

Reducing risk in cross-border transactions

A guide to navigating the M&A process

November 2017



Understanding the transaction landscape

Cross-border merger and acquisition opportunities are increasing, as healthy company financials in many economies drive an appetite for deals. Grant Thornton's International Business Report (IBR)¹ shows that companies within Africa and the Middle East have the most appetite for transactions over the next three years, followed by North America and the EU.

However, while cross-border transactions can generate new market opportunities, they often bring heightened risk and a range of challenges. Deals can be hindered by many hurdles anywhere in the process.

To successfully navigate your transaction landscape, it's important to understand and prevent potential risks. You also need to know how to smooth the integration process after completion of the deal.








We asked over 2,000 decision makers of mid-sized businesses to share the most significant risks encountered before and after a transaction. Mapping these challenges across the deal lifecycle, we added best practice guidance to mitigate these hazards. Our aim is to provide a guide that will enhance the success of your cross-border transaction, across any industry or region.



To successfully navigate your transaction landscape, it's important to understand and prevent potential risks.

¹ Grant Thornton research undertaken in Q2 2017. Full methodology at the end of this report.

Pre-deal transaction risk ranking²

- 1  Regulatory issues
- 2  Tax challenges
- 3  Legal constraints
- 4  Management issues
- 5  Cultural differences
- 6  Availability of finance
- 7  Valuation issues

Post-deal transaction risk ranking²

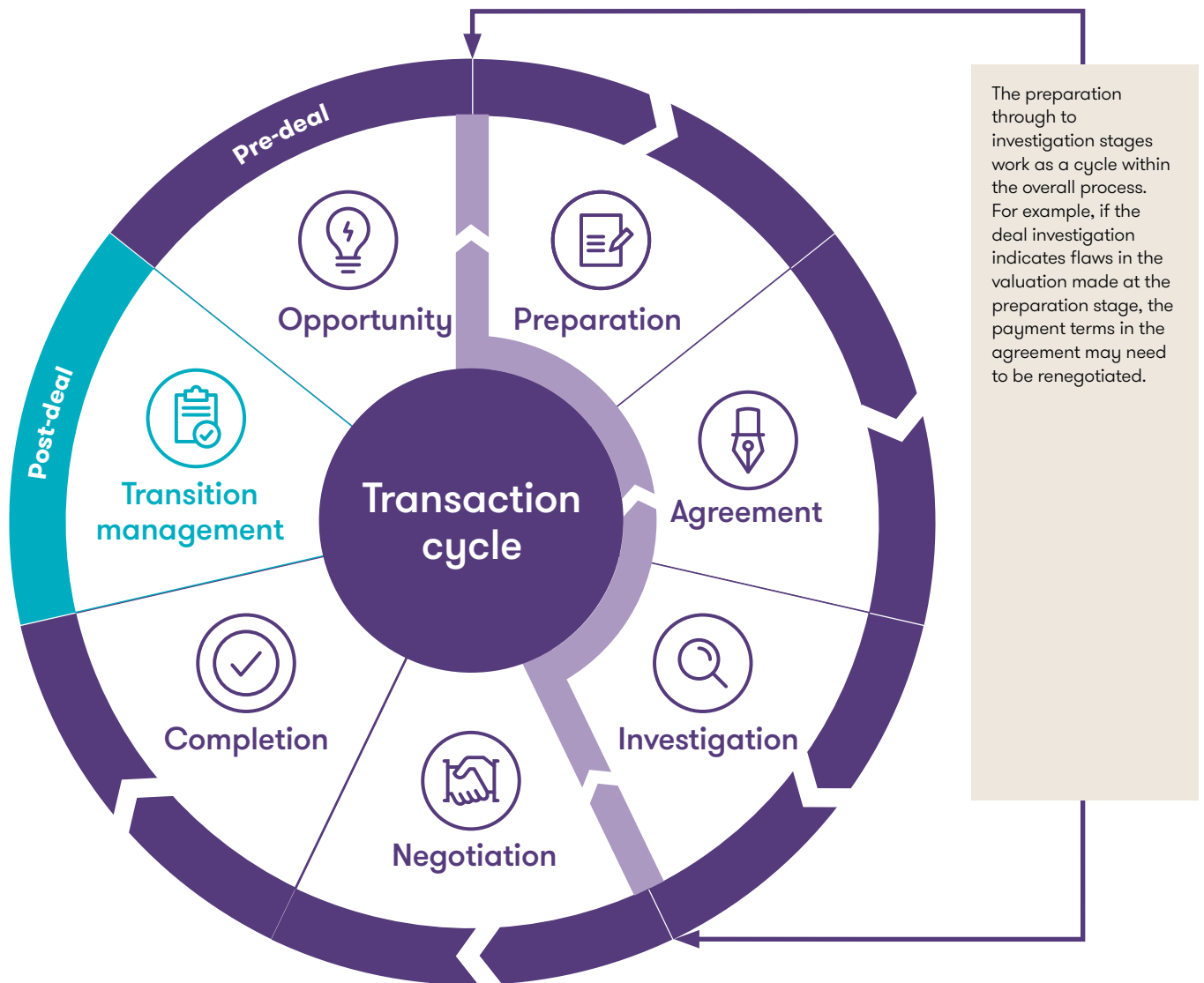
- 1  Challenges of integrating new business
- 2  Misunderstanding the market opportunity
- 3  Regulatory surprises
- 4  Unidentified political or economic instability
- 5  Losing key personnel
- 6  Suppliers not supporting the acquired business
- 7  Breakdown of trust or communication among leaders

