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Asia on the Buyside: The Key to Success

The human capital and hidden risks in cross-border acquisitions

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Foreword

Economists the world over agree that Asia will drive global economic growth over the next ten years, if not longer. According to the IMF, the region's economies will grow by 7.5% in 2010, and are likely to continue to accelerate through 2011 and beyond.

In stark contrast, growth in the advanced economies is expected to hit just 2.6% in 2010, just over one third of what is predicted for Asia.

Asia's growth will be driven primarily by its twin economic powerhouses, China and India, and will be buoyed by both a resurgence in domestic consumer demand and shifting demographic trends. At the same time, two new tigers, Vietnam and Indonesia, are emerging as powerful economies in their own right. Both are expected to grow by 6% in 2010, outstripping predictions for their peers across South East Asia.

As a result, cash-rich Asian businesses are increasingly undertaking cross-border acquisitions as they look to expand operations abroad, acquire brands and technology and seek new revenue streams. Between 2005 and 2006, the number of overseas acquisitions undertaken by Asian bidders accounted for 13% of global cross-border purchases. However, between 2009 and the first half of 2010, that number almost doubled to 25%, demonstrating the buy-side clout of Asian firms.

As Asian bidders make their way onto the global stage, the challenges and perils of target selection, pricing, due diligence, and integration await them. These companies must be mindful of a host of potential pitfalls, from understanding local labor laws and legislative requirements to assessing the background, reputation and integrity of the target business as well as intangible assets such as patents, trademarks, brand names, and human capital.

Understanding national and organizational cultural differences is also vital to ensuring a positive deal outcome. A solid appreciation of cultural differences can make the identification of potential operational synergies much easier, ultimately impacting the success of a deal.

Another key area of concern is HR-related financial risk, including pension/benefit liabilities, severance costs, and change-in-control employment contracts. Employee communication and change management are also important issues to consider.

Indeed, Asian cross-border M&A bidders clearly have their work cut out.

With this in mind, Mercer, a leading global provider of consulting, outsourcing and investment services, and Kroll, the world's leading risk consultancy, commissioned mergermarket to produce *Asia on the Buy Side: The Key to Success*. This report highlights the importance of addressing both the human capital and risk management issues during the dealmaking process. It includes survey findings and insights from Mercer and Kroll consultants that readers may find both interesting and useful.

From 2006 to 2010, the number of overseas acquisitions undertaken by Asian bidders almost doubled.

Executive summary

During March and April 2010, 155 senior executives of Asian-based corporations and private equity firms that had undertaken a cross-border acquisition over the past three years were asked about their views on the risk management and human capital issues that impacted the success of their purchase.

Asia outbound M&A outlook

- **Respondents remain broadly positive on Asian cross-border dealmaking over the foreseeable future.** The majority (83%) of respondents expect Asian cross-border acquisitions to increase over the next 18 months. Hong Kong-based respondents are the most bullish with 94% expecting this, whereas 60% of Korean respondents expect the same.

- **Greater China is the likely target area for 49% of the companies saying that they will acquire overseas in the next 18 months.** Respondents also said that they are most likely to complete a cross-border transaction in North America (29%), South East Asia (27%) and India (22%). Very few respondent organizations (1%) are planning on targeting a Japanese business in the near future.

- **Expansion into specific high-growth economies abroad is the main reason why Asian bidders want to acquire overseas.** This expansion seems to be very dependent on the country in which the respondents' operations are based. For example, more than half of the respondents in India suggest that their biggest M&A driver will be technology acquisition. On the other hand, a similar percentage of Hong Kong-based respondents point to lower costs and greater economies of scale as the main reasons for buying abroad.

- **Price matters for most.** 42% of respondents believe paying the right price is the most important measure of successful cross-border M&A, while 30% suggest that the number of customers retained is the most crucial gauge.

- **Businesses that completed deals worth over US$500m are more likely to transact in the future.** 38% of respondents who have previously spent US$50m or less on an acquisition went on to say that they were likely to transact again over the next 18 months, compared to 75% of those who have conducted a deal worth US$500m or more in the past.

- **The riskiest regions for Asian bidders are Eastern Europe & Russia, Africa, and Greater China.** Respondents are particularly concerned about bribery and corruption in Eastern Europe and Africa, as well as political or social unrest in the Middle East.

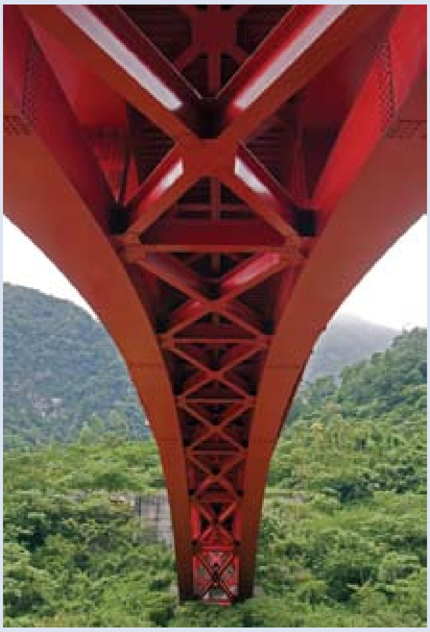
The hidden risks

Only 40% of Asian buyers surveyed viewed their most recent cross-border transaction as very successful or a complete success. Why?

The importance of addressing HR issues during a transaction

- **Asian cross-border acquirers recognize the importance of HR-related issues.** More than 80% of respondents believe that intangible assets (human capital, brands, patents, etc.) and cultural differences are important factors to consider during a deal. Furthermore, 66% of respondents think that HR-related metrics should be considered in assessing the outcome of transactions.

- **Staff retention programs broadly work.** The vast majority of respondents implemented employee retention plans during their most recent transaction. Furthermore, over 70% of respondents indicate that their retention initiatives were successful in retaining key employees post-transaction.



"Only 40% of Asian buyers surveyed viewed their most recent cross-border transaction as very successful or a complete success. Why?"

- **Compensation is one of the most common and challenging issues for Asian buyers as they cross borders.** Even within Asia, compensation is a complex matter. In Korea, for example, seniority-based pay systems are common. In Japan, some companies must adhere to a strict ratio between the highest and lowest paid employee. In China, there are government-mandated compensation limits for all state-owned enterprises.

- **Cultural differences should be considered at the pre-deal stage.** Most respondents (84%) state that they would consider the implications of national and organizational cultural differences prior to any deal announcement.

- **Many organizations are aware of the critical HR-related risks that can emerge from a cross-border transaction.** Hidden costs such as pension liabilities can just as easily derail a deal as cultural issues if they are not properly investigated before the deal is signed. Some 55% of respondents point to HR-related financial risks as one of the key areas they examine during due diligence.

Investigative due diligence exposes hidden risks and potential deal-breakers

- **Conducting investigative due diligence has a positive impact on deal outcome.** Of those respondents who have undertaken investigative due diligence during their most recent cross-border M&A, almost 82% report that their acquisition was ultimately either 'very successful' or a 'complete success'. Of those respondents who noted their most recent cross-border transaction was not very successful, 54% said that they would allocate more time to investigative due diligence in the future.

- **Investigative due diligence provides investors with intelligence to support negotiations.** Of the 35% of respondents who have always conducted investigative due diligence when dealmaking, 51% note that the exercise ultimately resulted in a restructuring of financial terms. A further 29% explain that it resulted in a change in the management team. Interestingly, more than nine out of ten (92%) respondents who restructured a deal after conducting investigative due diligence went on to state that the outcome of their deal was successful.

- **Singapore and Hong Kong-based respondents considered their recent cross-border transaction as the most successful.** Interestingly these two markets, together with Australia, were ranked as the top three users of investigative due diligence.

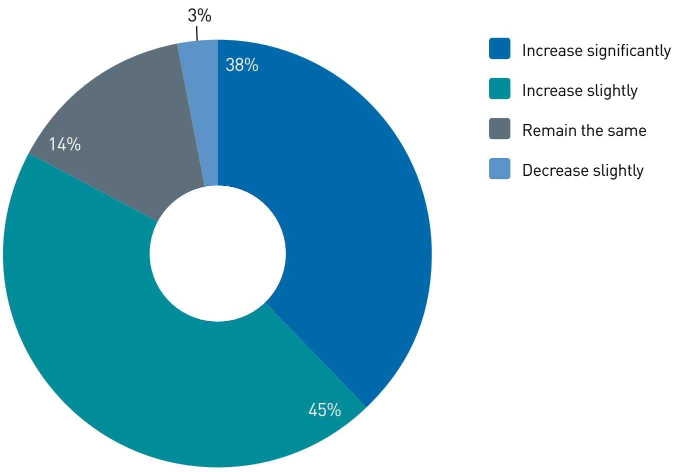
- **Asian bidders tend to overlook critical issues that can impact *long-term* deal success.** Despite almost 75% of respondents noting that they always, or at least have considered, conducting investigative due diligence in the past, they have often overlooked critical risk issues such as the integrity of key employees (17%), management team's track record (4%) and exposure to regulatory risks (1%).

- **Fraud, an impediment for Asian bidders.** While identifying instances of fraud pre-deal is critical, it is equally important to watch for signs of wrong doing once a transaction has been completed. In their most recent cross-border transaction, 47% of respondents uncovered fraud post-close, causing them to renegotiate or exit.

Survey findings
Asia-Pacific's M&A landscape

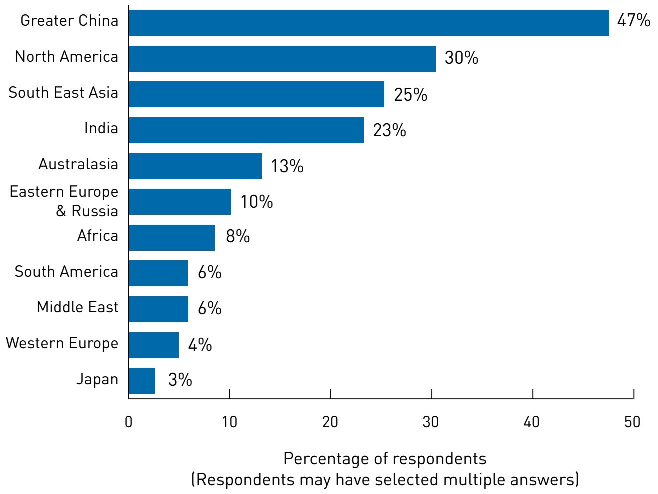
Asian cross-border M&A activity is expected to rise over the next 18 months

What do you expect will happen to the level of Asia-Pacific cross-border M&A activity over the next 18 months?



Greater China and North America are the most likely destinations of Asian cross-border acquirers...

Which geographic region do you expect Asia-Pacific cross-border acquirers to aggressively target over the next 18 months?



The general consensus (83%) amongst survey respondents is that Asian outbound M&A activity will continue to rise over the next 18 months with more than a third anticipating a significant increase. In contrast, just 3% think that cross-border deal flow from the region will decrease.

One bullish respondent explained, "Asian companies are now stronger and bigger, and are looking to take their businesses to the next level. Therefore they will now increasingly look to acquire companies, especially in the US and Europe, as they look to expand market share abroad". Another commented that, "More Asian businesses are striking cross-border deals to benefit from synergies and efficiencies".

Close to half (47%) of respondents believe that the bulk of Asia-Pacific cross-border acquirers will target assets located in Greater China, owing, as one respondent put it, to "its great potential in terms of economic clout, rising domestic income, consumption levels, and political stability".

