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Global M&A: Five Factors Midmarket Companies Must Consider Before Making an International Deal

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International mergers and acquisitions (M&A) are high-reward, high-risk propositions. While opening up access to vast new markets and bringing rapid growth to companies, they can also increase companies' exposure to many types of risk. Executives at a company looking to complete an international deal can increase the chance of success by recognizing and understanding the regulatory, political, cultural, financial, legal, and marketing challenges specific to the country where the target company is located.

Pinpointing the right international company to target for a merger or acquisition is a painstaking and difficult undertaking. And once a target is determined, pursuing and closing the deal is an elaborate process fraught with potential hazards, including serious complications due to a range of cross-border issues. Detailed here are five significant types of factors that midmarket companies must take into careful consideration when pursuing an international merger or acquisition.

Factor 1: Regulations and Politics

Government regulations will have an impact on every part of a company's deal. Rather than be caught unaware, it is vital that companies look before they leap into the international pool. For example, a country's laws might limit the amount of investment allowed in an acquired company and present an obstacle to attaining additional capital.

In certain international dealings, it's not what you know, but who you know, that makes the difference. Companies need to understand how intimately connected the seller is to the local market. Is the real value of the target company the product or service being acquired? Or is the value really the relationships that the seller has with local authorities?

Even though political stability is an issue in many nations, the rewards of a deal are often worth the risk – if the timing and other factors are right.

> **International scenario: China.** The People's Republic of China is a prime example of a country where the influence of regulatory and political factors on a deal is inescapable. It's very difficult to bypass red tape, and at times dealing with the government is an exceedingly complex process. The rules are unclear, and many government policies are anti-free market. China's restrictions on pulling money out of the country are one area of particular concern to buyers. Depending on how the U.S. company is structured, cash repatriation issues can expose the company to significant risk.
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> *How to help mitigate the risk:* Knowing in advance how to set up different types of entities and holding companies in China can make it possible to bring cash back to the United States with minimal losses and taxes. Transactions should be structured to facilitate the cash repatriation of earnings.

Factor 2: Culture

When it comes to interacting with local cultures, there are “high-context” and “low-context” countries. Negotiating a deal in a high-context nation is usually more time-consuming because it’s harder there to develop a relationship with a potential partner before the business discussions begin.

High-context cultures include China, France, Italy, Japan, Korea, Saudi Arabia, and Vietnam. People in these countries tend to rely more on context, such as nonverbal cues, when interpreting a situation and communicating with others.

In high-context cultures, personal relationships are more critical than Americans are used to. In fact, personal relationships can be more important than written communications or legal contracts for developing trust. In addition, people’s posture and tone of voice might carry more meaning than their words.

International scenario: Japan. Cultural awareness can make or break a deal in Japan. Generally not confrontational, the Japanese might not be very forthcoming when a problem arises. Decisions tend to be made by consensus rather than by management. “Agreement” may not mean agreement on a solution but simply agreement that an issue needs to be addressed.

How to help mitigate the risk: U.S. managers should educate themselves about cultural differences before interacting with their Japanese counterparts. First impressions are lasting impressions, particularly if the acquirer’s representative seems to be insensitive at the first meeting. It’s important when operating in high-context countries to be aware of body language, tone of voice, and other nonverbal subtleties. The acquirer’s representative also must be keenly aware of everyone’s title and status and behave accordingly.

Factor 3: Accounting and Taxes

In many countries, financial transparency is not the norm, and accounting principles may be unfamiliar. For instance, generally accepted accounting principles (GAAP) in certain countries can vary from U.S. GAAP in ways ranging from subtle to obvious. Subsequently converting the target company’s financial data to U.S. or international GAAP can be difficult.

The opportunities for financial synergy tend to be overstated in multinational deals. Pricing in a new country may look attractive, for example, until it is discovered that local sales commissions more than offset an expected price decrease. Foreign-currency exchange risks and fluctuations must also be considered.

