ODGERS BERNDTSON JAPAN

Japanese cross-border M&A

Translating strategy into success.

ODGERS BERNDTSON

Japanese companies have become increasingly active in cross-border M&A.

According to Nikkei, the first ten months of 2018 were the strongest by volume and value for the Japanese M&A market since records began in 1980.

Abenomics has ushered in rising corporate profits, inexpensive financing and deregulation, all of which have opened up opportunities for Japanese companies to pursue growth and diversification-driving investments abroad.

Even traditional, family-owned Japanese companies that have focused solely on the domestic market throughout their histories are looking beyond their national borders.

Still, the risks attached to such transactions are substantial and write-downs on overseas assets are not uncommon.

To understand why Japanese companies haven't been more successful in this area – and what they can do to increase their chances of a positive result – Odgers Berndtson Japan spoke to a select number of Japanese executives in a variety of industries with experience in cross-border M&As. They told us about the challenges they faced, how large M&A transactions transformed their companies, and the lessons they learned in the process.

Bringing change home

A large cross-boarder acquisition is likely to have implications for the Japanese parent company's business lines, management structure and corporate governance policies.

Adopting more globally-recognised structures and policies, in advance of a large cross-border transaction, could help to make the integration process smoother. But this can be easier said than done in a business world where the culture and traditional practices of Japanese company are well-established and very resistant to change, however necessary.

A growing diversity

Expanding into new markets is often difficult to achieve organically.

For a senior leader at a financial services group, M&A was an attractive option for them because "to become one of the top 10 firms globally we need to grow our client-driven business overseas and this is not easy to achieve through organic growth."

An electronics company executive concurred, "Having an overseas presence is important for our consumer electronics business and M&A is our best strategic option for growth. Buying an established business allowed us to quickly gain the tools and know-how needed to be successful in a new market."

One interviewee explained, "The goal of our M&A activity is primarily to diversify our business. Our target companies are, for that reason, most likely to offer us new technology or products. After 90 years in a niche, as a traditional printing business, we needed to transform our business in order to survive and grow. The financial crisis illustrated our vulnerability to a market downturn and the importance of mitigating our financial concentration risk by acquiring new income streams. Since then, we have pursued constant transformation, primarily through M&A."

At times though, the purpose of cross-border M&A is not to grow an existing business line, but to acquire new ones.

Managing M&A

Diversifying markets and business lines will have an inevitable knock-on effect for the company's management structure. But some changes can be made in anticipation of major M&A activity.

For example, bringing on a chair of the board who is a non-executive from outside the company. This is common practice in the west, but is fairly unusual among closely-held, traditional Japanese companies.

One executive we spoke to shared that before its first major cross-border acquisition the company changed its traditional management structure by appointing a CEO with international business experience. "We also listed on the NYSE and introduced a matrix management system. Still, the group was always operated by Japanese managers."

A chief strategy officer at a different company noted how his company changed following a series of cross-border acquisitions. "As a result of offshore M&A, we now have a couple of non-Japanese corporate executive officers in our global management team. Compared to our Japanese team members, they bring different views, insights and perspectives on how to develop, manage and grow the business. Although we do not have any non-Japanese board members yet, we would be open to considering this in the future. In any case, the quality of the discussion at senior executive management committee meetings and board meetings has improved greatly.

Embracing change, adding competencies

A large cross-border acquisition can also attract the attention of regulators. A consulting firm executive noted,

"After the acquisition, the Statutory Auditor began to show much more interest in us and our corporate governance structures. As a result, we decided to establish a global headquarters in Tokyo to oversee our international business."

Overall, the mindset adopted by the companies we spoke to has been to embrace the changes brought about through cross-border M&A.

One senior executive told us, "Large-scale M&A will inevitably spur transformation, but we think hard about the direction of change and know exactly why we want to do it. We strategically acquire offshore businesses in order to grow and change and maximise our performance. Acquiring an entirely new business line in an area where we do not have any insight or experience requires HQ to adapt significantly and obtain new competencies in order to maximise the benefits from a strategic investment."

Overall, the mindset adopted by the companies we spoke to has been to embrace the changes brought about through cross-border M&A.

Understanding the keys to success

Finding, acquiring and integrating large-scale foreign business operations is always an enormously complicated and difficult undertaking, but the challenges are even more numerous for traditional Japanese firms with ingrained, long-standing corporate structures and practices.