² Global IBR respondents ranked each potential risk. Full methodology at the end of this report.

Navigating challenges throughout the cross-border transaction lifecycle

The transaction process

While the lifecycle of an individual transaction will vary, all transactions broadly progress through the key stages outlined below.



The risks and challenges affecting the transaction lifecycle





Agreement stage

Tax challenges

46% of IBR respondents place tax challenges as the second most concerning risk for managing cross-border transactions. Tax rules and structures can vary by country and have significant implications for an acquiring business. Advisers with knowledge of the relevant regional and industry specific tax landscape will help you avoid pitfalls. For example, a buyer may assume they can make use of an acquired business' past tax losses yet, this may not be possible in all cases.

“In Germany, we have change of ownership rules which govern the transfer of tax. These rules have recently been considered as partially unlawful by the jurisprudence and therefore tax advice needs to be continually updated during the transaction process to ensure reliable tax structuring.”

Kai Bartels, global leader of mergers and acquisitions, Grant Thornton

Tax planning is carried out within the agreement phase of a deal, where financial modelling and purchase price negotiations take place. **Yet, researching tax rules and implications during the opportunity phase is also crucial.** Ensure you understand current compliance levels and that your new business entity is compliant during the due diligence phase and tax requirement post-completion.

Availability of finance

Risks stemming from the availability of finance can differ considerably by region. In North America, for example, only 11% of respondents identified risks around the availability of finance while in Latin America this figure rose to 46%. In Africa and the Middle East, it reached 66%, likely driven by the complexity of Islamic banking conditions for some businesses.

Most scrutiny on finance occurs during the deal agreement phase, where financial modelling takes place and funders and business leaders agree payment terms. However, **you should determine at the onset whether you'll be able to meet financial requirements, and ensure you understand target companies' working capital arrangements** to assess their likely post-deal performance.



Investigation stage

Legal constraints

Legal constraints are considered the third most critical risk prior to deal completion. Legal requirements differ by region and must be fully understood to ensure a deal can proceed. The majority of legal investigation occurs during the due diligence process, at deal investigation. However, as with regulatory and tax issues, you should also examine legal constraints at the opportunity stage, when considering if a deal is viable.