A further 30% of respondents believe the majority of Asian buyers will target North American businesses, due in part to a weakening US dollar. According to another respondent, "Many US companies are ripe for acquisition primarily because they are so cheap at the moment".

Less than 10% of respondents feel that Asian buyers will acquire in Africa, South America, the Middle East, Western Europe and Japan.

47%

of respondents said Greater China is the region where they expect Asia-Pacific cross-border acquirers to aggressively target over the next 18 months.

A case study of success – a personal perspective

In June of 2007, Four Dimension, a Beijing-based, private Chinese manufacturer of security vehicles acquired Johnson Security Ltd, a London-based manufacturer of specialized vehicles, to form FD-Johnson, with Four Dimension taking over Johnson's customers and manufacturing facilities. While Johnson at one time commanded more than 85% of the armored vehicle industry in the UK, rising production costs had resulted in a drop in market share, which Four Dimension saw as a substantial opportunity.

The deal got off to a poor start, with several high-level Johnson managers resigning. But with 2009 revenues more than double similar figures for 2006, the transaction is now viewed as a major success.

Mercer spoke with FD-Johnson's CEO, Wang Shan, to learn more about his experience, the challenges he faced during the deal, as well as the post-deal integration efforts that led to the deal's success.

Mercer: What motivated you to undertake this transaction?
Wang Shan: The technology and brand equity of foreign cash-in-transit (CIT) vehicles far outpaced that of our Chinese counterparts. However, unlike producing mass market passenger vehicles, building CIT vehicles is an extremely labor-intensive process due to their customized nature. Therefore, the cost of building CIT vehicles in developed countries such as the UK is extremely high. I believed that combining Johnson's brand and technology with our cost advantages would create a strong opportunity to develop vehicles for both the domestic Chinese and European markets at a lower cost.

Mercer: What were the biggest challenges you encountered during the transaction or in the integration?
Wang Shan: We faced many challenges; the majority of which were related to people. First, Four Dimension has a relatively short history. We did not have the talent pool or management capabilities of a multinational company. As such, we experienced many difficulties building trust between our Chinese managers and the Johnson employees from the very start. Johnson's staff thought we were there to steal their technology and that we would leave once that knowledge was transferred, resulting in mass redundancies. Employee communication was very poor.

Also, it was difficult to make changes. As a private company in China, I can change corporate policies such as compensation, with relative ease. However, in the UK this was difficult. For example, I attempted to change our factory employee's salary structure to incorporate a variable performance-based portion. In doing so, I proposed that we take away a portion of total fixed pay and make it performance-driven with a larger upside. This was resisted by both employees and the management team.

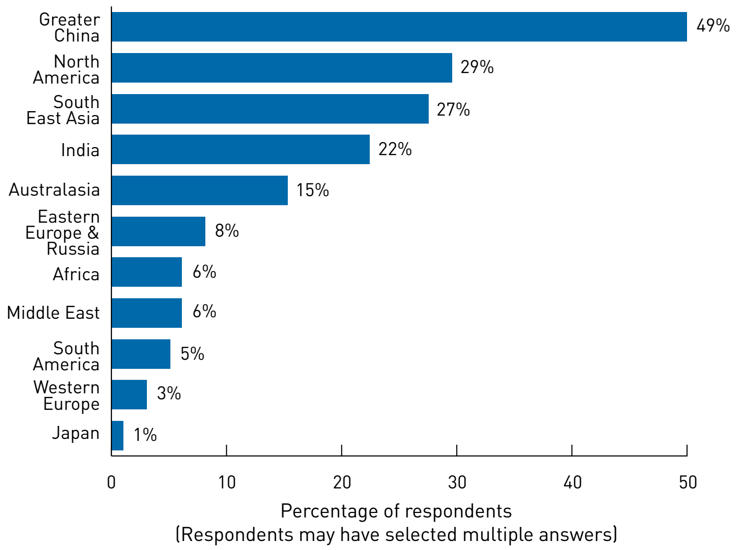
We also experienced many management conflicts, at least initially. We sent Chinese managers to oversee the operation; however, various decisions made by Four Dimension managers resulted in several senior Johnson managers submitting their resignations. We eventually made compromises, including bringing our management team back to China and naming an original Johnson executive as general manager.

Mercer: Did you encounter any cultural differences between the two businesses?
Wang Shan: One of the immediate differences we noticed was that most employees at Johnson had more than 10 years of service at the company, compared with only two to three years on our side. Recommendations from us were usually met with, "Why should we change, we've always done it this way," from our British employees, meaning that implementing new processes and protocols was even more difficult.

Mercer: What advice do you have to give to potential Asian bidders looking to acquire abroad?
Wang Shan: In our next acquisition abroad, I would not send a team to integrate or make changes to existing operations after the transaction. In this deal, we attempted to change too many things and as a result created a great deal of chaos for everyone in the months following the close of the deal. Next time around, I will do nothing and allow things to go through a stable transition period to ensure that I gain the confidence of the staff, management, suppliers, customers, and all the other stakeholders at the target company.

...A sentiment which those who are actually likely to transact abroad agree with

Percentage of respondents likely to undertake a cross-border acquisition in the following target region(s) over the next 18 months



Of those who say that their business is likely to undertake a cross-border M&A transaction over the next 18 months, Greater China was the most mentioned (49%), with North America the next most probable location (29%).

US investment risks

Asian investments in the US play an increasingly important role in its economy. These cross-border deals present challenges that do not exist when working intra-country or intra-region. At a minimum, they involve different political cultures, multiple sets of regulatory frameworks and legal structures as well as different languages and time zones. Most significantly, they almost always involve different business cultures and expectations of appropriate business conduct.

According to the survey respondents, the top three concerns regarding US investment are political risk, economic risk, and risk of labor unrest. While these risks are real and provide a useful lens for viewing opportunities, they are often less significant than the risk of running afoul of government regulations or out-and-out fraud. Understanding a company in the context of the legal, regulatory, and business framework in the US is crucial to a deal's success.

For example, the US Foreign Corrupt Practices Act (FCPA) is at the forefront of compliance risk, and its enforcement has become increasingly stringent. At the same time, the Securities and Exchange Commission (SEC) has increased its investigations into and prosecutions of financial fraud.

Targeted due diligence in advance of a transaction can help mitigate an investor's risk in the US. Information obtained from open record sources such as litigation, regulatory filings and financing statements can provide excellent indicators of financial fraud. However, these indicators must be evaluated in the context of US regulations and not just from an Asian viewpoint.

By way of example, a recent due diligence investigation Kroll conducted on behalf of an Asian client revealed a key executive of the target company had previously been the CFO of a company accused of accounting irregularities. Although he was never charged criminally, the executive was a defendant in a number of civil lawsuits related to the fraud. Initially, the client was not concerned by the allegations in the civil lawsuits since the individual had not faced criminal prosecution. However, Kroll's extensive review of hundreds of original documents filed as exhibits to litigation surfaced information that led the client to conclude the individual was complicit in the fraud. Kroll's investigative findings also raised the client's suspicions that future business dealings with the individual might put the client at risk for future bad acts or fraud.

Lisa Silverman, Managing Director, Chicago, Kroll

Organizations from Greater China are investing locally…

Percentage of **Mainland Chinese** respondents who are likely to undertake an acquisition in the following target regions over the next 18 months	
Hong Kong, Taiwan & Macau	68%
North America	28%
India	24%
South East Asia	24%
Africa	8%
Australasia	8%
Eastern Europe & Russia	8%
Western Europe	4%
Japan	0%
South America	0%

…while 75% of Indian organizations are looking to the Americas…

Percentage of **Indian** respondents who are likely to undertake an acquisition in the following target regions over the next 18 months	
North America	50%
South America	25%
Pakistan & Sri Lanka	25%
Africa	17%
Australasia	17%
Eastern Europe & Russia	17%
Greater China	17%
Middle East	17%
Western Europe	8%
Japan	0%
South East Asia	0%

…and Australian companies continue to build a presence in North America and South East Asia.

Percentage of **Australian** respondents who are likely to undertake an acquisition in the following target regions over the next 18 months	
North America	40%
South East Asia	33%
New Zealand	27%
Greater China	27%
India	20%
Africa	0%
Eastern Europe & Russia	0%
Japan	0%
Middle East	0%
South America	0%
Western Europe	0%

CEO compensation across borders

Do any of your direct reports make more money than you do? In a recent transaction, we negotiated a retention plan as well as the target CEO's compensation on behalf of a Chinese acquirer. This target company was listed in Australia and its CEO's total pay was more than 10 times that of the acquirer's CEO – a very interesting but potentially difficult situation.

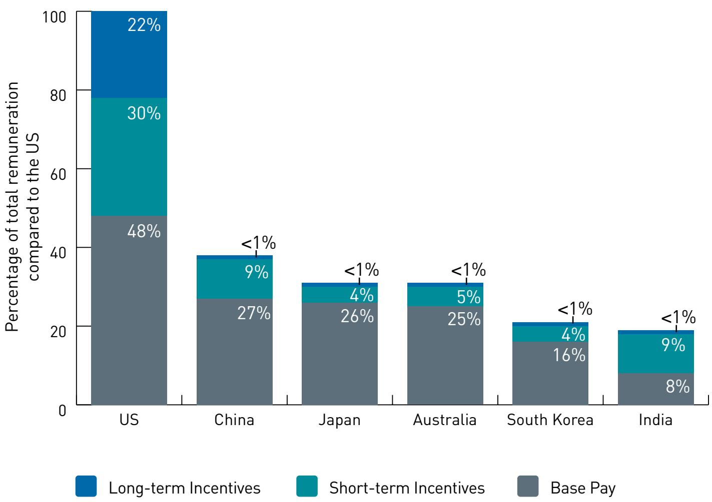
One of the most common and challenging issues for Asian buyers during cross-border acquisitions is the issue of compensation. Even within Asia, compensation is complex. In Korea, it's common to see a seniority-based pay system. In Japan, companies are sometimes bound by a strict ratio between the highest and lowest paid employee. China has government-mandated compensation limits at all state-owned enterprises.

In the US, 53% of a CEO's total compensation is at risk, with the majority of it tied to long-term measures. Contrast that with the typical CEO of a Chinese red chip (state-owned) company, where the CEO has virtually zero percent of his/her salary in long-term incentives. This may not make much sense until you understand that CEOs at Chinese state-owned enterprises are often political appointees, and are rotated when his or her term is reached. Therefore, the concept of a long-term incentive plan does not fit in most circumstances.

So how do you harmonize these pay programs? More often than not, the answer is you don't. You need to rely on local market benchmarks to obtain the most competitive talent, which often means working outside your comfort zone.