A well-defined corporate strategy, in-house M&A expertise, a clear commitment from the CEO, and a willingness to adapt post-acquisition are key elements of M&A strategy.

As a result, some Japanese companies are finding that promising cross-border M&A transactions have not achieved their anticipated results.

Luck and timing also plays a role. A senior leader at a financial services group told us, "When the 2008 global financial crisis hit, we saw a one-in-a-million opportunity to acquire a distressed investment bank and become a truly global house. It was a big gamble. Suddenly we owned a firm led by non-Japanese senior executives with a large investment banking practice, something that had not been part of our core business in the past. Furthermore, the crisis fundamentally changed the investment banking business model and reduced the appetite for risk, meaning that we weren't fully able to take advantage of the talent, business model or clientele we had acquired."

This financial crisis acquisition was a unique situation, but the company's experience of not being able to fully reap the benefits of a large cross-border M&A deal is not.

So what steps can traditional Japanese companies take to improve their chances of success when undertaking a significant investment in cross-border M&A?

Having a well-defined corporate strategy, in-house M&A expertise, a clear commitment from the CEO, and a willingness to adapt post-acquisition, have all been identified by Japan's Ministry of Economy, Trade and Industry in a recent report as useful strategies.

Four best practices for successful M&A

We have distilled the insights we collected from senior executives with cross-border M&A experience into the following set of best practices.

1. Have a clear strategic vision

While growth is a worthwhile objective for any company to pursue, many executives we spoke to offered caution on the imperative to have a clear-minded strategy.

M&A activity undertaken in the absence of a clear articulation of the company's strategy and goals, and without adequate due diligence and preparation, is less likely to be successful in the long term.

The CFO of a pharmaceutical company added, "We are not seeking acquisitions of a particular size, we are looking for acquisitions that can offer us innovation, infrastructure, or new sales channels and that align with our overarching corporate strategy and vision."

He continued, "We engage in pre-M&A discussions to increase the probability of success. Investment into R&D businesses, in particular, involve higher risks and our CEO talks to individual researchers around the world to ensure the merger makes sense. This hands-on approach wouldn't work with the kind of mega-mergers other pharma companies undertake."

A Chief Strategy Officer also spoke about the importance of pre-M&A discussions: "As a management team, we discuss each individual investment opportunity in terms of its affinity to our core technology and potential synergies.
How far the investment will take us from our core technology domain defines the size of the risk and we proceed if we are confident that we will be able to manage that risk as a team."

An electronics company executive put it simply: "All our acquisitions must align with our well-defined strategy and growth objectives."

Over-reliance on external advisors can lead to less-informed decision making about which M&A opportunities to pursue, which can cost the company more in the long run.

2. Become an M&A expert

One potential pitfall the executives highlighted was a lack of M&A-specific in-house financial literacy. A pharmaceutical CFO noted, “Investment bankers advise companies on these transactions, but the acquiring company needs to fully understand what they are trying to do before the fact.” This is true for any company undertaking M&A in new markets but it is especially true for traditional Japanese companies that are less likely than their domestic counterparts elsewhere to have this capacity in-house or to know where to find it.

Having an in-house team with experience in cross-border M&A including due diligence, valuation, negotiations and post-merger integration, substantially increases a company’s chances of success.

Having learned from past transactions, one executive explained, “We now have an established methodology for cross-border M&A and we make sure we have all necessary information such as a detailed valuation model for the target company with more than 200 different projected rates of return based on the value of the transaction. This is internal know-how we did not have 10 years ago.”

3. Your CEO has to be highly committed

For most organisations, truly transformative change comes from the top. Traditional Japanese companies are no different. The proactive commitment of top executives to a particular transaction increases its chances of success.

An executive in a consulting firm noted how the Japanese firms that have been successful with overseas M&A, “have very strong leaders who are often founders or family members of the founders. Only highly committed leaders are able to bring about innovative and disruptive transformation. Therefore, Japanese companies need to run their M&A deals as segregated projects with strong, dedicated leadership.”

A senior executive at a printing and technology company echoed this sentiment: “Any investment opportunity comes with uncertainty, but we are fortunate to have a CEO who (is a family member of the founder and) hasthe guts to make difficult decisions.”