IBR respondents identified the EU and Latin America as having the most problematic legal constraints while, at an international industry level, they were particularly prominent within the utilities sector. **Overcome this risk by ensuring your adviser has a strong network of people to offer reliable legal due diligence and advice.**

Valuation issues

Effective valuation is key to an acquisition's success and has a dual purpose; to assess the company's current value and to forecast its value after the acquisition. The latter requires a more complex valuation process and should take into account the likely synergy of both companies and any integration issues.

The majority of valuation analysis occurs during the deal investigation stage, where financial due diligence is carried out. However, it's at the deal preparation stage where the initial pricing and valuation occurs. **Ensure you understand the market value of the target company. This insight should be supported by analysis and benchmarking of profitability, cash flows and working capital requirements.**

Following the deal investigation, you may choose to renegotiate the price of the deal agreement, based on the final valuation. However, if valuation issues are significant, be prepared to walk away from the deal.

Misunderstanding the market opportunity

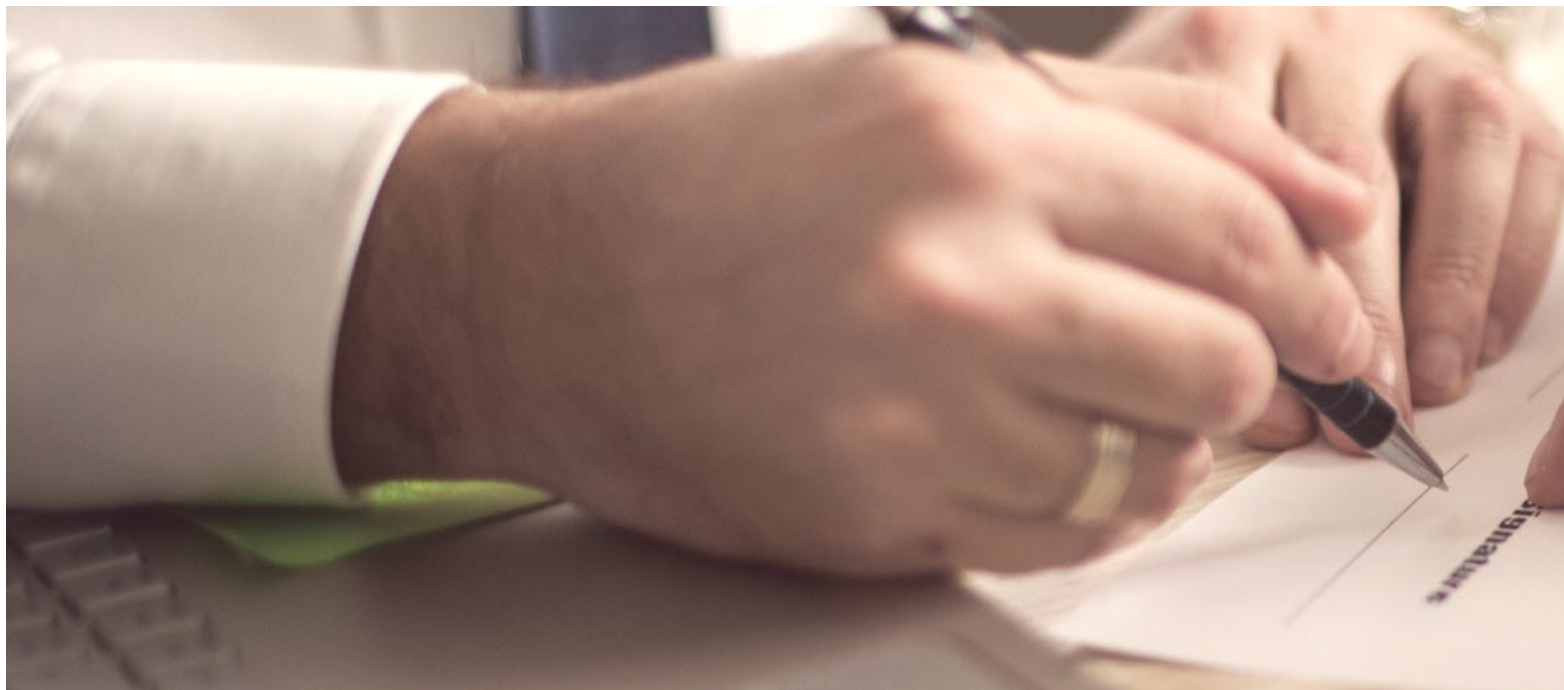
Misunderstanding the market opportunity can cause significant problems once a deal completes. 34% of IBR respondents claimed this was the second most common reason for an underperforming transaction, particularly within Africa and the Middle East, and APAC (42%), and globally within manufacturing and TMT (38%).