Garry Wang, Greater China M&A Leader,
Mercer's Global M&A Consulting Business

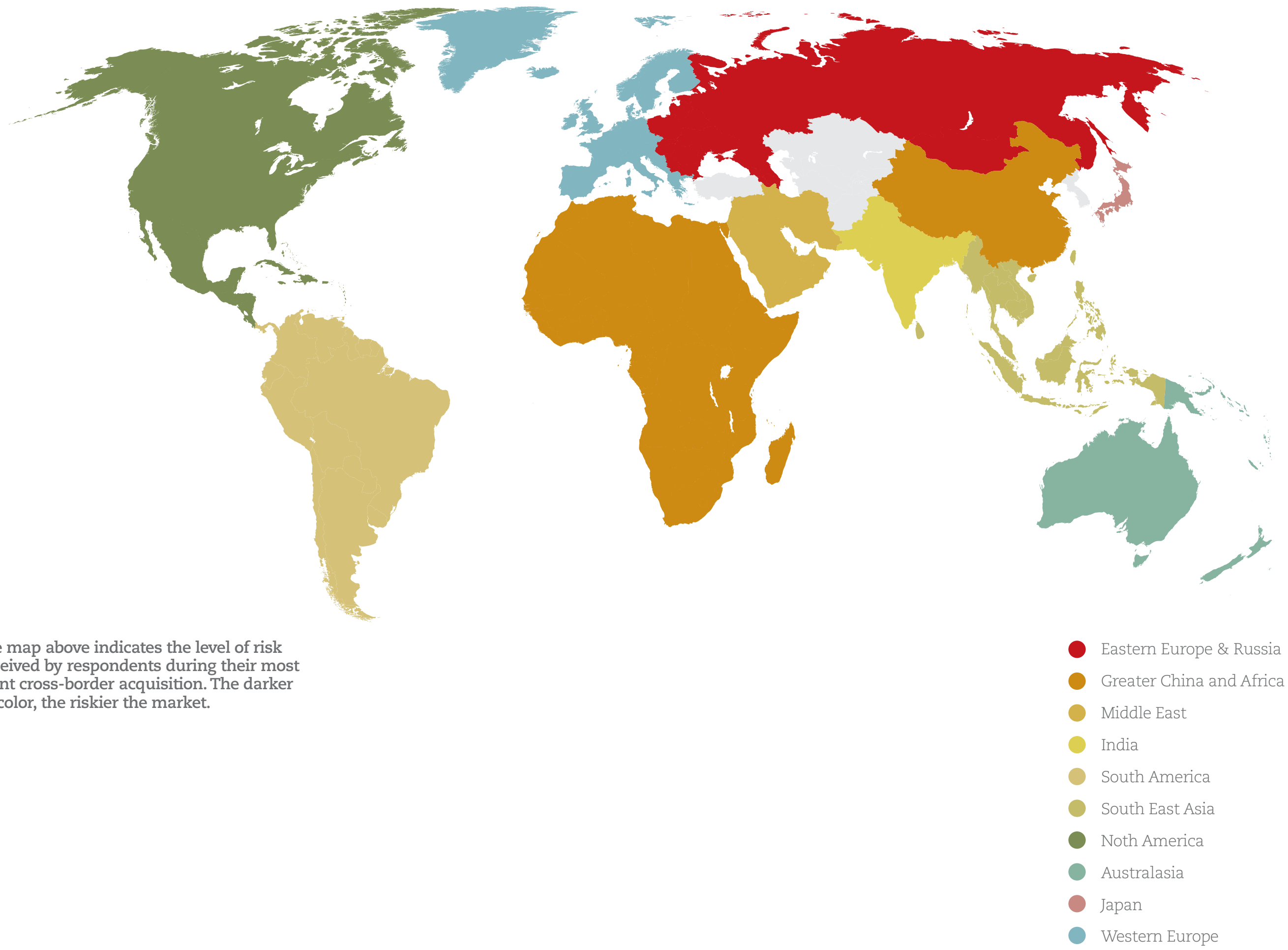
Asia-Pacific CEO median total direct remuneration in general industry companies



Eastern Europe and Russia are seen as the riskiest regions for cross-border M&A, mainly due to bribery concerns

When asked to rate the various risks associated with cross-border M&A in different regions, respondents score Eastern Europe & Russia at the top, giving it an average rating of 61 out of a possible 70. Greater China and Africa came not far behind, both with a score of 58. On the other hand, Australasia, Japan and Western Europe all emerge with scores of less than 35.

At the same time, respondents rank financial market/economic instability as the greatest concern to cross-border acquirers, giving it a total score of 77 out of a possible 110. Undisclosed liabilities and political and social unrest also rank fairly high. On the other hand, respondents are less concerned with risk of labor unrest, which scores less than 70.



*The map above indicates the level of risk perceived by respondents during their most recent cross-border acquisition. The darker the color, the riskier the market.

Each year, more Asian companies are expanding their horizons and moving into new markets around the world – but that growth comes at a price.

Many companies in Asia count among the world's most successful and fastest-growing because they are active globally. They are increasingly looking overseas to secure more resources, customers, efficiencies and greater diversification.

Every region around the world is benefiting from their growth. For some, such as Africa, Asia is already the largest source of investment.

As Asian companies search and compete for the best deals around the world, they are facing new challenges, such as:

- Making deals in unfamiliar jurisdictions
- Operating in different economic, political, business and legal environments
- Complying with different regulations that have severe consequences if violated
- Coping with an unstable global economic environment that can make predictions almost impossible, even in the short term

The challenges

According to our survey, Asian companies are encountering significant issues concerning bribery and corruption in Africa, Eastern Europe and Russia, South America, Greater China and India.

1. Bribery and corruption

When assessing bribery and corruption risks in respect of any potential transaction, the issue must first be analyzed at the country level. An understanding of the prevalence of graft in that country must be reached, and a detailed analysis of the relevant legislation conducted.

Whilst this process will be more exhaustive in high-risk regions, such as Africa, India and South America, it needs to be conducted in every region and country. It can be a costly mistake to overlook this for geographies perceived as lower risk, such as Western Europe and the US. In the UK, the Serious Fraud Office has begun to devote substantial resources to graft concerns, and has already achieved a significant number of settlements with UK companies involved in corruption.

Secondly, one must look at the owners' and managers' track record, undisclosed connections, suspicious contracts, and the integrity of key employees at the target company. In Brazil, companies that 10 years ago frequently engaged in corruption because 'that's how things worked' may now have genuinely cleaned up their act. Others may have slipped into corrupt practices more recently to survive the economic crisis.

For an unfortunate few, instances of corruption and bribery come to light only after an acquisition or merger has taken place.

Our survey clearly shows that while Asian companies are aware of the countries where bribery and corruption is highest, they could be more diligent in understanding how it might impact their deal. A worrying 1% of the survey's respondents said their due diligence process looked at the target company's exposure to the FCPA or other regulatory violations. Investors should be aware that the US Department of Justice and the SEC are aggressively cracking down on FCPA violations globally and penalties can reach billions of dollars.

In today's highly regulated environment, companies need to be more responsive than ever to regulatory risks, be aware of how to deal with suspected problems and understand the steps they can take to minimize the impact of regulatory enforcement.

Kroll was recently appointed by a US-listed Asian company to review the ownership structure of its corporate partner and the alleged links of the entity's principals to senior political figures in Africa. Kroll was able to confirm that the client's partner had undisclosed links to high level politicians which posed an increased corruption threat under the US FCPA. As a result the client dissolved its partnerships and divested in excess of US$100m of its assets in the region.

Top risks by region rated by respondents

Region
Eastern Europe & Russia

Rank 1
- Bribery & corruption

Rank 2=
- Undisclosed liabilities
- Political/social unrest

Rank 3
- Financial market/economic instability

Region
Africa

Rank 1
- Bribery & corruption

Rank 2
- Political/social unrest

Rank 3
- Financial market/economic instability

Region
Greater China

Rank 1
- Protectionism

Rank 2
- Undisclosed liabilities

Rank 3
- Ineffective IP regimes

Region
Middle East

Rank 1
- Political/social unrest

Rank 2
- Ineffective IP regimes

Rank 3=
- Financial market/economic instability
- Undisclosed liabilites
- Protectionism

Region
India

Rank 1
- Bribery & corruption

Rank 2
- Undisclosed liabilities

Rank 3
- Financial market/economic instability

Region
South America

Rank 1
- Political/social unrest

Rank 2=
- Undisclosed liabilities
- Bribery & corruption

Rank 3
- Financial market/economic instability

2. Protectionism

In our survey, Russia and Greater China received the highest scores for protectionism.

In Russia, protectionist measures have certainly increased during economic crises. A recent controversial hike on tariffs for imported vehicles into Russia in order to protect the local car industry was not at all popular in Asia, especially in Japan.

South America also scored poorly in this category. Some South American countries have been involved in bitter disputes with China over trade-related protectionism. In 2009, the Argentine authorities launched 18 anti-dumping investigations against Chinese products, accounting for 64% of all similar measures taken in the whole of Latin America. Cases of commercial protection filed in Argentina against Chinese products have doubled every year from 2007 to 2009.

Among the more developed economies, Australia also scored poorly. Perhaps Australia's score was influenced by such high-profile incidents as the failed Chinalco-Rio Tinto deal. However, Australia has benefited enormously from China's inward investment, and protectionism is not considered endemic.

On a country level, it is important to understand the country's existing policies, the facts behind recent incidents, and why protectionist policies might change.

It is also important to note that protectionism does not only exist on a country level, and that pre-deal due diligence also includes an analysis of what is happening at a local level. In many instances, local protectionism and local corruption go hand in hand.

Protectionism may be something that currently benefits a potential acquisition target, yet equally may not continue for much longer, due to an upcoming political or regulatory change. Protectionism may also be something that will cause difficulties for a foreign company when it tries to make an investment or acquisition. Forewarned is certainly forearmed.

3. Political/social unrest

Many respondents identified political and social unrest as a key risk when investing in the Middle East, Eastern Europe, Russia and Africa. This was partly based on experience and partly on perception.

First-hand experience provides the most accurate but also the most painful lessons. There is no doubt that Asian companies have felt the consequences of social unrest caused by their investments. For example, the *Financial Times* recently reported that a popular backlash against Chinese investment in uranium-rich Niger led to the toppling of the government. As a result, the deposed president Mamadou Tandia "became the first African leader whose downfall could be traced directly to his embrace of Chinese suitors".

Of course Asia Pacific is a region that has had its own share of political and social unrest, and companies here understand the economic consequences of this. They also do not need to be told that perceptions gained from a distance do not always match reality.

Countries that are currently receiving publicity for political and social instability include: Kenya for its community unrest; Venezuela for nationalizing its industries; Thailand for its political turbulence and acts of civil disobedience; and Mexico for numerous cases of kidnapping and violent crime. However, there are Asian companies enjoying considerable success in each of these countries because they invested the time to research and understand the risks.

4. Fraud

A worrisome finding from the survey was that 47% of the Asian respondents who detected fraud within the company they acquired only discovered it after the deal was closed. Of the 53% who detected it pre-close, most took redemptive measures and then proceeded with a much more favorable deal.

When fraud is detected post-close, it is for two reasons: a lack of due diligence pre-close, or it is a new fraud that occurred post-closure.

In our survey, Russia and Greater China received the highest scores for protectionism.

Top risks by region rated by respondents (continued)

Region
South East Asia

Rank 1
- Bribery & corruption

Rank 2
- Protectionism

Rank 3
- Political/social unrest

Region
North America

Rank 1
- Financial market/economic instability

Rank 2
- Undisclosed liabilities

Rank 3
- Labor unrest/risks

Region
Japan

Rank 1
- Undisclosed liabilities

Rank 2
- Financial market/economic instability

Rank 3
- Protectionism

Region
Australasia

Rank 1
- Protectionism

Rank 2=
- Financial market/economic instability
- Undisclosed liabilities
- Bribery & corruption

Rank 3
- Labor unrest/risks

Region
Western Europe

Rank 1
- Labor unrest/risks

Rank 2
- Financial market/economic instability

Rank 3
- Protectionism

It is very common for fraud to coincide with a change in a company's ownership. Staff can become disgruntled after a transaction due to perceived or actual poor treatment by the new owners or managers. In these circumstances, they may feel fraudulent behavior is justified. For example, an employee might be tempted to steal intellectual property to sell to a competitor. They may also be suspicious of new foreign owners, or believe they can take advantage of them.

