

Mergers & Aquisitions

Mergers & Aquisitions Leverage

Transforming insights into M&A solutions

Vol.3 2015



A Focus on Fundamentals



The M&A deals in 2014 have shown an interesting trend line. Global M&A has accumulated USD 2.5bn worth of deals up to the end of Q3, making 2014 the third highest annual value on record after 2006 (USD 3.3bn) and 2007 (USD 3.7bn), and 11.7% above 2013's annual total of USD 2.2bn.¹

The macroeconomic fundamentals globally continue to be challenged. The US is continuing its slow recovery from the 2008 financial crisis. The US Fed has given a clear directional signal that quantitative easing will be pulled back until the US can fully manifest robust sustainable growth. Nonetheless, US firms are still reporting decent earnings, strong cash reserves, and the US economy shows sustained growth, which will continue to fuel M&A activity.

Europe's recovery is weak and poses a possible fresh crisis on the Euro currency front.

The Middle East economies are showing good growth by global standards. GDP growth among the Middle East, North Africa and Pakistan (MENAP) oil exporters will rise from two percent in 2013 to three and a half percent in 2014, as non-oil activity remains robust and oil production stabilizes. Non-oil sectors, such as construction and retail trade, will continue to drive economic activity, augmented by high levels of public infrastructure spending and strong private-sector credit in the Gulf Cooperation Council (GCC), and by post-conflict reconstruction in

the non-GCC countries. M&A activity in Middle East & Africa is more outbound focused.

Asia Pacific continues to show signs of improvement or to maintain its current growth through key economies such as China, India, Australia and Japan. Japan's expansionary policy shift and reenergized outbound investment in Asia and Africa will breathe life into 'Intra Asia' M&A.

China continues on its outbound acquisition strategy through State Owned Enterprises (SOEs), but we see a shift in the SOE acquisition strategy. They now seek to acquire with a view to build on their value chain, access new markets and technologies, integrate acquisitions and manage their business globally. This is very different from their previous strategy of acquiring pure resources/assets and leaving them alone.

Successful integration on an operational and strategic alignment level is critical to the success of the inorganic growth strategy of both Western and Asian (India, China and Japan) multinationals. This issue focuses on several aspects needed to drive that success.

I hope you enjoy reading this issue and that it helps you look at some of the pressing M&A challenges from a fresh and powerful angle.

Best regards,

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¹ Merger Market M&A Trend Report Q3 2014



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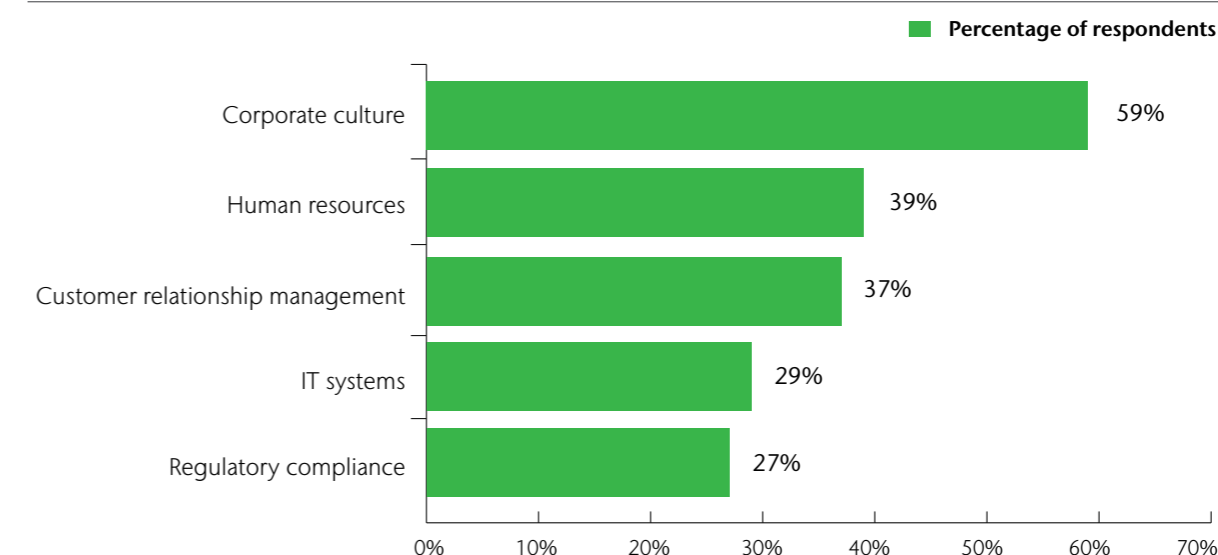
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Enhanced Value Captured in Deals

Transforming Post-Merger Operating Culture

We regularly hear from our strategic stakeholders, i.e., CEOs, Heads of Corporate Development and CHROs, that their top concern in a merger or joint venture (JV) is how corporate culture might derail the successful achievement of post-merger goals. Numerous studies, including ones conducted by Aon Hewitt, bear that out.

Figure 1: The integration of which of the following areas is most crucial for successful post-merger integration?



Source: Intralinks, Global M&A Survey

While we all appreciate the importance and complexity of culture, the real question that emerges is twofold:

- 1** How do we define current and future culture, and on what parameters?
- 2** How do we successfully execute this shift without disrupting business, customers, and risking post-merger deal goals?

Interestingly, we have found that when we pose these questions to our clients, we get very different answers, or worse still, no clear answers. In this article, we attempt to provide both a framework and an approach to address these two critical questions that every CEO is (or should be) asking as he/she considers a transaction.



The key question

So how do we go about defining ‘culture’? First, it’s important to step back and understand, what is culture in the context of an organization and a transaction.

Culture has two aspects. One is the familiar idea of national culture. But the more critical aspect is the ‘operating’ or ‘corporate culture’. Aon Hewitt describes operating culture as an organization’s ‘operating environment’, or more simply as ‘how work gets done’. It’s the operating culture that is key and constitutes the make or break element in transactions. Very often, we find that firms get too caught up in national culture and its implications. Make no mistake, national cultural differences are indeed crucial and need to be

addressed. But the more fundamental piece is the operating culture. Mergers or JVs fail essentially because of issues that an operating culture mismatch creates.