However, even companies that are not led by members of the original founding family are able to undergo transformative change. A visionary and proactive leader will be able to reimagine and recast their role into one more suited for a globalised business.

However, even companies that are

not led by members of the original founding family are able to undergo transformative change. A visionary and proactive leader will be able to reimagine and recast their role into one more suited for a globalised business.

As one senior leader explained, "CEO commitment is essential when undertaking a disruptive transformation
of this magnitude. Our new CEO recognises this and has taken responsibility for the international business (in addition to overseeing our domestic business) and all the regional business heads now report directly to him." This is a familiar hierarchical structure for most global companies but traditional Japanese companies have tended to divide management responsibilities for domestic and international business at the very top between a CEO and a more internationally experienced COO.

The executive continued, "Our new CEO disrupted the long-standing, unwritten rule relating to the division of domestic and international responsibilities – none of his predecessors had attempted this. He also began to attend international conferences to learn from his counterparts in other global banks and meet global financial regulators, bringing an English translator with him for language support. This level of commitment is necessary for successfully transforming from a traditional Japanese company to a global firm."

An EVP in a consulting firm shared: "We have a strong domestic Japanese corporate culture and the first strategic acquisition abroad required a significant battle with our conservative and rule-driven headquarters. Another EVP and I were worried that in the time it would take to receive approval for the transaction, we would miss our chance to become a global player. We decided to take the risk and move forward with the investment. After our success with this relatively small acquisition, the management team began to feel more comfortable with the idea of global expansion and to consider much larger investment opportunities."

Without the commitment of top leadership, M&A transactions become much riskier and more difficult to close but in some cases, the executives advocating the deal feel they have no choice.

Japanese companies should be willing to make changes to their existing management and corporate governance structures and to adopt best practices that will enable global growth.

4. Be willing to adapt

Large cross-border M&A transactions are necessarily transformative. The executives we spoke to told us that the earlier in the process a company confronts and embraces this fact, the better.

A commitment to change, learn and innovate is essential. One executive we spoke to noted, "Our founders' commitment to change and enthusiasm for innovation and growth has influenced the entire organisation. A long history of strategic acquisitions and an ambition to grow have resulted in a diverse business portfolio. Running a conglomerate is not always easy, but we are used to managing acquisitions now and we continue to use our acquired knowledge to change and innovate."

In beginning down the path of transformation, the pharmaceutical CFO noted that time is of the essence: "We begin post-merger-integration with the target company right after we closed the deal."

Without a willingness to adapt and learn from a target company, the full value of the investment is unlikely to be realised.

While no transaction is 100% risk-proof, for a traditional Japanese firm with global ambitions, implementing these best practices will improve their chances of fully reaping the benefits of cross-border M&A.

ODGERS BERNDTSON IN JAPAN

Since 1991, Odgers Berndtson, Japan has been partnering with our clients addressing the business and cultural challenges faced by Japanese organisations at home and, increasingly, abroad. We have delivered exemplary results for Fortune 100 companies, niche players, start-ups and non-profits.

In a market where there is still resistance to changing employers, and where only a small percentage of executives are truly international, identifying, assessing and enticing executives is often difficult. It certainly helps that all of our Partners have more than fifteen years of consulting experience with a focus on providing strategic management services – from executive search and assessment to organisational structure review. In addition, we are always able to call on the international reach and expertise of the Odgers Berndtson network of 63 offices across 30 countries.

Odgers Berndtson
Toyo Property Toranomon Bldg 6F
61-1-28 Toranomon
Minato-ku
Tokyo 105-0001
Japan
W: odgersberndtson.com

ABOUT THE AUTHOR

Hiroyuki Koshino
Partner, Japan

Hiroyuki has a track-record of leading senior-level and cross-border assignments for clients in the financial services, professional services, technology, and general industries.

Before joining Odgers Berndtson, he worked as a consultant for several leading executive search firms for more than eleven years. He also served as a professional coach at a Japanese coaching company.

Hiroyuki began his career with Sanwa Bank (currently MUFG Bank) where he worked for nearly 20 years in Japan and the United States, focusing on banking, corporate planning and business promotion for markets including Japan, China and the United States.

Hiroyuki received his BA from Waseda University and his MBA from the George Washington University in Washington, D.C.

hiroyuki.koshino@odgersberndtson.com

www.odgersberndtson.com

ODGERS BERNDTSON