The skills that Mercer provides can help prevent the occurrence of this type of reaction. Its advice on communicating with staff, compensation, retention, and integrating the cultures of the merged organizations can often reduce the risk of fraud incidence. Post-close, it is critical that the acquirer implement fraud detection controls at the target company to ensure that any sign of wrong doing is dealt with immediately before it causes severe financial and reputational damage.

5. Labor unrest

The risk of labor unrest received the lowest score in the survey, but it was still considered a significant risk in Eastern Europe and Russia, and in China.

Labor unrest can vary from a few protestors outside a factory, to a coordinated online campaign against a new buyer.

What can be done? Before buying a company with substantial manufacturing operations, have someone pay a discreet visit and check that labor disputes are not simmering. Check whether there has been a high turnover of staff in key departments. Labor unrest is a problem in itself, but it also generates new risks. A loss of disgruntled engineers and designers means a potential loss of valuable knowledge and intellectual property; and with it much of the value implied in your purchase price.

6. Undisclosed liabilities

Those with a research background will be interested to note that respondents ranked undisclosed liabilities of target companies high among their list of concerns in cross-border transactions. The countries that scored high in this category also scored high for corruption. This is because companies' undisclosed liabilities often exist in the form of promises to government backers.

7. Financial market/ economic instability

Last amongst the risks covered in this survey, but certainly not least, is financial market and economic instability. This risk scored the highest amongst our respondents, with no region scoring less than five out of 10 for the level of risks they perceive to be facing in cross-border transactions. However, with greater risk comes greater return. No doubt some Asian companies will prosper as a result of Greece's current economic turbulence.

Conclusion

Of those respondents who have conducted investigative due diligence, 56% of them assert that the procedure delivered sufficient intelligence for them to successfully restructure the financial terms of their transactions. At the same time, more than one in five indicated that intelligence garnered from their investigative due diligence resulted in either a restructuring of the existing management team, a better understanding of the strategy of current or past bidders, or an exit from a proposed bid. Given the increasing level of Asian investment into unfamiliar territories, investors are justified in their high levels of concern. However, Kroll believes with the appropriate level of market intelligence, competitive intelligence and investigative due diligence, the inherent risks can be mitigated and, if dealt with early in the deal cycle, can be reflected in the pricing and structuring of a deal.

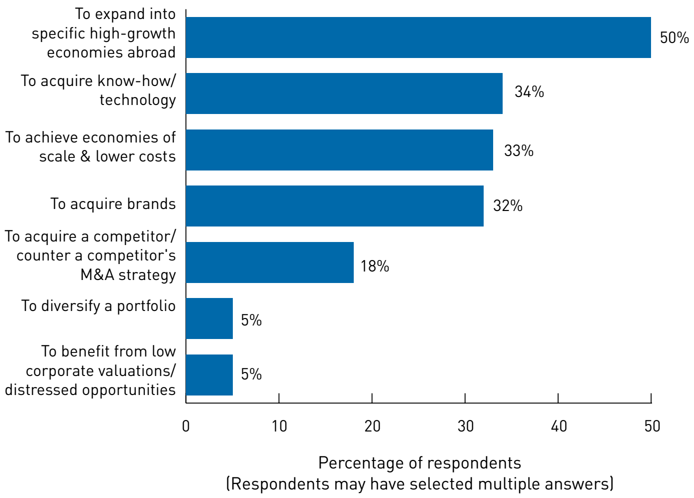
Jack Clode, Managing Director, Hong Kong, Kroll

Of those respondents who have conducted investigative due diligence, **56%** of them assert that the procedure delivered sufficient intelligence for them to successfully restructure the financial terms of their transactions.

Survey findings
Why do companies acquire?

Capturing high-growth opportunities, acquiring technological know-how and brands and lowering costs are all important drivers of Asian cross-border M&A

What do you believe will drive the majority of these deals?



Exactly half of respondents believe that Asian cross-border acquisitions over the next 18 months will be driven by an interest in expanding into specific high-growth markets, while 34% think the main driver will be a desire to acquire technological expertise. Conducting M&A in order to acquire brands and lower costs also featured prominently, with 32% and 33% of respondents mentioning these factors respectively.

Conversely, portfolio diversification and benefiting from distressed opportunities featured poorly as reasons for cross-border M&A, with just 5% of respondents each listing these two drivers as a primary factor steering Asian cross-border M&A transactions.

50%
of respondents said expansion into specific high-growth economies abroad would drive the majority of deals.

Was your recent deal successful?

Only 40% of Asian bidders view their recent deal as very or completely successful.

A substantial proportion of respondents were not convinced by the eventual outcome of their most recent cross-border acquisition, with 50% stating that the deal was 'quite successful'. Meanwhile, 40% were confident that their most recent acquisition was either 'a complete success' or 'very successful'. One in ten respondents rated the outcome of their most recent acquisition as unsuccessful.

It is interesting to note that:

- **Singapore and Hong Kong-based respondents considered their deals the most successful** with 50% and 47% respectively rating their transactions as very successful. On the other hand, Korean and Japanese respondents were the least bullish, with just 27% and 18% respectively rating their deals similarly.
- **Companies undertaking larger (US$100m plus) transactions tend to more effectively realize their M&A aims than those conducting sub-US$100m acquisitions**. 58% of respondents who spent more than US$100m on a cross-border acquisition rated their deal as ultimately very successful. In contrast, just 33% of those who invested less than US$100m rated their transaction similarly.
- **Employing experienced M&A teams seems to have a small but discernible impact on deal outcomes,** with 46% of respondents who state that their deal origination and execution teams are very experienced, going on to say that their transaction was very successful. This level of success falls to 36% when M&A teams are described as quite experienced.

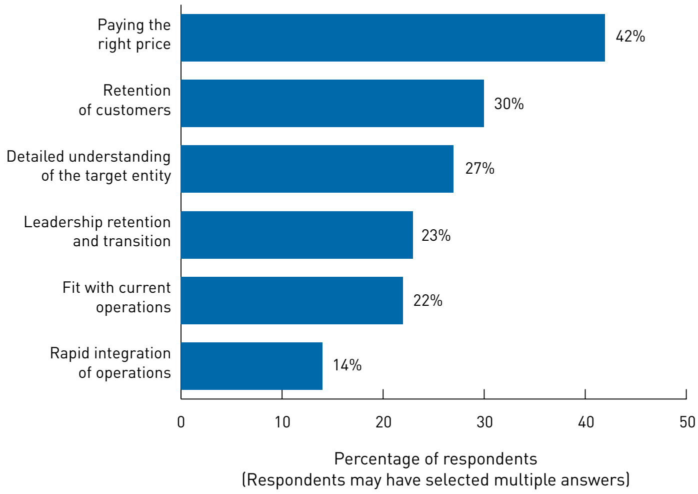
Capturing high-growth opportunities, acquiring technological know-how and brands and lowering costs are all important drivers of Asian cross-border M&A.

Survey findings
What constitutes a successful transaction?

Survey findings
Pre-deal challenges

What constitutes a successful cross-border deal?

What were the most important measures of success in terms of your most recent cross-border transaction?



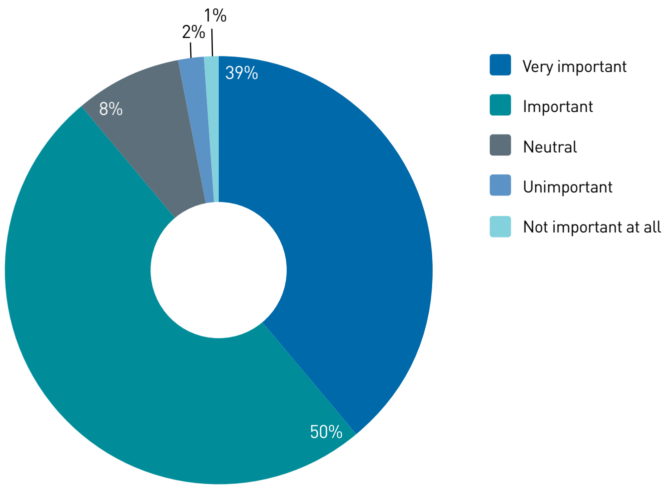
Of survey respondents, 42% believe that the most important measure of a successful cross-border deal is paying the right price, while 30% suggest that the number of customers retained is the most crucial success metric.

One respondent suggested that the most important measure of success was whether the bidder/target company's reputation is maintained over the deal process. Another respondent pointed to staff retention as the most crucial yardstick.

From pre-deal to post-deal, what did the 'successful' investors do right? What did the 'unsuccessful' investors miss?

1. The vast majority consider intangible assets as important

When undertaking a cross-border M&A transaction, how important a consideration are intangible assets?



89% of respondents view intangible assets such as human capital, patents, trademarks, and brand names as important considerations when conducting cross-border M&A, with 39% believing that they are very important considerations. Only 3% of those polled thought of them as unimportant.

A bidder's view of the importance of intangible assets is that they appear to impact final deal success. 41% of respondents who say that they believe intangibles are important go on to judge their transactions as very successful.

As one respondent commented, "Intangible assets are the drivers of the business and they are important in building customer confidence in your products and services". Others have equally strong opinions, with one respondent simply saying, "Our intangible assets are the core and basis of our business".

A number of respondents state that human capital is the most important intangible asset, with one explaining that, as a result, "Our HR team will continue to play a very vital role during future M&A acquisitions."

2. Factors that determine value-creation in a cross-border transaction

When asked to list the three most important value creating factors in a cross-border transaction, one word stood out: valuation.

Other factors that struck a chord with respondents include: having a deep understanding of the target company; the underlying deal rationale; the acquisition of technological know-how; transparent regulatory processes; and stable, affable governments in target countries. Here is a selection of some respondent comments:

- "Not over-paying is the key. Also, having the right people in the integration team and spending enough time to actually resolve the problems."
- "Understanding the market, and the culture of employees and the company are the three most important factors that determine value-creation from a cross-border transaction."
- "Trust and understanding of the culture is the most important factor."
- "Accessing better technology is the most important factor when determining value-creation from a cross-border transaction."

Three keys to a successful transaction

There are three key factors to help an organization achieve merger success, and people issues play an important part in each:

- **Business logic** – Why are we doing this transaction and what needs to occur for it to be considered a success?
- **Price paid** – What is the economic baseline and what improvements in post-merger performance do we need to see in order to pay any premium in price?
- **Integration** – How do we translate the strategy to merge or acquire into real value?

Business logic

Before beginning work on a cross-border deal, it is critical to understand the strategic objective behind it. This will enable the team to develop an appropriate approach for the deal (e.g. due diligence and the integration processes) and measure their success.

Price paid

A business's growth strategy determines how the organization identifies targets. It also determines how an organization approaches the financial side of a deal. Structuring acquisitions will have people implications, which need to be reflected in the approach to due diligence and integration planning.