How does operating culture manifest itself? The following are actual examples of its manifestation:

- **Core aspects of a firm’s strategy** – Is the firm’s strategy to be innovative vs. process and replicating innovation? In a recent technology global merger between a global Asia major and a US technology firm, the intent of the deal was to utilize inherent IP of the target to drive innovation in the combined entity to leapfrog into the mobile space. The firms’ operating model – a technology & telecom sector merger in Asia involving a large acquisition that resulted in doubling the acquirer’s workforce – the focus was on driving process excellence gains in the acquired operation and this was a ‘non-negotiable’ cultural element in the go-forward culture.
- **Firm’s value proposition to its customers** – There is always a dilemma on how to balance customer intimacy and customization vs. a standardized approach.
- **How decisions are made** – Are decisions taken in a centralized or delegated manner? Are the decisions by one leader, a committee, or by consensus? In a chemical-sector Asian client targeting western acquisitions, we found that there was a flashpoint between decentralized, individual-led decisions vs. now everything has to go through Asia Global HQ.

Figure 2: Culture assessment traits continuum

Assessment category	Assessment
Corporate structure & working projects	Continuum
Hierarchy	Flat <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/> Layers
Communication style	Informal <input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> Formal
Administration	Minimal <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/> Bureaucratic
Decision making	Decentralised <input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> Centralised
Management style	Consultative <input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> Directive
Innovation and risk	
Employees’ attitude to risk	Risk taking <input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> Conservative
Management tolerance of risk taking	Risk taking <input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> Conservative
Rewards based on innovation/risk	Innovation linked <input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> Other measures
Employee experience	
Collaboration	Team work <input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> Individual
Career progression	Formal performance management <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/> Ad hoc reviews
Training and development	High focus <input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> Low focus
Worklife balance	Very flexible <input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> Little flexibility
Reward philosophy	
Performance related pay	Bonus pay <input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> Base pay
Market competitiveness	Above market <input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> Below market

- **How information flows** – Is information tightly controlled or shared in an ad hoc manner vs. shared in an open and structured manner? In the case of a commodities-sector client, we found that information flow in the smaller, stand-alone acquired entities was unstructured and dependent on the principal/top leader. This precluded post-deal monitoring and governance, and failure to achieve the deal goals.

So the cultural question is often structural and hard-coded in the way the firm does business, and is not the soft, amorphous view that was often presented. Ironically, a fact that many leaders miss is that the national culture differences relevant to business, can also be broken down into these operating culture elements.

Let’s examine a few factors that are key to appreciating this operating culture riddle.

1. First, it’s critical to recognize that there is no right or wrong answer on these cultural elements. These are continuums and you need to land on the desired peg of this continuum.
2. Second, the culture change is part of the ‘journey’, not a destination. In fact, the desired positioning on culture elements can itself move. The desired end state on each element can change due to multiple factors that a firm encounters, such as undertaking an integration, strategic shifts, change from a minority to majority JV stake, business environment changes, external shocks, changes in control, a leadership change, and so on.
3. Third, while most culture elements are a continuum, there are always some non-negotiables with a clear peg – adherence to compliance, result & performance orientation, process excellence, etc.



Culture is a journey, a defined peg on a continuum for organizations to land on, with non-negotiable elements identified

In every merger, JV or strategic partnership, these points of difference will cause friction and result in flashpoints. 'Flashpoints' are points that cause a clash, disruptive disagreements. They pose a risk in the smooth functioning of the post-deal operations.

To bring these concepts to life, let's look at a few real client examples of these operating culture flashpoints.

- Focus:** An Asian client that had acquired a private equity-backed firm in the US in the industrial/chemical space faced an inordinate focus being placed on cost management, characterized by a short-term, firefighting attitude rather than growth, innovation, or a future-oriented culture. It thus ran the risk of its entire deal model and goals being thrown in jeopardy.
- Centralized approach:** A western commodity major that has done multiple JVs with majority or equal stakes in Asia has repeatedly faced delays or failures in realizing the strategic goals. They found out that decision-making and information flow in the JV partner was too centralized at the top, seriously impacting speed of execution and day-to-day operations. This, in turn, made it very challenging to execute the time-bound strategy that the JV envisaged.

- Performance goals:** A US-based industrial major, after acquiring an Indian local firm, found a fundamental mismatch in performance orientation and result focus. To the extent that there was no process, quality or efficiency goals for any function, the 'performance bonus' was not linked to performance or goals.

In addition, all decision-making, from incidental invoice approval to plant operational decisions, up to technology or capital budgeting decisions, was completely centralized. This was contrary to their deal assumptions of being able to execute rapid operational improvements, expansion, and product enhancements.

- Misalignment:** A global financial major was acquiring a large local player in one of the large Asian economies. Their plan was to shift the strategy of the integrated entity to a customer segment focus, rather than a product focus. They soon realized that the organization design, processes, and product design were all completely misaligned to this new strategic reality. The client quickly realized that if they did not correct this through a massive and radical intervention, the deal rationale would very quickly evaporate.
- Ambiguity in focus:** A global telecom major running managed services deals in Asia realized that ambiguity on process efficiency/improvement focus was a very slippery slope, which caused deals to become unprofitable and fail very quickly.

Figure 3: High-performing culture profiles by strategy

Rank order of difference from average company profile	All high-performing companies	Primary strategy within high-performing companies				
		Innovation	Customer service	Quality	Cost leadership	Niche player
1	Decisive	Decisive	Decisive	Proactive	Enterprise-focused	Proactive
2	Long-term oriented	Risk-taking	Open/Transparent	Long-term oriented	Long-term oriented	Long-term oriented
3	Proactive	Long-term oriented	Long-term oriented	People-oriented	Collaborative	Decisive
4	Open/Transparent	Proactive	Proactive	Open/Transparent	Results-oriented	Risk-taking
5	People-oriented	Growth-focused	Action-oriented	Decisive	Decisive	Enterprise-focused

Bold text indicates a unique difference from overall high-performing culture profiles

Top culture traits of low-performing companies:

1. Short-term focused
2. Indecisive
3. Reactive
4. Secretive/Closed
5. Task-oriented

The contours of culture

The question on a leader's mind is whether the issues highlighted above can be avoided, or at least managed proactively? The key is to understand 'the contours of the two operational cultural elements', or put another way, the root cause of these flashpoints.