Try to mitigate this risk during the deal investigation phase. Commercial and financial due diligence coupled with expert advisory and valuation support will provide you with adequate knowledge of the market.

“We chose Grant Thornton for their knowledge of our industry and demonstrable M&A track record. Their insight and ability to draw on a wider pool of specialist knowledge ensured that we received first-rate advice throughout the process.”

Shaun Walker, CEO, S-Tech Insurance Services Limited

To reduce your risk, always undertake a comprehensive due diligence exercise covering the target and its business practices, while also incorporating local input into potential legal, political and regulatory issues.



Investigation stage

Political or economic instability

Political or economic instability is the fourth most common reason for a completed transaction failing to meet expectations. From a regional perspective, with 52% and 50% respectively, Latin American, Africa and the Middle East offer the highest risk of unidentified political or economic instability, compared to the global average of 30%.

Although these scenarios can arise without warning, **effective due diligence** during the opportunity, deal preparation and deal investigation stages should clearly indicate the risk of instability increasing. **You can then devise strategies to offset volatility should it occur**, or conversely, to exit a deal instead.

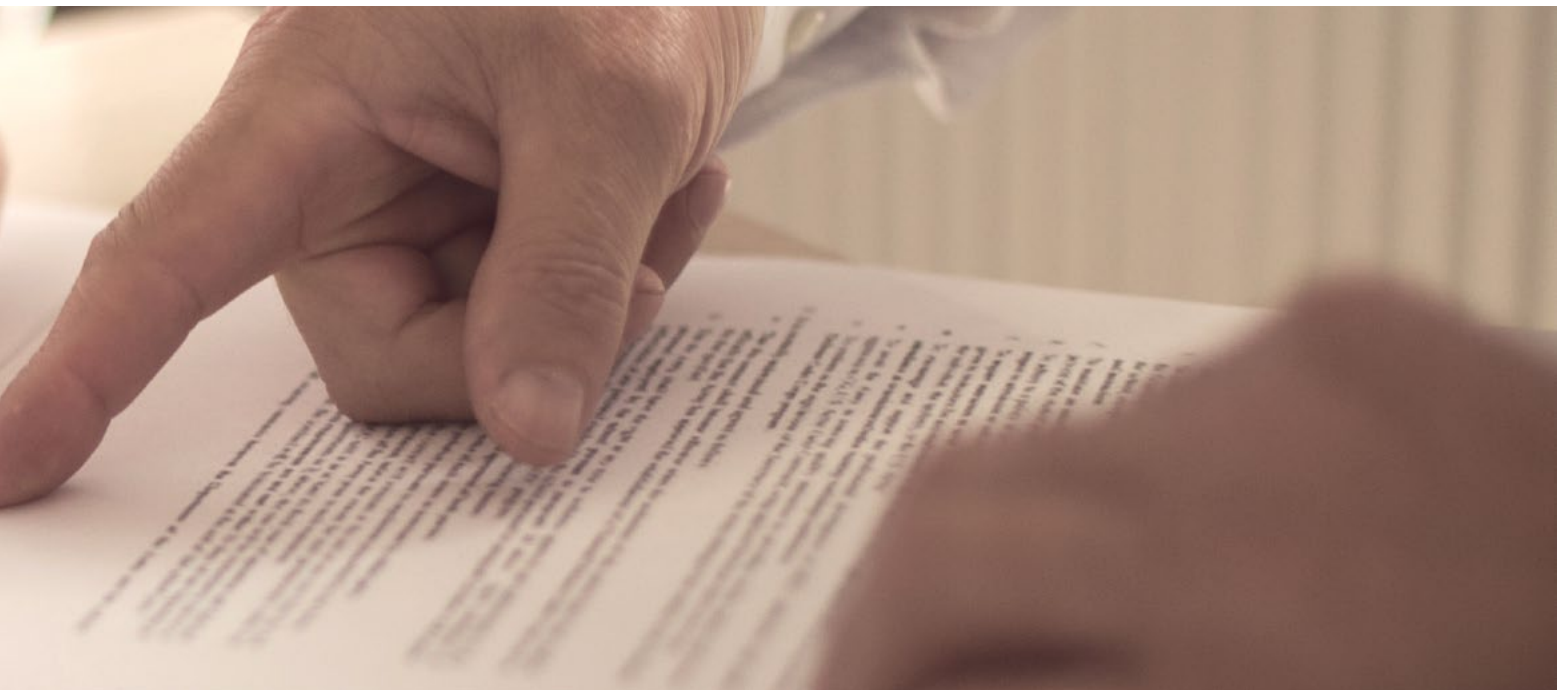
These risks may be particularly relevant in parts of APAC, where M&A activity is predicted to surge over the next 5-10 years. However, as the political landscape evolves, particularly within Thailand, Myanmar, the Philippines and Malaysia, higher political risk may prevent deals reaching fruition.



