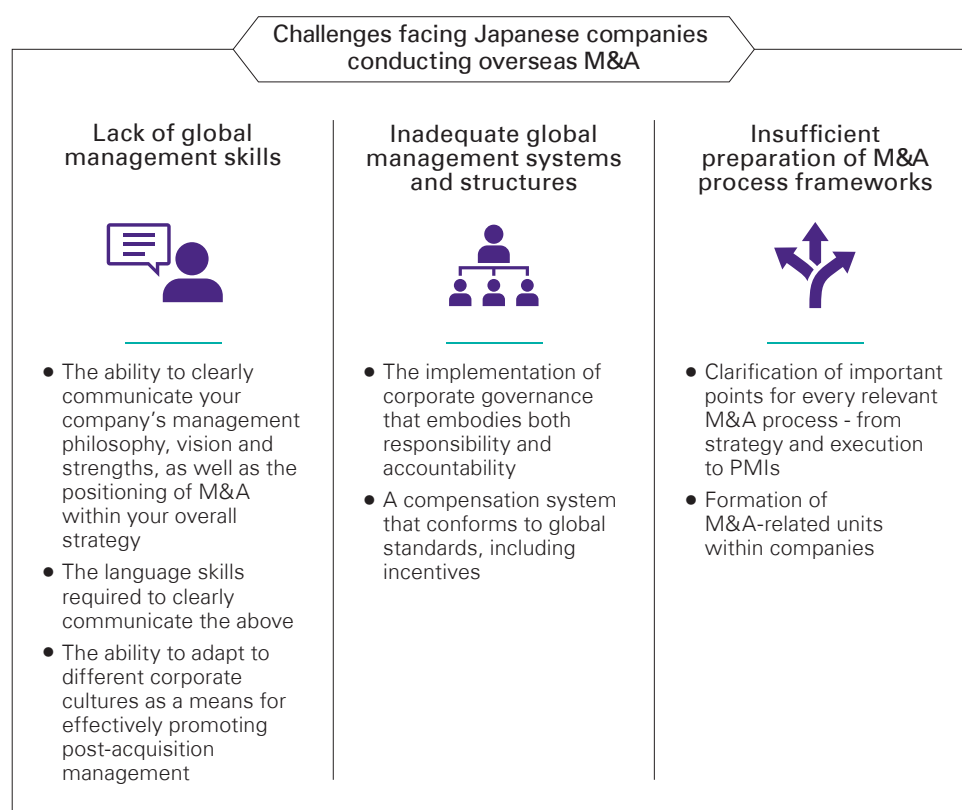
#### Shortage of global management skills

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



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 competitiveness 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

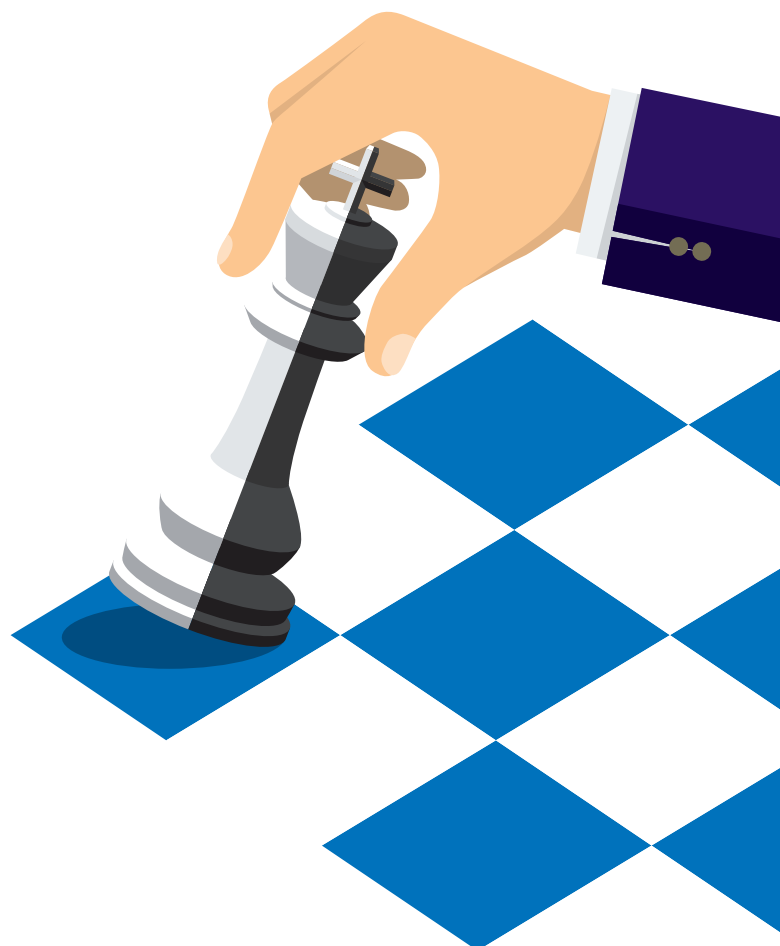
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Without a doubt, overseas M&A can be a powerful tool for building global business models that make good use of the strengths that a company has cultivated. However, overseas M&A can involve a broad spectrum of target countries and regions. The unique 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.





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Seiji Ota joined KPMG India's Delhi office in 2017 following a role at the Delhi office of a global consulting firm. He has more than twenty years of experience in M&A in India as the longest servicing Japanese national in the market, and has been involved in numerous advisory cases including Japanese companies' M&A expansions and establishment of joint ventures in India. He has also spoken at various seminars held in Japan and India. He holds bachelor's and master's degrees from the Soka University Faculty of Law and University of Delhi Faculty of Law, respectively.

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