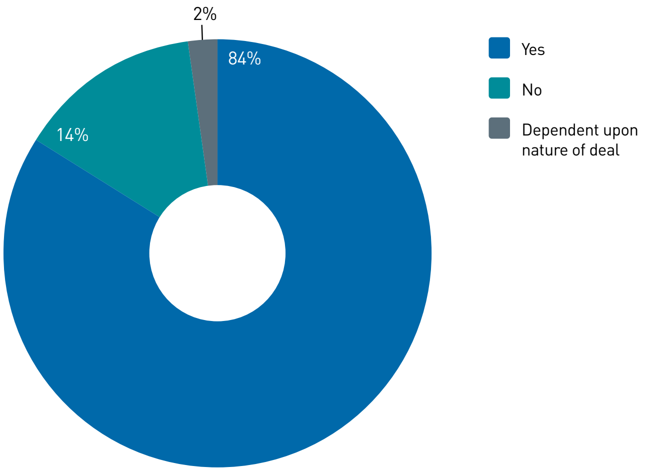
Integration planning

Even before a deal is confirmed, begin thinking about how to integrate the target into the acquiring organization. Understanding early in the deal process the type of deal this will be – asset vs stock – and the integration strategy for the deal – full vs partial – will be important through the life-cycle phases of the deal. Integration planning should include this understanding and reflect key findings from due diligence. Planning the integration of the two organizations, and then implementing those decisions, are both critical steps in realizing deal success.

Len Gray, Asia-Pacific M&A Leader
Mercer's Global M&A Consulting Business

3. Bidders from Asia Pacific should address cultural differences before deals are announced

When looking to undertake a cross-border acquisition, do you consider the implications of national and organizational cultural differences at the pre-deal stage?



Perhaps one of the most widely recognized deal derailers – be it national or organizational – is cultural integration. Countless acquisitions have performed poorly over the years due to companies failing to address this critical issue. While the integration process is usually addressed after the sale, cultural differences should be assessed during the critical pre-deal stage.

Survey respondents strongly agree on the importance of understanding cultural differences at the pre-deal stage, with 84% stating that they would consider the implications of national and organizational cultural differences prior to any deal announcement. First-time buyers should consider these comments stated by the survey respondents:

- "A good understanding of cultural differences makes the identification of potential operational synergies a lot easier, ultimately impacting the overall success of the deal."
- "It is very important to consider cultural differences. I've come across many instances where, because of cultural mismatches, an M&A transaction was unsuccessful – especially in China, where culture plays a very important role."
- "It is quite obvious that without considering the implications of cultural differences, and without having the opportunity to mitigate their negative effects, the chances of a successful deal completion will fall dramatically. This is something that I've personally witnessed on a number of occasions."

Culture matters in M&A: Driving greater value from your deal

Organizational cultural differences and people integration issues consistently top the list of significant challenges in conducting successful transactions. Failure to accurately assess and effectively manage these issues results in lost time, missed synergies and diminished value. For many, this means that national and organizational cultures must be understood and managed in a thoughtful, structured, practical and value-adding way; both before the transaction and throughout integration.

In any deal, the speed of integration and synergy realization rely heavily on the two organizations understanding each other's culture and how the companies operate: the similarities and differences, the opportunities and risks; as well as identifying the actions required to align respective 'ways of working' toward what is required for future business success.

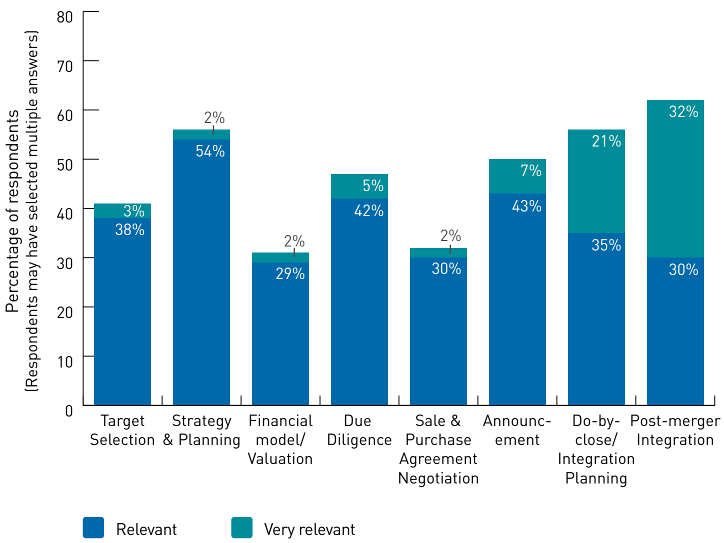
Mercer recently conducted cultural integration research with a number of leading organizations (including Microsoft, MillerCoors, and BAE Systems) that were actively leveraging culture to accelerate value creation in their transactions. Several themes consistently emerged:

- Align leaders early. Claiming and demonstrating alignment are two very different things. Identify the desired culture early (well before close) to guide the path of change. Ensure adequate time is provided for leaders (from both organizations) to debate, confirm and clearly articulate the behavioral patterns required to achieve the promise of the deal.
- Launch with clarity. Take an early stand on what the organization is and is not becoming. A 'wait and see' strategy invites ambiguity, slows momentum and ultimately derails the integration effort.
- Focus on value creation. Identify a finite number of integration initiatives to drive deal value and focus effort and resources accordingly. This means completely understanding the objectives of the deal and identifying which activities and behaviors must be preserved (that is, those that directly support value creation) and which are 'nice to have' or must be eliminated (that is, those that detract from or destroy deal value).
- Deliberately drive behavior. To reinforce or discourage particular behaviors, select the drivers (factors that influence behavior) that will have the greatest impact on the culture change that is needed.
- Choose words carefully. Time and again, it is the language used in a transaction that is key to ensuring alignment of effort. Be deliberate about choosing and reinforcing the 'appropriate' language and terminology. The same words can have very different meanings across countries and their organizations. It is important to take the time needed to understand what is being referenced.
- Track and celebrate progress. Measurement is the best understood (and least-leveraged) integration lever. Track early signs that your organization is changing in the ways intended. Identify digestible integration metrics and measure and reinforce them with vigilance. Recognize and visually celebrate achievements during integration and at the six-month and one-year anniversaries.

Ake Ayawongs, ASEAN M&A Leader
Mercer's Global M&A Consulting Business

4. HR is viewed as most critical during the post-merger integration stage

How relevant are HR issues in the following areas when planning to undertake a cross-border transaction?



62% of survey respondents say that HR issues were relevant during the post-merger integration phase, but only 47% of companies say they felt these issues were relevant during due diligence.

According to survey respondents, human resource issues are relevant throughout the deal stages, most notably during strategy and planning, announcement and due diligence. However, respondents also suggest that companies believe HR issues are only critical during the final deal stages. 62% of survey respondents say that HR issues were relevant during the post-merger integration phase, but only 47% of companies say they felt these issues were relevant during due diligence.

Interestingly, it would seem that there is a positive relationship between those who rated their deals as successful and those who feel HR is relevant throughout the deal process, perhaps suggesting that Asian acquirers would do well to involve their HR teams earlier in the deal, not later.

HR's role in a transaction

A significant amount of activity, both due diligence and preliminary decision-making, takes place in the pre-deal stage, and much of this activity has direct relevance to people issues and will affect the eventual integration process. Yet many companies do not have any HR representatives participating in pre-deal activities.

So how does HR contribute to deals? In all acquisitions, buyers want to be sure that they are paying the right price. This is more challenging in cross-border M&A because of differences in each country's legal and business frameworks – differences that are as significant for people issues as they are for finance, tax, accounting, environmental, operational and political issues.

Risks to price. The first step is to identify and understand each HR program that may carry financial liability or significant costs. This often includes underfunded defined benefit pension plans as well as unfunded retiree medical, executive benefit and change-in-control plans. Understanding how these programs work and their financial status at deal closing, as well as shaping the allocation of assets and liabilities between buyer and seller, are critical to achieving the best price and managing go-forward costs.

Loss of key leadership. One of the biggest risks in any acquisition is the loss of key leadership. Retaining talent is critical to maintain uninterrupted business operations and customer relationships, and to keep employees productively focused on their jobs during a period of uncertainty and change. Experienced buyers know that the cost of retaining leadership is an important investment that helps to achieve these outcomes. Leadership-retention costs are often large and need to be included in the deal model and mitigated through creative strategies.

Risks in not understanding the environment in other countries. Also important is an understanding of the major differences in business and HR practices between countries. One difference that often surprises buyers is the level of pay. In general, pay levels can vary greatly in different countries, especially at the executive level. This creates both challenges and risks for a buyer, especially when the target CEO has higher total compensation than the buyer CEO.

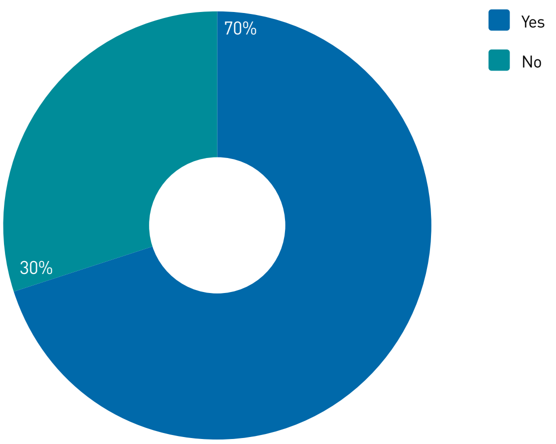
Organizational culture. Another critical factor when acquiring overseas is the culture of the target company. Culture is what makes the target organization unique, how it operates, and how employees typically behave. Culture is often cited by senior executives as one of their top concerns when assessing whether a deal will be successful.

Michael Hill, Australia and New Zealand M&A Leader
Mercer's Global M&A Consulting Business

One of the biggest risks in any acquisition is the loss of key leadership. Retaining talent is critical in order to maintain uninterrupted business operations and customer relationships, and to keep employees productively focused on their jobs during a period of uncertainty and change.

5. Dedicated M&A teams are the norm when conducting cross-border acquisitions

In your most recent cross-border acquisition, was there a dedicated M&A integration team in place?



Most respondents (70%) indicate that dedicated M&A teams were in place for their most recent cross-border acquisitions. However, a number of them hedged when explaining what they mean by 'dedicated.' According to one respondent, "Our team was actually put together on an ad-hoc basis – the team did the pre-deal preparation. When they decided to begin the transaction, they chose the relevant employees from different departments in the business to work on the actual transaction".

It should come as no surprise that businesses undertaking larger transactions are more likely to use dedicated deal integration teams. Of those who did, 98% undertook transactions worth more than US$50m.

Survey responses also suggest that employing a dedicated M&A integration team has benefits. Of those who did, 43% went on to say that their transactions were very successful. In contrast, only 30% of those who didn't utilize dedicated teams reported very successful deal outcomes.

6. Teams should be involved much earlier and have room for improvement

The majority of respondents (67%) rated their risk management teams' performance as either very good or excellent. HR teams also got the thumbs up from a cumulative 52% of respondents. However, while respondents are broadly positive on the performance of their HR and risk management teams, a large majority acknowledges that improvements could have been made. From their comments, three broad themes emerged.

First, both HR and risk management teams should be involved in a transaction as early as possible. Second, the two teams should formulate an integrated strategy for approaching the myriad issues they are likely to face. Finally, risk management teams need to provide industry-specific information and forecasts to their counterparts in a more coherent and focused way.