Suppliers not supporting acquired business

A chink in your supply chain can easily damage your business output. Failed supplier relationships were identified by respondents as a particularly prevalent risk within travel, tourism and leisure (35%), manufacturing (34%), transport (29%) and real estate and construction (28%). Supply chain issues may only materialise once new businesses have begun integrating. **However, proactive risk assessment can help you mitigate this risk in advance.**

Planning and communication failures can result in suppliers failing to support an acquired business. Identify key suppliers as part of your financial due diligence activity during the deal investigation. In some industries, it may be feasible to include warranties within the deal agreement to ensure supplier relationships. Otherwise, initiate communication with key suppliers before the deal completes and incentivise their retention if need be. **Preserving supplier relationships should form a key part of your post-merger integration strategy.**



Negotiation stage

Cultural differences

Risks arising from cultural differences are a concern for international business leaders and can cause problems repeatedly during the cross-border deal process. Often, these challenges become apparent during deal negotiations.

Respondents cited the APAC region as presenting the highest level of risk caused by cultural differences. A good adviser brings awareness of how best to address these issues and help you navigate the process. However, you should **identify from the outset where cultural differences may create challenges, particularly when shortlisting** target companies and preparing a deal.

Cultural differences may be present both regionally and organisationally, and you should work to address both. **Consider whether a company aligns with your business' operational culture, including policies on diversity, gender treatment and employment law.**

Breakdown of trust and communication among leaders

A breakdown in trust and communication among leaders will inevitably make a transaction more challenging. If allowed to escalate, it can lead to a deal's failure.

These breakdowns often arise from cultural differences, ineffective communication strategies or a lack of transparency. Friction is usually most apparent during the deal agreement and negotiation stages, and may also contaminate the integration process if there's a lack of cohesion between businesses.

Reduce mistrust and miscommunication - cultivate an awareness of risks arising from cultural differences and implement clear communication from the onset. Setting out a transparent post-merger integration strategy before completion, particularly if there are concerns around strategic changes or headcount reductions, will foster stronger relationships between leaders.