Let's examine Aon Hewitt's **GVAF** framework, which helps us understand and address this operating culture misalignment:

- G** Articulate the strategy and operating model goals/assumptions that are critical for the transaction's success.
- V** Run a Value driver tree analysis on these goals to identify the relevant operating cultural traits and establish a clear driver linkage of these traits to the goals articulated.
- A** Design and run a culture Assessment on the 'as-is' and desired 'to-be' culture state on these traits. Keep in mind the time horizon for the 'to-be' state and the fact that there may be multiple 'to-be' culture states for different time horizons post close.
- F** Identify Flashpoints and initiate remedial plans or execution.



Figure 4: Diagnose (Cultural traits and dimensions)

Culture traits on survey (Required and current)		Major cultural dimension
Decisive	Indecisive	How decisions are made
Decision making-intuitive	Decision making-data driven	
Results-oriented	Process-oriented	
Consensus-driven	Authoritative	
Open/Transparent	Closed/Guarded	How we interact with each other
People-oriented	Task-oriented	
Collaborative	Independent	
Division/Unit-focused	Enterprise-focused	
Inclusive	Exclusive	Assumptions about the strategy and business model
Accountable	Non-accountable	
Reactive	Proactive	
Cost-focused	Growth-focused	
Innovative	Conventional	
Short-term oriented	Long-term oriented	
Risk-tolerant	Risk-averse	
Hierarchical	Flat	
Internally-focused	Externally-focused	
Disciplined	Flexible	

Another key factor for successful firms is that they undertake the above process between announcement and close. This is followed by detailed execution post close, as per the plan.

The shift strategy

It's important to appreciate that a shift is possible only when you have clarity on what the flashpoints are, how they are linked to your deal goals, where you need to focus, the execution plan/dos & don'ts (see Figure 5 on the following page), and finally, how the outcome of culture alignment is 'measured'.

Figure 5: Tips to achieving a high-performance culture

Indicators of a successful culture integration	Mistakes to avoid during cultural integration
<p>In the longer term, the success of culture integration does not lie in the similarity of the merging businesses, but in bulding high-performance culture.</p> <p>The following activities should be included in culture integration plan:</p> <ul style="list-style-type: none"> ■ Leadership role modeling of desired behaviours ■ Communication of performance expectations ■ Talent and skill development ■ Reinforcement with formal mechanisms 	<p>Integration leaders not held accountable for culture integration</p> <ul style="list-style-type: none"> ■ Lack of urgency in addressing culture ■ Executives do not see the need to address culture ■ Leaders (often managers/supervisors) not skilled at leading change ■ What employees experience do not match what they are told ■ Relegating culture to HR – treating it as 'soft' stuff ■ Conduct assessment but ignore ongoing change process ■ Ignoring subcultures, which invariably exist

Let's now examine some of the mechanisms to enforce this culture shift:

1. Desired culture has to be defined in four to five key traits and clearly linked to strategic goals.
2. Implant the desired-goal culture definition and link it with the Executive Leadership team, and then cascade it down to the lowest level through functional leaders and managers.
3. Embed desired 'to-be' culture traits in process, go-to-market approaches, business & HR policy and behaviours.
4. Use communication and change agents to propagate 'viral change'.

Of the above, 'viral change propagation' of culture shift is an innovative adaptation from the new product (or concept) adoption strategy, followed by organizations

to drive product adoption with customers. As in new product adoption, if executed well, it can have a huge impact on the success of the initiative and the actual degree of the culture shift. It utilizes the concept of multiple generations of change champions, infection rate goal, and positive/negative multipliers.

In conclusion it's absolutely possible to ensure culture shifts, as we have seen from many of the successful culture change examples. However, it requires very structured and deliberate efforts to understand, plan, and execute 'maniacally'.



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Soaring Profits: The Successful Merger of Two Retail Giants

A first-hand account of how Aon's recommendations helped two retail giants in Southeast Asia streamline their processes, achieve higher efficiency, optimize and add bottom-line during a merger.

Introduction

2013 was a tumultuous year for mergers & acquisitions. While some large corporations have indulged in billion-dollar transactions viz. Microsoft's acquisition of Nokia, PriceWaterHouse's buyout of Booz and Heinz's takeover by Berkshire Hathaway; overall, the M&A environment globally and in Asia had remained gloomy all of 2013. M&A activity had been at its lowest in the last 3 years as organizations continue to struggle with both organic and inorganic growth in an otherwise sluggish business world.

However, the first half of 2014 has turned out to be much more action oriented, with large deals being witnessed both globally and in the Asia Pacific Region.

Aon Strategic Advisors & Transaction Solutions (ASAT) continues to support its clients through various transaction stages, both in the areas of risk advisory and human capital management. It has had the privilege of working on some of the most *marquee* transactions and handling all of them with great success. Aon's recommendations have helped these corporations achieve their deal targets with minimal business disruption.

Client situation/Background

One such request that came to Aon in early 2013 was from two Southeast Asian retail giants, that had hypermarket chains across the Asia-Pacific region. In this case, a Southeast Asian retail chain was taking over the operations of a European hypermarket business in a large Asian country. The acquiring organization had existing

operations in this Southeast Asian country and therefore, the deal goal was to enhance market share and revenues. The new entity also intends to launch an IPO in 2015 and list itself in the leading stock exchanges across the region.

Client challenges/Issues

The two organizations had many similarities and even more differences. On the business front, they catered to two different customer segments – the acquiring company focused on middle income group and below, and acquired company focused on middle, upper middle and higher income groups.

This meant that the products for their customers were also different and a complete merger was challenging and difficult. They also had significant different organization structures, manpower ratios and distribution of responsibilities within functions. However, the most striking difference of all was their organizational cultures.

Legacy culture at the acquired organization had the following characteristics:





Aon has learnt that ‘organizational culture’ is the single-most important factor when it comes to deal success. As per the research on acquisitive organizations in Asia 2012-13 ‘Making M&As Successful Study 2012-13’ reveals the following key findings:

- **Culture operates at multiple levels**
- National culture, operating culture and individual cultural biases
- **Culture gaps across the two entities** can be a significant challenge for leadership teams. In some cases, business results may be delayed/denied. A root cause analysis will generally reveal a lack of productivity or a lackadaisical culture in one of the entities.
- **Culture alignment should be a key priority:** Constant focus on cultural alignment is required during due diligence, pre-announcement, and integration

Hence, it was extremely important for Aon to ensure cultural alignment during the post-merger integration stage, while undertaking this assignment.

