Family Business
THE GUIDE FOR FAMILY COMPANIES
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Finding a cultural fit in global M&A

Business owners seeking a foreign partner or buyer must go beyond the standard due diligence.

THE MERGERS and acquisitions market has been booming since early 2005, and family companies have been among those making headlines. Judging from the number of financings and mergers our office is involved in, this activity level may continue for quite a while. Each week we field requests from family business owners interested in putting their company on the block as well as those seeking investors.

This is not the first time that M&A activity has exceeded expectations at the top of a business cycle. What is new in this cycle is the influx of capital from foreign investors and global private equity groups.

Globalization continues to lure U.S. businesses to seek new markets overseas. The abundance of private equity and debt capital has bid up multiples, which are currently at historically (some would say excessively) high levels. But at today's exchange rates, foreign buyers and backers can compensate for those high multiples with lower-valued dollars.

As a result, foreign firms' acquisitions of U.S. companies rose 27% in value in 2005 compared with the previous year, according to financial publisher FactSet Mergerstat LLC. Between June 30, 2005 and June 30, 2006, Canadian firms gobbled up 347 U.S. companies, worth almost $16 billion, and U.K. investors spent more than $35 billion to purchase 324 companies. Japan, France and Germany were also big spenders in the U.S.

Family companies are particularly attractive acquisition targets for foreign investors or global private equity groups. Family firms' long-term strategic orientation, close employee relationships and conservative financial structure alleviate some of the risk for foreign investors entering the U.S. market. A group of Japanese merchant bankers who recently approached our firm said they were particularly intrigued with our family business focus.

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This is great news for family companies seeking a foreign partner or buyer. But merger deals with foreign companies are much more complicated than transactions with American partners. The cultural fit between buyer and seller is as key to the long-term success of a merger as the financial considerations.

In addition to routine due diligence, family businesses seeking foreign capital would be wise to assess the cultural compatibility of a potential foreign partner—especially if the transaction involves stock or an earn-out, enmeshing the seller to the buyer for some time after the ink has dried.

A world of difference

It is dangerous to draw sweeping stereotypes of ethnic cultures. But here are some factors to look out for before entering negotiations with a foreign party:

• **Communication and negotiation styles.** Differences in negotiation styles can jeopardize a perfectly fair transaction. One recent deal almost fell through between a German buyer, who took a "my way or the highway" approach to negotiations, and an American seller offended by this approach. Obviously, not all German-descended businesspeople have this trait, but it took an outside adviser to help this transaction along. The adviser apprised each party of the other's sensitivities and urged them not to take their counterpart's style personally.

In many cultures, especially Asian traditions, people are uncomfortable responding to any request in the negative; they consider it rude. So if you ask a colleague from China or Japan if she can get a task done by the end of the month, she is likely to say "yes," even if she knows she will be unable to do so. Eugene Nesbeda, managing director of New York City-based CITIC Capital Partners, explains that it is better to avoid yes-no questions; ask, "When you do think you can deliver that to me?"

"It takes extra effort to make sure

communications are clear" when people from different cultures try to do business, according to Nesbeda.

Handshake agreements and letters of intent may be interpreted differently. In certain Latin cultures, for instance, letters of intent are a mere statement of understanding, which may be deviated from unilaterally if the circumstances change. A U.S. party, accustomed to the rigidity of the terms of an executed letter of intent, may be offended if the other party "changes its mind" in the middle of negotiations. Continually checking on the parties' plans in the process of negotiations is a key to the transaction's success.

• **Fact-gathering.** Foreign business reporting is often much less transparent than the U.S. standards of financial and operational reporting. "At the end of the day we see companies go over and apply their U.S. lenses and make quick assessments that are very inaccurate," warns Nesbeda. For instance, while U.S. companies track their accounts receivable in days (0-30, 30-60 and 60-90, for example), Chinese companies age receivables by the year (0-1, 1-2, 2-3, etc.).

• **Risk assessment.** When conducting a transaction with a U.S. company, you can fairly easily project the future success of an alliance because of the relative transparency of the information available. Not so with a global partner! Before negotiating with an international party, review the rationale of the business plan, including the assumptions behind such a plan. Both parties' agreement on this plan will help keep the negotiations on track even without a firm letter of intent.

Respect your partner's values

Given such cultural differences, it's clear that negotiations with non-U.S. parties must be handled delicately. The respect given to each party's values—especially important in family companies—will be a factor in how the transaction's long-term success is judged. Those values may include the following:

• **History.** Look for clues as to whether a potential foreign buyer will respect and honor your family business's traditions and legacy.

• **Employee relations.** How important is it to you that a buyer keep your employees? How will the foreign acquirer treat your employees? In China, companies tend not to provide benefits such as health insurance or pensions. Japanese firms, though, take an almost paternalistic approach; they treat employees like family, tying them to the company for the long term.

• **Customer relations.** The partnership approach to customer relations now in vogue in the U.S. is not followed in certain other cultures. Does your potential global partner approach transactions as a win-win situation, as opposed to focusing on the one-time sale? Be sure to ask what the foreign partner espouses, and call one or two customers to verify the answer.

• **Community involvement.** Will your partner be a good corporate citizen? What is its track record concerning the community and the environment?

Check the references

There are many variations within cultures throughout the world, so don't just rely on broad generalizations about a particular country. Ask potential foreign partners if you may contact their customers and suppliers. Talk to these references about each of the factors mentioned above.

In a very hot M&A market, sellers tend to focus on getting the best price for their company. But it's just as important to seek out a comfortable cultural fit. As the owner of a family company, you likely take pride in what you've built, and care about what happens after you sell—to your employees, customers, suppliers, community and overall legacy. FB

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