International scenario: Brazil. Brazil has a notoriously complex tax system, including two different collection options for businesses: actual (or real) profit, in which a company is taxed based on profit earned; and presumed profit, in which taxes are collected based on the gross revenue a company expects to make. Brazil

Mitigating the Risks of Cross-Border Transactions

In international deals, companies should establish the strategic logic of the transaction and adhere to the strategy of the deal throughout all aspects of the transaction. This includes doing the following:

- Understanding the local country’s M&A process and retaining advisers familiar with the seller’s culture
- Understanding the true ownership structure and company history
- Understanding the seller’s goals for the transaction
- Analyzing and adjusting valuation metrics
- Analyzing liquidity levels and foreign currency risk
- Structuring for cash and asset repatriation
- Planning integration processes prior to acquisition
- Identifying integration issues
- Engaging in intensive integration activities
- Determining a potential exit strategy

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has more than 40 different taxes and contributions, and tax litigation is common. Another concern is due diligence, particularly in family-owned companies, which often are hesitant to open their books. Remitting payments is also tricky; the inflow and outflow of funds in Brazil requires registration with the central bank, and exchange controls apply.

How to help mitigate the risk. The acquiring company needs to understand and document the accounting principles used in computing purchase-price adjustments because agreeing to the other party's local GAAP might be costly. When tax laws are as complex as they are in Brazil, the best course of action is to employ an experienced local tax expert as part of the tax diligence and transaction-structuring team.

Factor 4: Legal Issues

Local legal issues add a layer of complexity to deals. The legal language might be similar, but it does not mean the legal regime is the same. As a result, foreign investors could be exposed to unexpected sources of legal risk and often have no legal recourse. Especially in developing countries, foreign investors need to be aware that government regulations can and do change frequently and might not be respected by a country's court system.

Although bribery is part of the usual way of doing business in some countries, U.S. investors must adhere to the U.S. *Foreign Corrupt Practices Act*. It prohibits any U.S. person or firm from paying, or promising to pay, any money or item of value to any foreign government official or political party for the purpose of obtaining or retaining a business.[1]

International scenario: Europe. The laws on severance pay tend to be worker-friendly in Europe, making a restructuring or turnaround deal difficult. In Italy and France, firing an employee is extremely difficult, and a company that manages to fire employees could be required to provide them with severance pay equal to several years' salary.

How to help mitigate the risk: Retain local advisers familiar with the legal landscape. It needs to be absolutely clear to companies looking to expand into foreign markets, including European markets, exactly what duties are required of local employers.

Factor 5: Sales and Marketing

Local markets are full of pitfalls. Brands and campaigns might not translate to a different language. New packaging might be required for markets in new countries to address language differences and local ideas of how much is enough.

Sales processes need to be adapted to a new market's culture. A direct sales approach that works in the U.S., for example, might be considered offensive or might even be illegal in another country.

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International scenario: Mexico and China. When Parker Pen marketed a ballpoint pen in Mexico, the advertisements were supposed to say, "It won't leak in your pocket and embarrass you." However, the mistranslation of one word changed the ad to read, "It won't leak in your pocket and make you pregnant."[2] In another instance, China banned a Nike commercial featuring basketball player LeBron James fighting an animated kung fu master. China claimed the ad was insulting to national dignity, possibly because James defeated his opponent.[3]

How to help mitigate the risk. A buyer should retain advisers intimately familiar with the selling company's language and culture.

Recognizing the political, economic, and cultural norms that are a big part of any cross-border transaction helps a company pursuing an international merger or acquisition to understand the strategic logic behind the potential transaction and then use that logic as a guide to determine whether the opportunity exceeds the risk. The chance to mitigate risk is deeply rooted in planning and taking into consideration the local variances that could make or break the deal.

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[1] For additional information about the FCPA, see Jonathan T. Marks, "Building and Enhancing FCPA Compliance," a Crowe white paper, March 2011, http://www.crowehorwath.com/ContentDetails.aspx?id=1815

[2] Nick Robinson, Cambridge English for Marketing (United Kingdom: Cambridge University Press, 2010), http://www.cambridge.org/servlet/file/store7/item6595637/version1/Case%20study%204%20International%20customer%20communications.pdf

[3] Tracy Carbasho, Nike (California: ABC-CLIO LLC, 2010), http://books.google.com/books?id=pCT05HUsYZ8C&pg=PA26&dq=nike+banned+lebron+james+ad+china&hl=en&sa=X&ei=G2B9Uq-9GM6dkQeUpoCwAQ&ved=0CC0Q6AEwAA#v=onepage&q=nike%20banned%20lebron%20james%20ad%20china&f=false

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