Simply put, the brief given to Aon was – Ensure maximum alignment between the two organizations with minimal business disruption and employee attrition, also

identifying opportunities for cost-saving and creating bottom-line impact through synergy of structures, systems and processes.

Aon’s approach

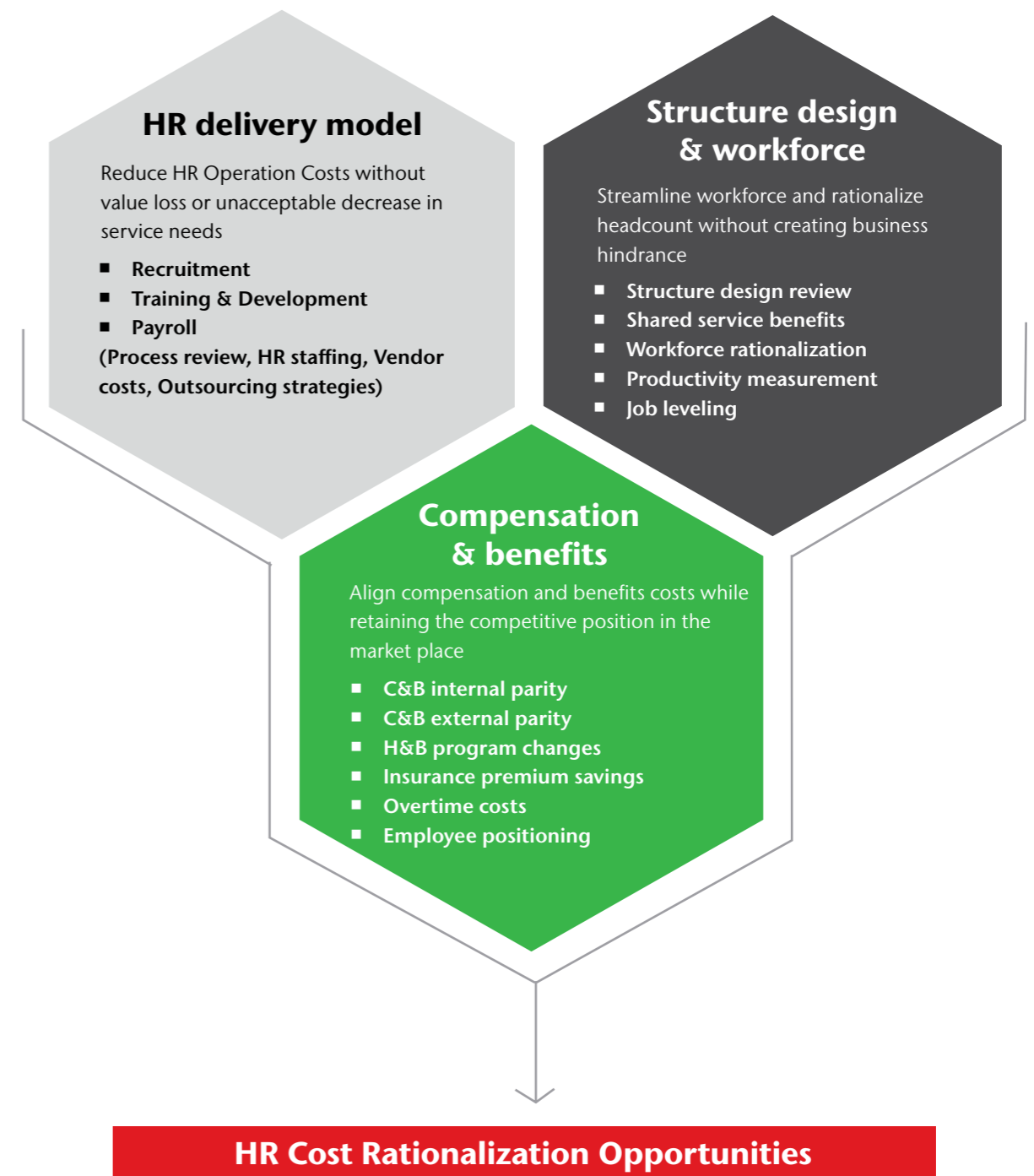
To achieve the aforesaid, Aon employed its well-researched model on **Strategies for Operational Excellence.**

Aon commenced by conducting detailed interviews with leadership teams of both the organizations in a bid to understand the organizational background and context, strategies, value chain, organization structure, and possibility of functional alignment. A key focus area during these interviews was to understand the similarities and differences that exist in their systems and processes, and more importantly, identifying the cultural nuances and differences.