Transition management

Challenges of integrating new business

37% of IBR respondents cited the challenges of integrating new businesses as their main post-completion hurdle.

The prevalence of this issue reflects the range and volume of challenges that can surface during integration. Difficulties can arise from strategic conflicts, incompatible technologies, dual reporting systems, cultural differences (both organisational and regional), loss of key personnel or the challenge of operating across different locations, languages and time zones.

While regulatory, tax and legal stumbling blocks are often prioritised as key risks to mitigate pre-acquisition, the less technical challenges can be overlooked. Prevent post-deal setbacks by assessing integration issues at the preparation stage of a deal. **Due diligence will highlight the operational and cultural risks that must be managed post-completion, supported by a clear assimilation strategy and targets for performance improvement. A post-merger integration plan is the basis for executing these actions.**

Regulatory surprises

Despite respondents identifying regulatory issues as their primary concern when managing a cross-border transaction, regulatory surprises still emerged as the third most common reason for transactions later underperforming. At 31%, this figure is surprisingly high and reflects the importance of receiving regulatory guidance and conducting thorough due diligence at the pre-completion deal stage.

Avoid regulatory surprises; make sure you place sufficient importance on comprehensive due diligence exercises, focussing on detailed financial information.

Losing key personnel

Losing key personnel after an acquisition can cause significant operational and performance problems. Failure to retain expertise within an organisation can make it harder for the business to achieve targets, but it will also dampen morale, fragment teams and impact external relationships, too.

Although this risk was ranked only fifth by respondents, it was notably prevalent within the transport (47%), business services (47%), utilities (46%), and travel, tourism and leisure (42%) industries.

Identify key individuals and consider how to incentivise their ongoing commitment. This mitigates the risk of losing personnel. Bear this in mind during deal negotiation and transition management stages, as cultural differences may estrange key personnel.



Key takeaways for a successful transaction

The deal process is complex and can be volatile, with both foreseen and unforeseen risks causing disruption. Ensure your cross-border transaction completes successfully; pre-empt potential stumbling blocks at every stage.

Successful transactions need an adviser with regional and industry experience, strong negotiating skills, cultural sensitivity and commercial pragmatism to guide you through deals.

Our skilled advisers will ensure you receive high-quality due diligence and accurate valuation advice. Their knowledge of the regulatory, legal and tax landscapes and a broad network of professional contacts will help minimise your risk and execute your post-merger integration plan more efficiently.

Contact us

Our Grant Thornton member firm specialists understand the fluidity of the deal process and offer a seamless, integrated service from start to finish. We draw on internal support and external networks to anticipate problems before they arise and deliver in-depth knowledge of your target market and industry.

To find out how the team can support your cross-border transactions, contact our member firm specialists:



Fabian Kunz
Senior Manager,
Transaction Services
T +41 43 960 71 71
E fabian.kunz@ch.gt.com

IBR research methodology

The Grant Thornton International Business Report (IBR) provides insight into the views and expectations of more than 10,000 businesses per year across 36 economies.

Questionnaires are translated into local languages with each participating country having the option to ask a small number of country specific questions in addition to the core questionnaire. Fieldwork is undertaken on a quarterly basis, primarily by telephone. IBR is a survey of both listed and privately held businesses.

The data for this report was drawn from interviews with more than 2,268 chief executive officers, managing directors, chairmen or other senior executives conducted in between April and June 2017.

About Grant Thornton

Grant Thornton is one of the world's leading organisations of independent assurance, tax and advisory firms. These firms help dynamic organisations unlock their potential for growth by providing meaningful, forward looking advice.

Proactive teams, led by approachable partners, use insights, experience and instinct to understand complex issues for privately owned, publicly listed and public sector clients and help them to find solutions. More than 47,000 Grant Thornton people across over 130 countries, are focused on making a difference to the clients, colleagues and the communities in which we live and work.