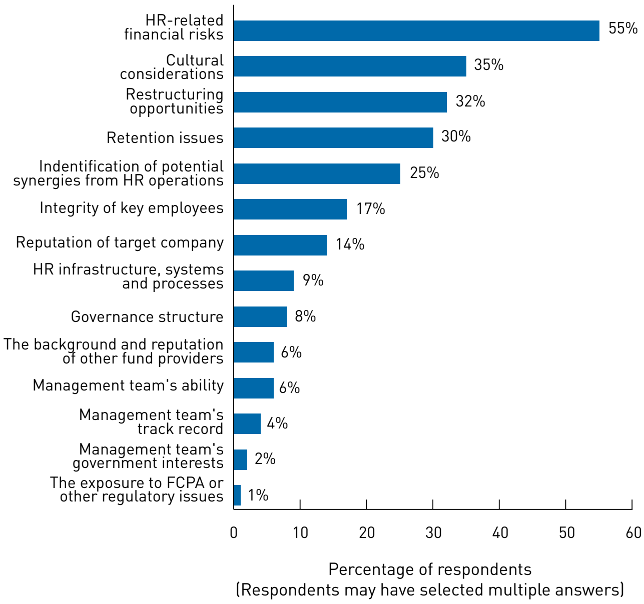
Here are comments from respondents, all of whom viewed their recent deals as successful:

- "With regards to HR, there is a need to take a more strategic view of the deal."
- "Risk management improves their understanding of what is actually driving the business forward."
- "The risk management team should not only focus on target history, but also on the business continuity side."
- "HR's understanding of cultural issues during an M&A deal can be improved."
- "Risk management teams need to keep a wider view of market conditions, as well as the related financial position of the target company."
- "HR really needs to get involved at an early stage as they need to understand the deal structure and which group of people will be involved in the eventual post-acquisition integration."
- "The two teams must be able to structure due diligence exercises properly."

Survey findings
Due diligence: A critical factor

7. Due diligence is critical…

What key areas, if any, did you focus on when conducting due diligence?



The primary purpose of due diligence is to ensure that no material 'surprises' emerge once the deal has been signed. In many respects it can be regarded as the most crucial part of any transaction.

Despite this, many organizations fail to hunt for key HR-related risks that can emerge from a cross-border transaction. Hidden costs, such as pension plan liabilities, can easily derail the deal. It is essential that companies investigate them before the deal is signed.

For 55% of respondents, HR-related financial risk is one of the key areas examined during due diligence. HR-related financial risk includes pension/benefit liabilities, severance costs, and change-in-control provisions in employment contracts. A further 35% testify that they look into the cultural aspects of the takeover. However, less than 20% say that they investigated the integrity of key employees or the reputation of the target company.

One respondent noted that the most important HR-related due diligence task is to look at HR-related financial issues in order to extract maximum value from potential synergies. Another, who highlighted cultural considerations, went on to say that, "It's very important to find out how much work needs to be done in order to bring the two parties together post-deal in order to properly value the target".

The importance of addressing HR issues during due diligence

In M&A, due diligence forms the base upon which a number of critical decisions – both strategic and operational – are made. The process can uncover issues and risks that may justify a change in the proposed purchase price, or even steer the buyer away from an organization entirely.

While few would argue with the necessity of robust financial due diligence, many buyers in Asia Pacific neglect to properly investigate the human capital issues that can lead to costly surprises and seriously hinder post-deal integration.

Our recent cross-border M&A engagements have encountered numerous HR-related issues that are critical to pricing and/or the ultimate success of the deal. Examples include:

- Change-in-control provisions in executive contracts
- Stock option plans in the US which form a significant part of executives' total compensation and which need replacing in a carve-out situation
- Significant risk of critical employees leaving the company due to compensation or other considerations
- Employee protections under the European Acquired Rights Directive
- Lengthy notice period requirements and expensive severance provisions in European situations, where cost synergies are the key deal value driver
- Defined benefit pension liabilities and associated issues with trustees and regulators in the UK
- Statutory termination payments in Asia which are unfunded and need to be reserved in the target's balance sheet
- Compliance-related issues with social security and employment law in a number of developing countries

HR representatives are appearing more frequently at the table with their colleagues from finance, legal, operations and other functional areas during the early stages of discussion and decisions. This is a welcome development, given the importance of the people-related issues in cross-border situations.

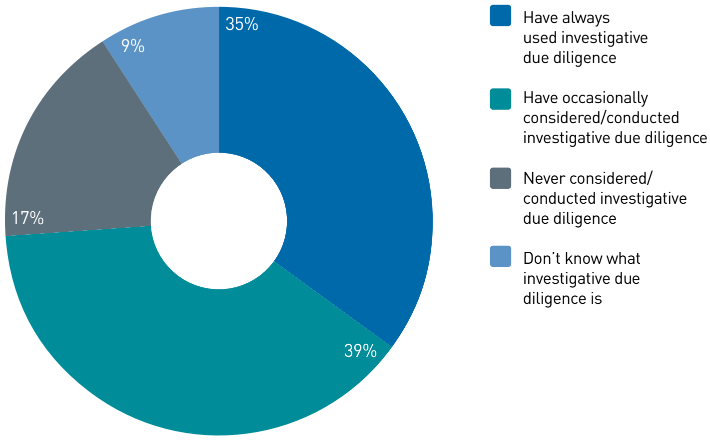
Phil Shirley, Hong Kong M&A Leader,
Mercer's Global M&A Consulting Business

Investigative due diligence is proving to be a hit with Asian bidders, but it is not fully utilized

Just under three quarters (74%) of respondents state that they have conducted, or have considered conducting due diligence during previous exercises, with 35% of those polled stating that the process is a crucial component of dealmaking. However, 26% have never conducted due diligence, or have never encountered it before.

Investigative due diligence aims to detect hidden liabilities, imminent litigation, loss of key staff or intellectual property to competitors, and other issues the target company may not have disclosed which will have a material impact on how the company should be valued.

Have you ever used or considered conducting investigative due diligence in order to detect hidden risks?



Investigative due diligence has a positive effect on deal outcome: Almost 82% of respondents who have undertaken investigative due diligence went on to state that the outcome of their transaction was very successful.

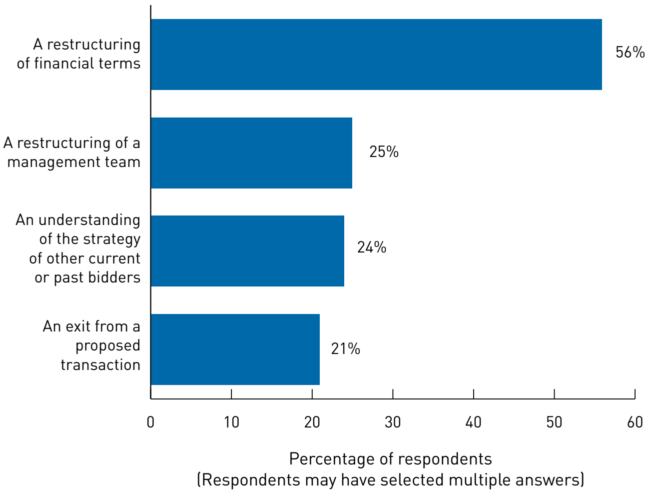
Interestingly, respondents from Singapore, Hong Kong and Australia were the top three users of investigative due diligence.

Of those respondents who have noted their most recent cross-border transaction was not very successful, 54% said that they would allocate more time to conduct investigative due diligence in the future.

Survey findings
Due diligence: A critical factor

… justifiably perhaps, considering the amount of intelligence such due diligence yields

If you have conducted investigative due diligence in the past, has the intelligence ever resulted in any of the following?



Of those respondents who have conducted investigative due diligence in the past, a considerable 56% of them assert that the procedure produced enough intelligence for them to successfully restructure the financial terms of the transaction.

At the same time, more than one in five indicate that the intelligence garnered from conducting investigative due diligence resulted in a management team restructuring, provided insight on competing or past bidders, or, as a result of the risks identified, exited from a proposed bid.

92%
of respondents who restructured a deal after conducting investigative due diligence went on to state that the outcome of their deal was successful.

What is investigative due diligence?

Case study:
A private equity fund considering investing in a Sri Lankan tea plantation called Kroll to investigate the plantation and its promoters to ensure that there was no history of fraud, and that they operated in a compliant and ethical manner. Kroll identified that the tea plantation and the individuals associated with it did not exist and concluded that the entire issue was an elaborate fraud.

In a typical M&A transaction, the investor will approach the due diligence process from the following three different perspectives: (1) legal; (2) financial; and (3) investigative. Legal and financial due diligence have much in common. In particular, they are both document-intensive and they both rely on information provided by the target. Investigative due diligence differs from legal and financial due diligence in two very important respects: content and methodology.

Content
Combining public record research and human source inquiries investigative due diligence aims to seek out information on issues such as management background, competing bidders, company reputation, ethical track record, regulatory compliance, market conditions, hidden interests, environmental liabilities and non-disclosure of material facts.

Methodology
Intelligence gathered by investigative experts is derived independently from public and proprietary sources but most importantly, human source inquiries. Discreet human source inquiry is critical and also the most challenging part of investigative due diligence. By discreetly and skillfully interviewing sources who are familiar with the subjects in different contexts and capacities, useful information that is not reflected in the public domain can be obtained, however care must be taken to ensure the investigations are conducted in adherence with local privacy laws.

To ensure optimal benefit, it is important to perform such inquiries only after having adequately profiled the subject through desktop and public records research. This profile should then generate necessary leads and potential sources, as well as appropriate questions to ask.

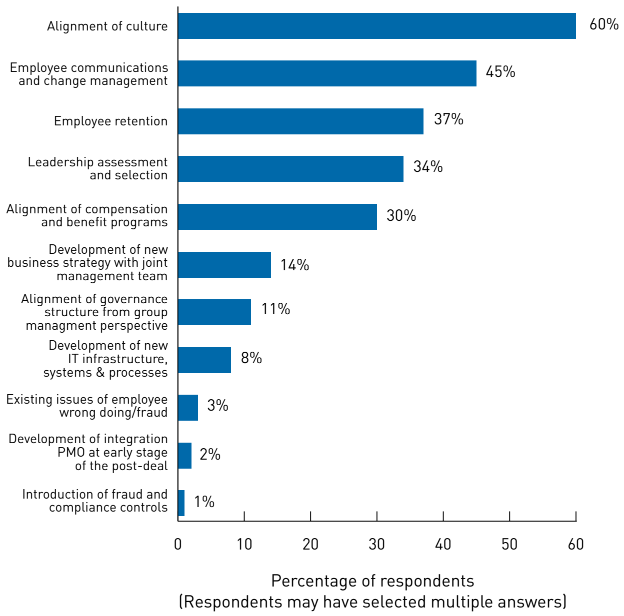
Intelligence from investigative due diligence can make or break a transaction. Experienced and successful investors place a great deal of importance on investigative due diligence and conduct it early in the deal process, before significant time and effort has been invested in the transaction.

Violet Ho, Managing Director, China, Kroll

Survey findings
Post-acquisition challenges

1. Cultural integration and employee communication are key HR issues during post-deal integration

In your experience, what are the key HR/investigative issues to tackle when integrating a new acquisition?