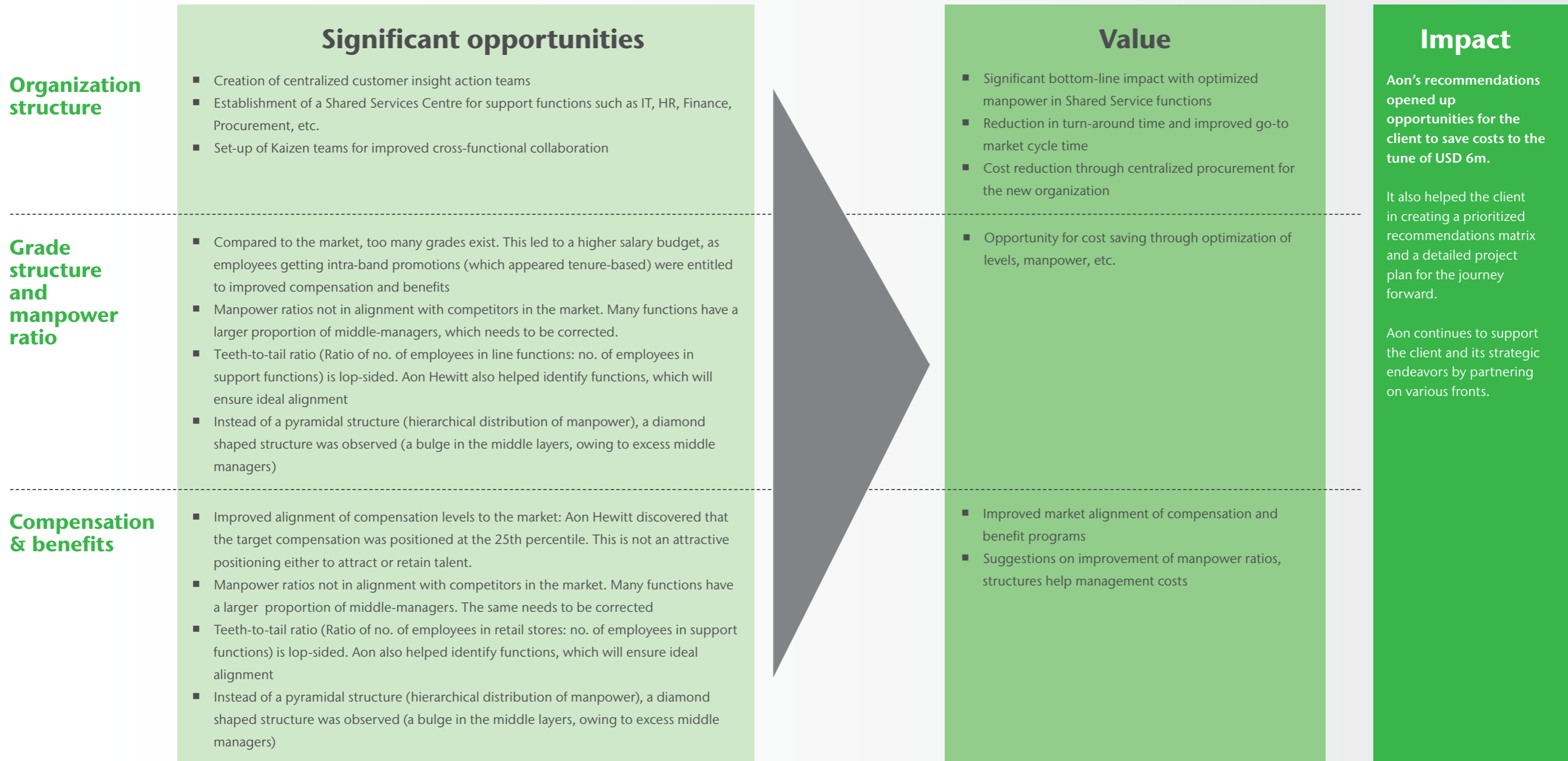
Aon also conducted a thorough review of data and documents that were received from the client. These documents requested by Aon pertained to organization structure, job descriptions, grade structure, HR policies, HR operations metrics and data (recruitment and selection, learning and development, performance management), manpower numbers, employee compensation and benefits, attrition, etc.

Aon conducted numerous one-on-one interactions with employees across levels, functions and regions, and Focus Group Discussions (FGDs) both with employees in hypermarket stores as well as in the corporate office. The objective of these discussions was to capture the employee pulse, expectations from the new organizations, areas of strength and opportunity for the organization, etc.

We also conducted an in-depth benchmarking exercise for all systems and processes with our existing proprietary databases in the Retail Sector and with Best Employers.



Value and impact created as a result of Aon approach



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Navigating Through Human Resources Reform for China's State-Owned Enterprises (SOEs)

Chinese State-Owned Enterprises have started undergoing extensive reforms as a result of increasing competition. With a focus on people, Human Resources reform (HR) is seen to be a more critical area as compared to other reforms. Hence, these SOEs are now challenged by their existing compensation systems, lifetime employment approach, as well as governance structure.

Globalization and an increasingly competitive environment have caused SOEs in China to undergo extensive reforms. In recent years, Chinese SOE reforms have looked in-depth into areas such as management process and organizational structure. Efforts are underway, especially in public financing, corporate mergers and acquisitions, and governance structure optimization.

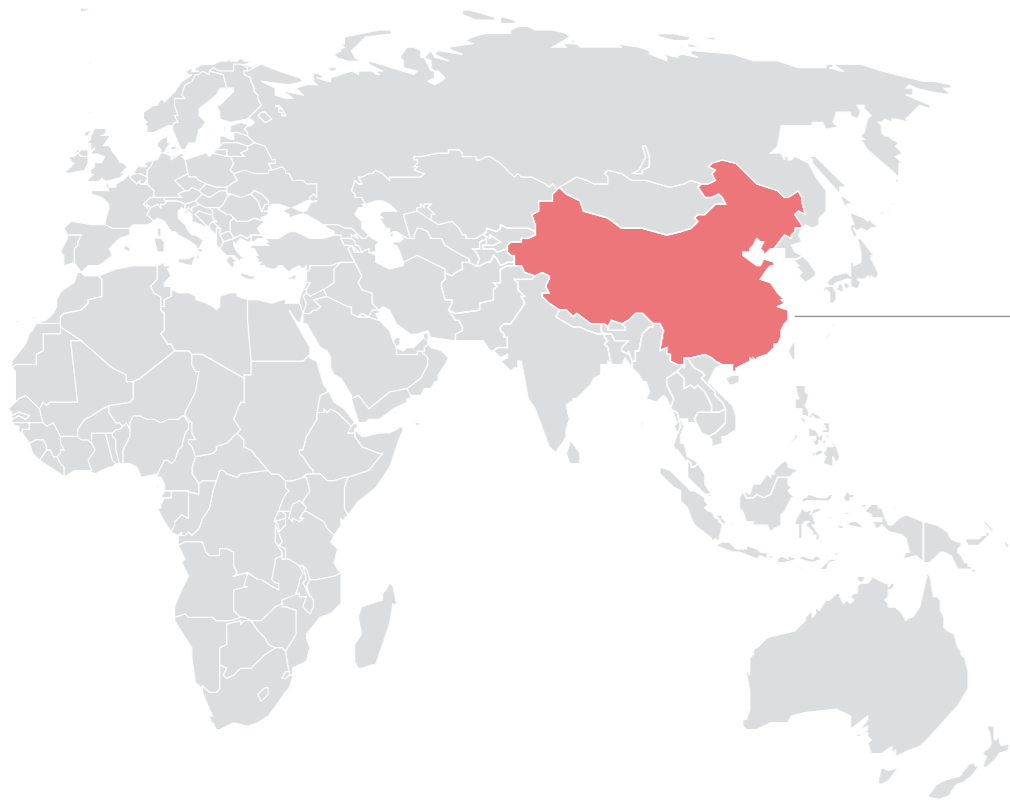
Among all these areas, people and people process are the most critical and thus Human Resources (HR) reform is assuming greater significance in SOEs. The special status that Chinese SOEs enjoy in society and culture transcends the business environment, and has thus made people reform a challenge. Some of the important HR challenges

occurring during SOE reforms in China are discussed below:

1. Compensation system – Design by seniority or by performance

Employees with a longer tenure in SOEs are usually better placed in their compensation, as compared to newer colleagues. These long-serving employees can receive higher salary and better welfare despite performing similar work as their new counterparts. They also may be given priority on opportunities for internal promotions. In SOEs, tenure and loyalty are deeply rooted in the organization.

From management's perspective, a tenure-based compensation system is an effective method to minimize controversy and discontent among corporate employees. Some SOEs that are less likely to reform have expressed concern that any reform may bring negative outcomes. For example, senior employees worry that their authority may be weakened. Additionally, with longer-serving employees deemed more trustworthy (based on their proven loyalty and stability), this could be discouraging for high-performing, new employees.



This seniority-based compensation system in SOEs could prove to provide inadequate support for new employees' ambitions – leading to high-performing new talent looking externally to advance their careers. Consequently, SOEs will not be able to capitalize on their people investment.

Some SOEs have realized this and are now taking necessary steps. Performance management is becoming a trend as seen by the increasing adoption of job analysis, job evaluation, and the setting of specific key performance indicators. These lead to more well defined jobs for incumbents.

Meanwhile, the resistance of tenured employees should be handled appropriately and sensitively. Through good communication, HR can assist tenured employees to recognize the merits and rationale of a performance management system in China's increasingly competitive business environment.

2. Lifetime employment – How to deal with underperforming workers

As a result of an employment system providing a high degree of social welfare and social stability in the planned economy period, HR policies of SOEs are still attached to the concept of 'lifetime employment'. It is not uncommon to find three generations from the same family working for the same company. With an undefined exit process for non-performers, SOEs will have to deal with talent shortages and redundancy.

To counter this, many SOEs deal with under-performers by providing training to strengthen and enhance their skill set and develop competencies required for their current positions or transfers, or by recommending voluntary separation or early retirement.

Many SOEs deal with under-performers by providing training to strengthen and enhance their skill set and develop competencies required for their current positions or transfers, or by recommending voluntary separation or early retirement.

With this, some incumbent employees become more competitive when faced with a possible exit scenario from the company. However, significant layoffs from SOEs will create social tension, such as an increase in the unemployment rate and in government welfare, etc. Layoffs shall be made based on business needs and the performance of employees. Mindful linkage and setting meaningful key performance indicators are crucial. Communication is also a key success in this process.

3. Governance structure – Involve executives' commitment

A general approach in SOE reform is an improvement of their governance structure. Special efforts have been in place to examine the corporate leadership team – especially the roles of the chairman, general manager, and party secretary.

SOE leaders tend to play the dual roles of businessmen as well as government officials. Besides considering economic benefits and growth, they also have to consider political stability and harmony within the community they lead. On the other hand, being overly concerned about the latter will inevitably weaken executives' commitment towards people changes.

Prioritizing stability across the company would weaken any transformational effort. Faced with dramatic external forces, such as strong competition, weak financial performances, and declining industries, SOEs will be encouraged to increase the speed of HR reform.

Despite all these challenges, many SOEs have successfully executed HR reform. Management of the HR function no longer remains a domain for the HR department only. It requires executives and managers to consider HR at a strategic level and assume responsibilities at all levels. In fact, SOE leaders are aware that modern HR management must obtain strong support from corporate executives and employees.

With the increased emphasis on globalization, the new challenge facing SOEs is how to manage growth better and effectively integrate acquired subsidiaries, along with their people and processes, into a truly global company. To promote HR reform, SOEs can consider setting key performance indicators linked to business drivers. Meanwhile, succession planning and job rotation can also help. This will continue to be a long journey, and effective HR practices can lead to the success of SOEs' reforms in China.

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Leveraging Insurance Due Diligence on Cross Border Deals

A common practice in North America, Europe and Australasia, insurance due diligence is a relatively uncharted area in Asia. As a result, understanding of premium costs is limited, leading to underinsurance. Learn how you can navigate insurable risks and understand their related costs.