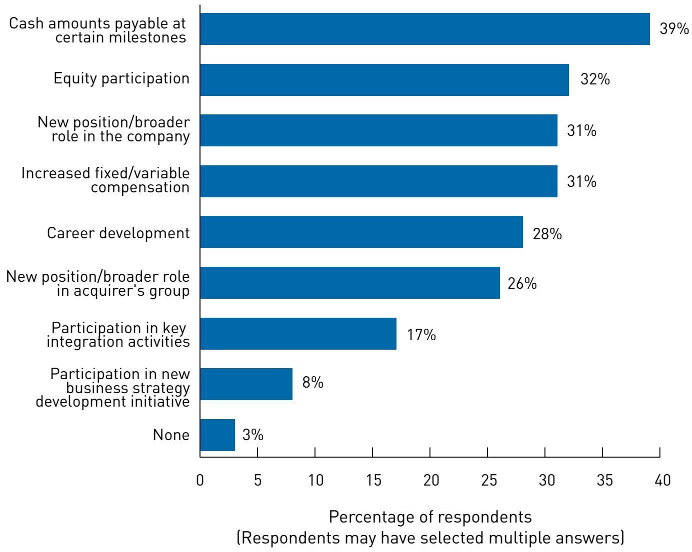
Aligning different organizational cultures with the acquirer's business strategy is critical for success. 60% of respondents agree. Most companies, however, find this alignment difficult to achieve.

Almost half (45%) believe that employee communication and change management are fundamental issues to tackle. More than one third of respondents also point to organizational culture as a key area for due diligence. This indicates that most companies understand that failure to accurately assess and effectively manage this issue results in lost time, missed synergies and diminished value.

Effective communication during periods of change is another critical issue. Rumors, misinformation, and speculation can take root during periods of change, affecting both morale and productivity. Attention to communication over the deal life cycle can be an effective antidote.

2. Cash is the most prevalent talent retention tool

What types of retention programs have you typically implemented for key employees?



Identifying and retaining key employees is a complex challenge that is critical to sustaining profitability gains. Without these current and future leaders, high performers, key contributors and those with scarce critical skills or knowledge, future success will be at risk. Therefore, companies must develop strong retention strategies to ensure that key employees remain motivated and engaged, and that they remain with the enterprise.

39% of respondents stated that they implemented employee retention programs that paid cash to employees at certain milestones. As one person quipped, "Money always works!"

In addition, just under one third of respondents offered equity participation programs, increased fixed or variable remuneration, or offered new positions and/or broader roles to employees. At the other end of the spectrum, less than 5% of respondents failed to offer any type of employee retention program.

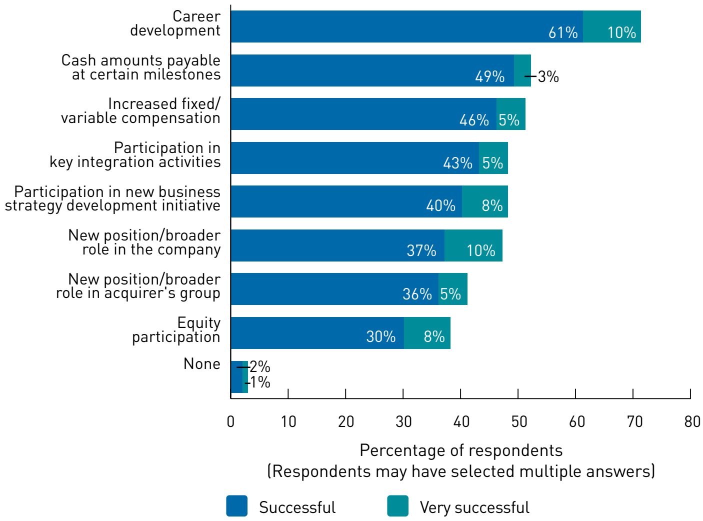
39%

of respondents stated that they implemented employee retention programs that paid cash to employees at certain milestones.

Survey findings
Post-acquisition challenges

3. Respondents rank career development programs as the most effective for retention

If you have used employee retention programs, how successful have they been?

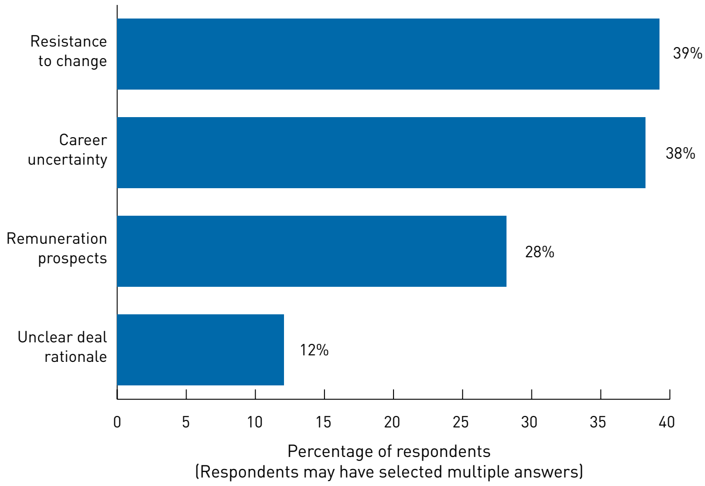


Money isn't the only tool for retaining and motivating key talent. Many organizations find that a total rewards approach that includes career development opportunities serves equally well if not better.

Some 71% of respondents rate career development initiatives as either successful or very successful in retaining employees, ahead of milestone cash payments (52%) and increased fixed or variable compensation (51%). At the other end of the scale, giving employees the chance to participate in business strategy development, allowing equity participation, or simply doing nothing, were cited as less successful in retaining employees.

4. Resistance to change and career uncertainty are the greatest barriers to employee engagement and integration

What are the biggest barriers to the successful engagement and integration of employees?



The change and stress of a transaction can negatively impact employees creating anxiety, disappointed customers, delayed product launches and lower service levels. These problems are exacerbated by the pace of the deal and the dynamics involved in the new distribution of power, control and resources. If managed poorly, such changes can damage productivity, erode employee engagement, and delay value creation. If managed well, however, change can do the opposite.

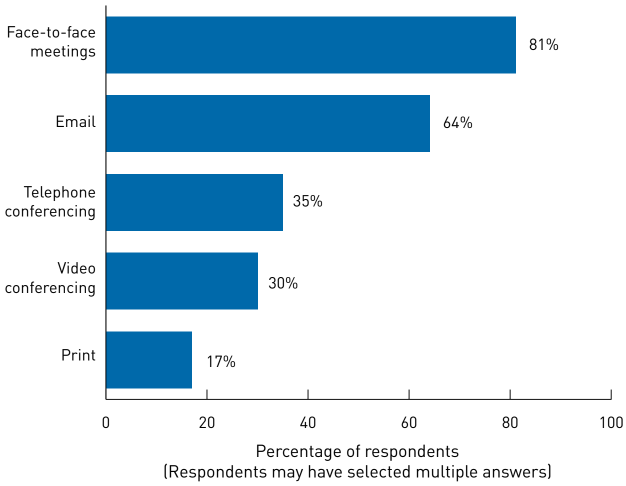
Respondents believe that the biggest obstacles to employee engagement are resistance to change (39%) and career uncertainty (38%). Remuneration prospects trails at just 28%, while only 12% judge that an unclear deal rationale is the largest obstacle to overcome.

71%
of respondents rate career development initiatives as either successful or very successful in retaining employees.

Survey findings
Post-acquisition challenges: Dealing with fraud

5. Face-to-face meetings are the most effective means of communicating with employees

What channels are utilized for employee communications during a cross-border M&A transaction and which are most effective?



Effective communication is essential when managing people during periods of organizational change. Responsive people strategies help employees to successfully navigate these periods. Effective communication can encourage employees to let go of the past and embrace the way forward, allowing the organization to realize the value of the deal sooner.

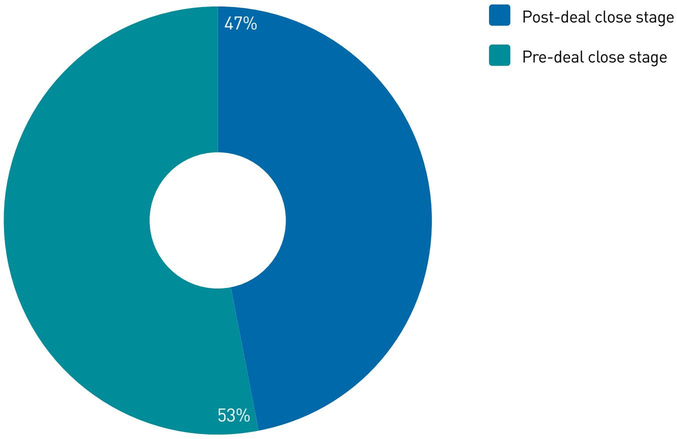
Getting communication right also helps to mitigate other M&A risks — the loss of key talent, diminished customer service and satisfaction, a lack of confidence in leadership, and increased resistance to change.

More than four of every five respondents believe that face-to-face meetings are the most effective method of employee communication during an M&A transaction; email communication and video-conferencing follow at 64% and 30% respectively. On the other hand, a mere 17% of respondents think that print is the most effective manner of communicating.

A number of respondents explained that the best method of communication depended very much on the seniority of employees in question, with one noting that, "Face-to-face meetings would only be worthwhile between the two parties' senior management teams". Another writes that, "In addition to regular meetings, communication sessions and team-building exercises should be used to ensure buy-in from the target's management".

6. Close to half of those respondents who uncovered fraud in their target company did so *after* the deal was completed

If you uncovered fraud at the target company during your most recent outbound acquisition, at what stage of the investment cycle did this occur?



Of those respondents who uncovered evidence of fraud taking place at their target company, a sizable 47% of them mention that this fraud was only discovered after the transaction had completed.

Of those respondents who discovered fraud post-deal close, 38% of them go on to say that the bidder exited the transaction before ultimate deal completion, with the remainder (62%) saying that the discovery of fraud resulted in changes being made to the terms of the transaction. This contrasts with respondents who uncovered fraud at the pre-deal stage, the majority (87%) of whom undertook redemptive measures, such as altering deal terms, to mitigate its effects. Only 13% of respondents who unearthed fraud pre-deal close, ended up exiting the transaction.

What the respondents said:

- "Yes, we discovered fraud during the post-close stage and we ended up exiting from the deal."
- "Yes, we discovered fraud at the target company at the post-close stage, which had a negative impact on the deal, but we ultimately renegotiated it."
- "Yes, at pre-close stage. It was handled by restructuring the deal agreement."
- "Yes, we found evidence of fraud at the post-closing stage, and we had to renegotiate the deal to mitigate its deleterious effects."

Lessons learned

What would you do differently to ensure the success of a future cross-border M&A acquisition?