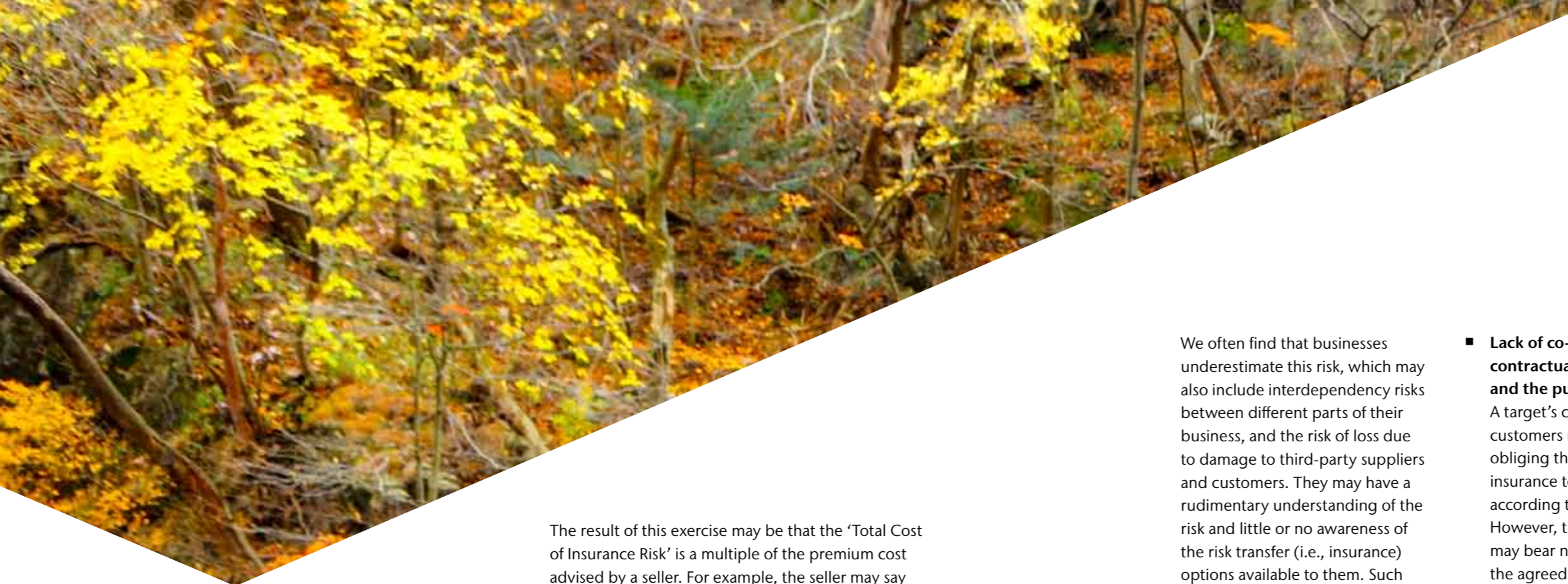
Insurance due diligence involves reviewing the insurances and related costs for a target company prior to signing a deal. This provides a buyer and the financing banks with an understanding of how well their investment will be protected going forward; equally importantly, it identifies risks and costs (or savings) that should be factored into deal negotiations, either by way of allocation of risks or through price adjustments.

While this diligence stream is relatively common in the developed markets of North America, Europe and Australasia, where insurance-related costs are much higher, for many Asian companies acquiring targets in these markets, the benefits of this are still not widely understood. We have noted some of these below, focusing on the financial outcomes from undertaking such a process.

While most Asian companies will think of premiums when they think of insurance costs, there may be other costs that should be considered and factored in when reviewing the 'Total Cost of Insurable Risk'. These include:

- **Higher levels of self-insured deductibles on claims:** It is not uncommon to see deductibles of USD 100k and above on property and liability insurances, so if there are multiple open claims, there may be multiple deductibles yet to be paid from the P&L of the target. This may be the case for businesses with large workforces, which have been subject to a high volume of work-related injury claims under their Workers Compensation and Employers Liability Insurances.
- **Cost of collateral:** In the US, there may be collateral requirements from insurers that front the self-insured part of any third-party loss, as well as insuring that part of the risk that is transferred to them.





- **Cost of risk improvements required by insurers:** Insurers may require or recommend improvements to the safety infrastructure and construction of the premises, the cost of which may be significant, e.g., upgrades to sprinkler systems and replacement of insulated wall panels that represent a catastrophic fire hazard.

These costs can run into six to seven figures. Our specialist risk engineers can advise on whether these requirements are market standard, the practicality of implementing them, as well as possible alternative measures.

Premium costs should also be reviewed. For example, if the transaction involves the carve-out of a division of a much larger business, the target division will not have the same purchasing power as a stand-alone business. If the acquirer does not have its own global insurance programs to fold the target into (and frequently Asian companies do not), then the cost of insuring the target will most likely spike upwards.

If the target is distressed or part of a group that is distressed, they may have cut back on the purchase of insurance; similarly, a fast growing company may be less focused on risk management and not keep the purchase of insurance in line with the growth of the business. In both instances, the costs may be suppressed by being under or uninsured.

The result of this exercise may be that the 'Total Cost of Insurance Risk' is a multiple of the premium cost advised by a seller. For example, the seller may say the premium cost is USD 1m, but once the other issues above have been considered, the 'Total Cost of Insurance Risk' may be a multiple of USD 1m, producing a much larger number to be factored into the modeling and deal price negotiations.

Incoming deals to Asia

For western companies investing in Asia, insurance due diligence review can help identify underinsurance and the related cost of rectifying this by purchasing full cover. Given Asian countries are developing markets for risk management, it is not uncommon to find that companies do not have a structured approach to identifying and quantifying insurable risks, or retaining or transferring them to the insurance market.

As a result, there are often gaps in the insurance arrangements of target companies which, if not rectified, could result in significant losses that the target company would have to absorb. Examples of the issues arising include:

- **Lack of sufficient cover for cash flow following damage to property.** While it may be possible to rebuild a factory or warehouse in Asia within a six-to-twelve-months period, a business may suffer a cash crunch if it cannot deliver products and its customers defect to the competition.

In addition, even when the property is reinstated in six-to-twelve months, it may not be possible to win back customers for a long period of time – for example, 18-24 months.

We often find that businesses underestimate this risk, which may also include interdependency risks between different parts of their business, and the risk of loss due to damage to third-party suppliers and customers. They may have a rudimentary understanding of the risk and little or no awareness of the risk transfer (i.e., insurance) options available to them. Such options provide cover for loss of profits and ongoing fixed costs, as well as additional expenses that may be incurred.

- **Natural catastrophe risks:** These have been highlighted by the earthquake/tsunami in Japan and the Thai floods in 2011. Increasingly companies are looking to identify their exposure to 'Nat Cat' risks in these and other countries in Asia, e.g., Taiwan (earthquake, windstorm), Philippines (earthquake, windstorm), and Indonesia (earthquake).

In some instances, the availability of cover may be restricted or there may be co-insurance clauses applicable (e.g., being asked to self-insure 20% of earthquake losses in Taiwan). It would be better to be aware of these prior to signing and of the possible risk transfer solutions that may be available to mitigate such risks.

- **Lack of co-ordination between contractual risk management and the purchase of insurance:**

A target's contracts with customers may include clauses obliging the target to buy insurance to certain limits according to agreed terms. However, the insurance in place may bear no resemblance to the agreed cover. For example, they may be obliged to buy product liability insurance on specified terms and to have the policy cover their customers, but this may not be reflected in the coverage they purchase.

- **Declaring property values that only equate to a percentage of the property at risk (e.g., only declaring 60%):** There is a lack of awareness that insurers can then reduce a claims payment to the same percentage, only paying 60% of the loss. While this may result in upfront savings on premium costs, the cover in place will not be fit for purpose if there is a claim.

The above are examples of how we help buyers navigate insurable risks and understand their related costs, when involved in an M&A transaction.

If you wish to understand the benefits of this due diligence stream for a specific transaction, please contact us.

If the target is distressed or part of a group that is distressed, they may have cut back on the purchase of insurance; similarly, a fast growing company may be less focused on risk management and not keep the purchase of insurance in line with the growth of the business.

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Enhanced Value Captured in Deals

Corporations and private equity firms continue to look to acquisitions for growth; in fact it is considered impossible to build world-class organizations without doing such deals.

Research shows that in the first decade of this century, those companies that engaged in M&A outperformed those that did not. Studies have shown however, that up to 70% of large deals fail to create meaningful shareholder value, with the top three reasons for derailment being:

- Ignoring integration challenges
- Overestimating synergies
- Not retaining key employees

It may be that an overemphasis on financial metrics when setting the business case for a deal, and a lack of effective measurement of operational and people-related issues are the cause of this. Large organizations are often accused of working in silos, and in a deal situation, this may lead to less effective coordination of resources and poor risk management.

This article aims to address several key themes we feel are relevant, based on our experience working on deals around the world.

A clear process

Early documentation of the deal rationale and assumptions used in the business case allow due diligence teams to conduct their jobs more effectively, as there is a clear direction.

This allows organizations to assess their progress against the original rationale, respond to issues proactively, and reduce inefficiencies created by a lack of clarity between the different parties involved.

One of the most challenging parts of the M&A process is ensuring that all parties understand the rationale for the transaction, as this determines how performance targets are set through to integration.

In our experience, in successful deals, non-financial metrics such as employee engagement, talent acquisition, and retention are measured throughout the deal life cycle in some way. From our observation, the use of performance metrics in deals in leading organizations has been shown to lead to better communication across all parties; clarity of decision making, problem solving and conflict resolution, and performance evaluation.

One of the keys to successful M&A is to have a repeatable model, stressing the importance of a focused set of skills and capabilities that can be applied consistently in creating value. We find there are few organizations with an end-to-end process that is well implemented and clearly defines roles and responsibilities and milestones throughout the deal's life cycle.

The agreement of a timetable with milestones for achieving targets is important to react to deviations from the original plan, as often occurs in deals. Any slip-ups can then be reacted to with greater agility and extra time or resources applied to achieve targets, particularly as these will relate back to the deal rationale, and why the company entered into the transaction.

Organisational effectiveness

How effectively an organization is structured for acquisitions has a bearing on how successful it will be at making deals. It is important to understand how decisions are made during the acquisition process, and how clearly the logic for value creation is decided upon, when arriving at the decision to make an acquisition. Firms may have a separate M&A function or this may be embedded within Corporate Development or Strategy.

However it is structured, organizational effectiveness for transactions is an important capability; in fact, it can be a core competence. This function can provide strategic direction and coordinate the various stakeholder groups to ensure that strategic objectives and implementation are aligned.

Additionally, the tools and processes supporting the transaction process, such as strong project management, play a very important role.

Some organizations, typically those serial acquirers experienced in deal making with significant in-house capabilities, have an overall deal playbook, with defined processes for the different stakeholder groups at different stages. Each deal is different, so any playbook has to be fairly easy to adjust and customize for deal specifics, and cannot work if it is too prescriptive. Those companies experienced in deals tend to have comprehensive process flows that can be adapted easily to specific deal situations.

Often, there are materials available during different deal phases, but these are not embedded through agreed processes. As a result, intellectual capital is not captured centrally and there is often duplication. In a deal environment, when time is of the essence, this must impact on value capture.

Interestingly, some companies with very detailed playbooks report that though these are in place, they are not used. The existence of a playbook seems variable within companies – some areas have them and some don't. One of the most useful insights on the use of playbooks in deals is the importance of focusing on deliverables, rather than processes, as this is what creates value.

Organisational learning

Post acquisition audits and organizational learning are weak in many organizations. This stage may be neglected, but can provide very useful insights to facilitate a higher success rate in future acquisitions.

Organisational learning is a key enabler of success, and calls for codification of the experience gained by participating in deals, in the form of tools, templates, and documentation to enable replication through training and knowledge sharing.

The consistent evidence that many acquisitions fail to create value suggests there is great potential for acquirers to learn from deal experience, and apply this to future deals. Taking this idea further, building this learning process into core M&A competence-building and strategy can lead to effective and efficient management of deals and create a sustainable competitive advantage.

Developing performance metrics and benchmarks through different deal phases facilitates organizational learning. Robust post-acquisition audits can contribute to effective learning and the development of successful acquisition programs; these should consist of performance benchmarks, including both short- and long-term objectives that are tailored to different types of acquisitions.

On closing, companies often find the wider deal team from different parts of the organization dissolves, and it becomes challenging to get them all back together for a review. Nonetheless, there needs to be a formal process for capturing lessons learned.

Even in organizations that conduct post-deal reviews, there is often no documentation of this, so the learning is only (hopefully) retained in the minds of the people working on the deal. One of the challenges is knowing at what point to conduct a post-deal review, as the integration process can be long.

Codification of knowledge and learning is important to ensure it can be referred to in

Value of deals can be enhanced through:

- Early documentation of deal rationale
- Effective organizational structure
- Organizational learning



future deals. Maintaining a central repository that can be easily referred to when initiating a new deal can be particularly challenging, especially when deal teams are geographically dispersed, and working on cross-border transactions.

Avoiding the pitfalls

While many of the themes identified as being ways to capture greater value in deals are not new, many organizations continue to suffer from value leakage by not addressing them.

Increasingly, we are seeing forward-looking organizations looking to implement robust solutions, such as Aon's TransAction Manager Platform, to articulate the process through different deal phases, and bring consistency of approach, clear governance and accountability, and the opportunity to learn from their experience.

Making a connection between the deal rationale at the start and integration issues later on, allows for a more holistic approach to deal success. A more thoughtful approach to how to organize effectively for deals allows for the operational and human capital integration risks to surface earlier in the process, rather than focusing solely on financial performance.

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About Aon

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