The most popular responses to this question tended to revolve around four main issues:

- Encouraging HR teams to focus on employee retention and communication issues
- Motivating both HR and risk management teams to complete their respective tasks on time
- Hiring external advisors to aid both HR and risk management teams in any future transaction
- Formulating a suitable strategy to allow both teams to mutually benefit each other during any future deal process

HR

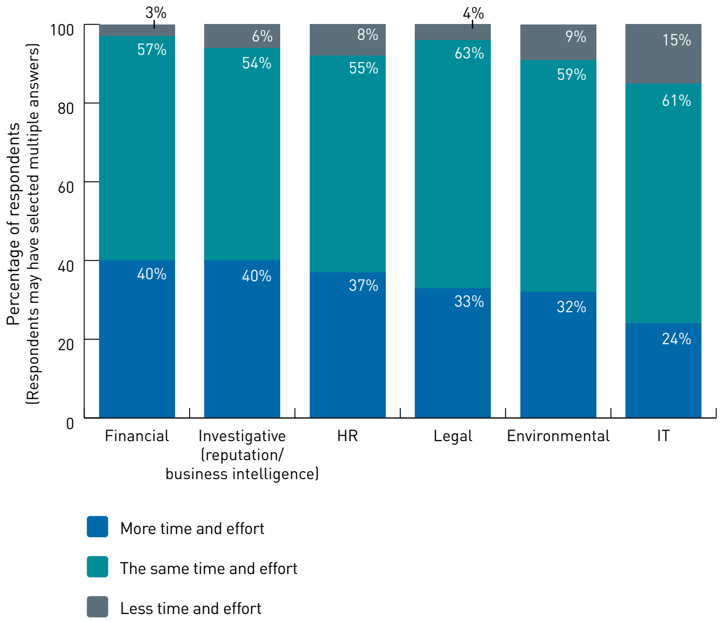
- "HR should identify key staff at the target earlier on during the process and ensure they will remain with the company post acquisition."
- "HR teams should try to understand and identify employee concerns as well as key talent."
- "We would try to get external resources for HR if required."
- "We would try to involve HR from the beginning of the deal."
- "Our HR team needs to improve the communication gap between the two parties."
- "HR should analyze compensation and compare it to actual metrics pre and post-deal close."
- "HR should come up with clear policies for leadership and employee retention."
- "HR should reduce the risk of people leaving by communicating better and by getting involved at an earlier stage."

Risk management

- "Risk management teams should pay more attention to identifying potential risks/benefits earlier on in the process."
- "The risk management team should conduct a more thorough analysis of the target in order to value it more effectively."
- "We would use local risk management advisors at the target entity which should help us ensure the success of a future acquisition."
- "Should understand the uncertain and complex business environment to reduce the risk factor."
- "Increased effort to understand the target company and its operations, people and its integration with the local market."

More than 35% of respondents say they would spend more time on HR and investigative due diligence

In terms of time and effort expended pre-deal, how would you change your time and resource allocations across the different areas of due diligence?



More than one third of respondents stated that, if they had the chance, they would spend more time and effort conducting investigative (40%) and HR-related (37%) due diligence.

Furthermore, of respondents who noted that their most recent cross-border transactions were not very successful, 54% state that they would allocate more time to investigative due diligence.

More than one third of respondents stated that, if they had the chance, they would spend more time and effort conducting investigative (40%) and HR-related (37%) due diligence.

Survey methodology

- Between March and May 2010, Remark, the research and publications division of mergermarket, canvassed 155 senior executives of Asian-based corporates and private equity firms who had undertaken a cross-border acquisition over the previous three years. The goal was to uncover their views on the risk management and human capital issues that impact the success of Asian outbound cross-border acquisitions.
- Respondents were selected at random from a list of mergermarket-recorded M&A transactions for the period 29 March 2007 to 29 March 2010. Transactions with a deal value of more than US$5m were included. If the consideration was undisclosed, mergermarket included deals on the basis of a reported or estimated value of over US$5m. If the value was not disclosed, mergermarket recorded a transaction if the target's turnover was greater than US$10m.
- Only true merger and acquisition deals were collated. Transactions included usually involved a controlling stake in a company being transferred between two different parties. Where the stake acquired was less than 30% (10% in Asia Pacific), the deal was only included if its value was greater than US$100m.
- Transactions such as restructurings in which shareholders' interests in total remained the same were not collated as were property deals, letters of intent, memorandums of understandings, head of agreement and non-binding agreements.
- All US$ symbols refer to US dollars unless otherwise stated.

Regional definitions are as follows:

Greater China
Mainland China, Hong Kong, Taiwan, Macau

North America
USA, Antigua, Aruba, Barbados, Bermuda, British Virgin Islands, Canada, Cayman Islands, Cuba, Grenada, Jamaica, Mexico, Puerto Rico, Saint Lucia, Trinidad and Tobago

South America
Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, French Guyana, Guyana, Paraguay, Peru, Surinam, Uruguay, Venezuela

Middle East
Afghanistan, Bahrain, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Oman, Palestine, Qatar, Saudi Arabia, Syrian Arab Republic, United Arab Emirates, Yemen

Africa
Algeria, Angola, Benin, Republic of, Botswana, Burkina Faso, Cameroon, Cape Verde, Central African Republic, Chad, Congo, Congo, the Democratic Republic of, Egypt, Eritrea, Equatorial Guinea, Ethiopia, Gabon, Gambia, Ghana, Guinea, Guinea-Bissau, Ivory Coast, Kenya, Lesotho, Liberia, Libya, Madagascar, Malawi, Mali, Mauritania, Mauritius, Morocco, Mozambique, Namibia, Niger, Nigeria, Rwanda, Sao Tome & Principe, Senegal, Sierra Leone, South Africa, Sudan, Swaziland, Tanzania, Togo, Tunisia, Uganda, Zambia, Zimbabwe

Eastern Europe & Russia
Armenia, Azerbaijan, Belarus, Bosnia-Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Montenegro, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Ukraine

Western Europe
Andorra, Austria, Belgium, Channel Islands, France, Germany, Ireland (Republic), Isle of Man, Liechtenstein, Luxembourg, Monaco, Netherlands, Switzerland, United Kingdom

Japan
Japan

India
Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Republic of Seychelles, Sri Lanka

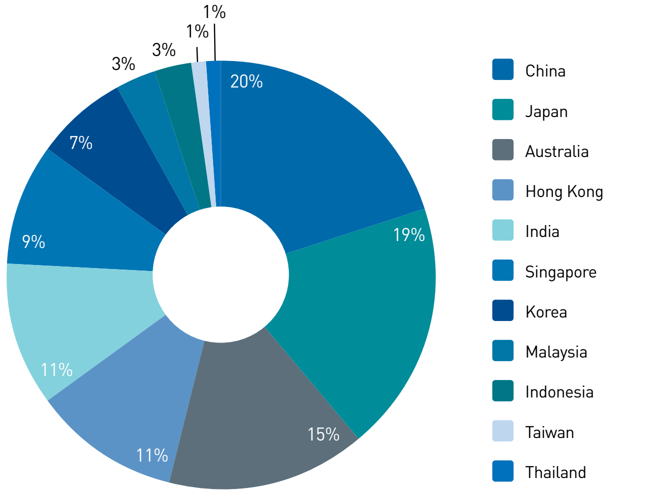
South East Asia
Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Timor-Leste (East Timor), Vietnam

Australasia
Australia, Fiji, Guam, Marshall Islands, Micronesia, Federated States of New Zealand, Papua New Guinea, Samoa, Solomon Islands, Tonga

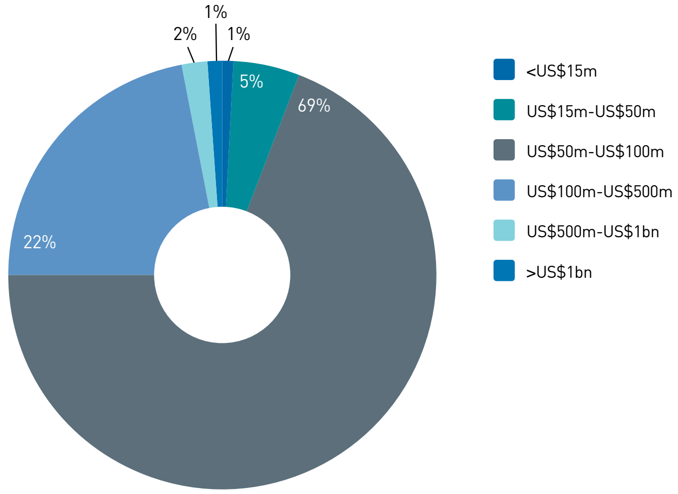
- According to mergermarket and for the purposes of this report, a cross-border transaction is defined as a deal in which the bidder is predominantly located in one geographical entity while the target business is situated in any other geographical entity.
- All data quoted is proprietary mergermarket data unless otherwise stated.

Pre-qualifiers for the respondents who participated in this research

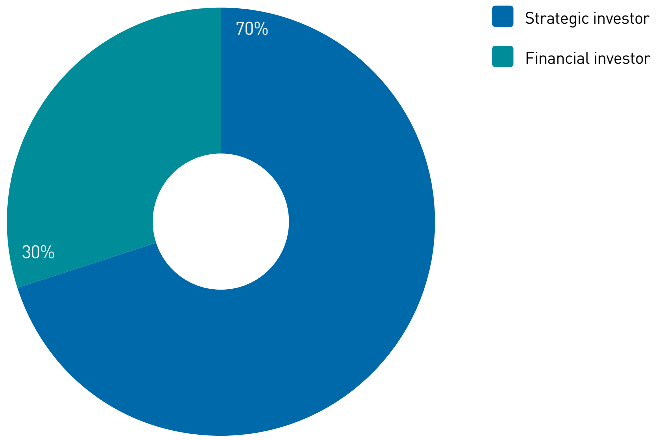
In which country are the bulk of your operations based?



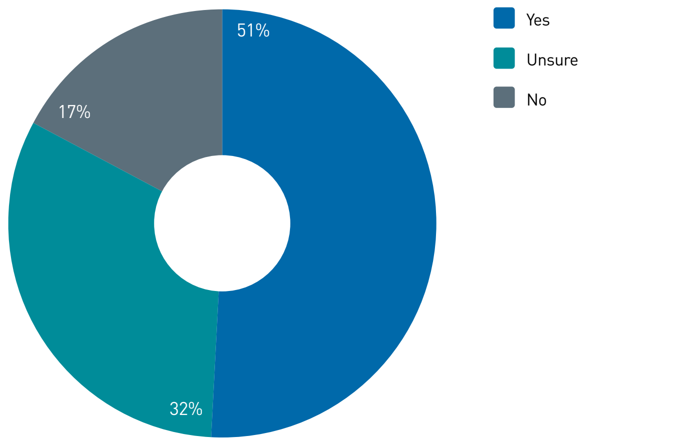
What was the deal size of your most recent cross-border M&A transaction?



Are you a strategic or financial investor?



Is your business likely to undertake a cross-border M&A transaction in the next 18 months?



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About us

KROLL

Kroll is renowned for investigations across the transaction cycle, from pre-deal investigative due diligence to post-closing dispute support and internal investigations.

All major cross-border transactions - private equity, M&A, IPOs carry with them enormous risk. For more than 35 years clients have turned to Kroll to answer key pre-deal questions:

- What is the background and reputation of the counterparty?
- Are their representations honest and accurate?
- Are there hidden integrity issues or liabilities?

By finding answers to these critical questions, bad transactions can be avoided and good deals are enhanced.

Some deals can hit serious post-closing problems. Kroll is on hand to assist clients navigate issues relating to fraud, commercial disputes and even litigation. Kroll works closely with its clients to reach the right solution, be it remedial action to rectify problems, or negotiating a commercially acceptable exit and at all times, limiting reputational damage.

Kroll's global team comprises more than 3,000 professionals from a wide range of backgrounds, including former prosecutors, law enforcement agents, forensic accountants, financial analysts, intelligence analysts and former business journalists.

Kroll is currently assisting clients across Asia Pacific to secure and protect successful transactions globally.



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mergermarket is unique in the provision of origination intelligence to the investment banking, legal, private equity, acquisition finance, public relations and corporate markets.

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