Cross-border M&A and Japanese Companies

- Overcoming Challenges in Cross-border M&A –
Insights from Leading Domestic and Overseas M&A Players

Report on FY2018 Survey concerning Capacity Enhancement for Facilitation of Japan’s Domestic and Cross-Border Investment (Project for Survey/Study concerning Challenges in Acquisition of Foreign Companies by Japanese Companies)

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Introduction

Today, Japanese companies face many changes. They include a decline of domestic demand, economic globalization, economic growth of emerging countries and digitalization based on AI, IoT. As a result, companies are concerned about the future of sustainable growth based solely on continuation of existing businesses. As one way to overcome this situation and build business models that work on a global level, many Japanese companies have been engaged in cross-border M&A in recent years.

However, companies which have started their cross-border M&A activities also run into a big wall, the wall of “globalization,” so to speak. If a Japanese company does cross-border M&A, it needs to work together with the bought-out foreign company to conduct business and create new value, as a matter of course. To this end, Japanese companies must have a global business practice that can work in any country or region. Many Japanese companies, however, lack related experience and knowhow, so even if they have actually carried out cross-border M&A, they often run into communication issues with their overseas subsidiaries and fail to realize what they wanted to achieve initially.

As well, many voice concerns that companies, even if they did cross-border M&A in the name of “globalization” or “capturing growing overseas demand,” only have abstract, unclear answers to questions such as “What do we want to achieve in the medium-to-long term?” or “Why do we have to venture into cross-border M&A? What is the sense of crisis we have as a reason for M&A?” In such cases, companies will probably have a hard time in Post-Merger Integration (PMI) because of poor consideration of “Why are we buying out this company?” or “How are we managing it after acquisition?”

Having said that it is still true that cross-border M&A is a powerful tool for companies to survive global competition while taking advantage of the strengths they have developed. Japanese and foreign companies which effectively utilize cross-border M&A have a good understanding of where they may face difficulties in cross-border M&A and strive to overcome them through “thorough preparation.” More specifically, these companies have made internal discussions on their own visions, strategies, and strengths and established judgement criteria for “Why do we do cross-border M&A?” In addition, these companies have developed structures that can work for cross-border M&A and global management and “frameworks” of M&A in anticipation of PMI.

In this survey, we heard opinions from many people including those in charge of PMI who are directly facing the challenges of Japanese companies at the forefront (at acquired companies) and the management of acquired foreign companies. We also talked to foreign companies, funds, and experts that have a rich background in M&A and they shared with us precious experiences concerning their past practice. We hope that Japanese companies which are or will be engaged in cross-border M&A will find a lot of useful information in this report.

This report also provides cases where Japanese companies achieved growth by accepting and using the investments from foreign companies and foreign-affiliated private equity (PE) funds. Through objective analyses, foreign companies and foreign-affiliated PE funds are well aware of challenges Japanese companies may face when trying to operate on a global scale. When trying to expand globally, Japanese companies could benefit from the perspectives of these foreign players or in some cases even take advantage of their investment as in the cases presented in this report.

Faced with a big wave of changes, companies cannot survive today’s global competition without taking action for changing themselves even if it is accompanied by some pain. During this survey, some said it would be at parent companies in Japan that PMI should be done (after cross-border M&A). These voices suggest that change of the buying company itself is the most important in effectively utilizing cross-border M&A. We hope that this report will accelerate discussions on strategies and visions with the management and the change of management structures and organizations so that they would work on a global scale.

April 2019

Investment Facilitation Division, Trade and Economic Cooperation Bureau, Ministry of Economy, Trade and Industry

1. Survey objectives and methods

1.1. Survey objectives

As Japanese companies have recognized cross-border M&A (In-Out) as an important and effective tool for realizing growth globally in recent years, cross-border M&A activities are on the rise especially among large corporations. On the other hand, because doing cross-border M&A is more challenging than doing M&A in Japan or expanding overseas through establishing local subsidiaries, there are many cases where companies fail to achieve what they initially expected to.

Against this background, the Ministry of Economy, Trade and Industry (METI) started “Study Group for Japanese Companies’ M&A Overseas” in FY2017, where they discussed M&A-related challenges Japanese companies face with experts and put together important points for Japanese companies’ effective utilization of cross-border M&A and actual cases into a report. METI was expected to provide support for cross-border M&A by utilizing this report and an outcome of this Study Group called “Nine Actions for Successful Cross-border M&A (hereinafter referred to as Nine Actions)” and sharing important points and concrete measures for cross-border M&A with not only large corporations in the Tokyo metropolitan area but also regional or medium-sized companies.

That was when METI made the following efforts in one of its commissioned projects in FY2018, “FY2018 Survey concerning Capacity Enhancement for Facilitation of Japan’s Domestic and Cross-Border Investment (Project for Survey/Study concerning Challenges in Acquisition of Foreign Companies by Japanese Companies)” so that Japanese companies could produce good results in a fiercely competitive global environment by using M&A:

- Held workshops in Japan for companies engaged or planning to be engaged in cross-border M&A which involved two-way discussions with a view to disseminating and promoting “Nine Actions,” spreading important points concerning cross-border M&A among Japanese companies, and delving into challenges facing Japanese companies.
- Held round-table talks with a number of expatriates dispatched from Japanese companies as part of PMI and the top executives of acquired companies and conducted interviews with foreign companies and foreign-affiliated PE funds with a view to sharing useful input for working out details of measures against challenges concerning cross-border M&A.
- Organized the appeal and challenges of investing in Japan through interviews with foreign companies and foreign-affiliated PE funds in order to understand trends and challenges of inward foreign direct investment in Japan

<Figure 1> Relation between this report and “Nine Actions”

Composition of this report		Nine actions	
Preparation of global management capabilities and systems	3.1.1 Global management capabilities	Action 7: Efforts to highlight the company’s own strong point and philosophy	Action 8: Enhancement of self-innovation and global management capabilities through cross-border M&A
	3.1.2 System and structure for global management		
Creating “Patterns” with the overall M&A process in mind	3.2.1 Clear positioning of M&A in growth strategies	Action 1: “Desirable situation” and clarification of realization scenario	Action 2: Sharing and dissemination of “strategy and scenario for growth”
	3.2.2 Defining M&A objectives		
	3.2.3 Selection of target companies based on the compatibility with one’s own strategy	Action 3: “Spend more time” for careful preparation	
	3.2.4 Implementation of business DD to determine the compatibility with one’s own strategy		Action 4: Basis for decision making not for perfunctory acquisition but for growth of company
	3.2.5 Effective way of due diligence		
	3.2.6 Early development of plan for post-acquisition management system		Action 5: Immediate start of actions right after the closing of deal toward integration of companies
	3.2.7 Visualization of acquired company through monitoring	Action 6: Thorough “visualization” of the acquired company	
	3.2.8 Ingenuity in reporting to parent company		
	3.2.9 Speed up of decision-making process by transfer of power		
	3.2.10 Enhancement of M&A capabilities and externalizing knowledge	Action 9: To become “an expert of cross-border M&A” through accumulation of past experience	

[METI1][i2]

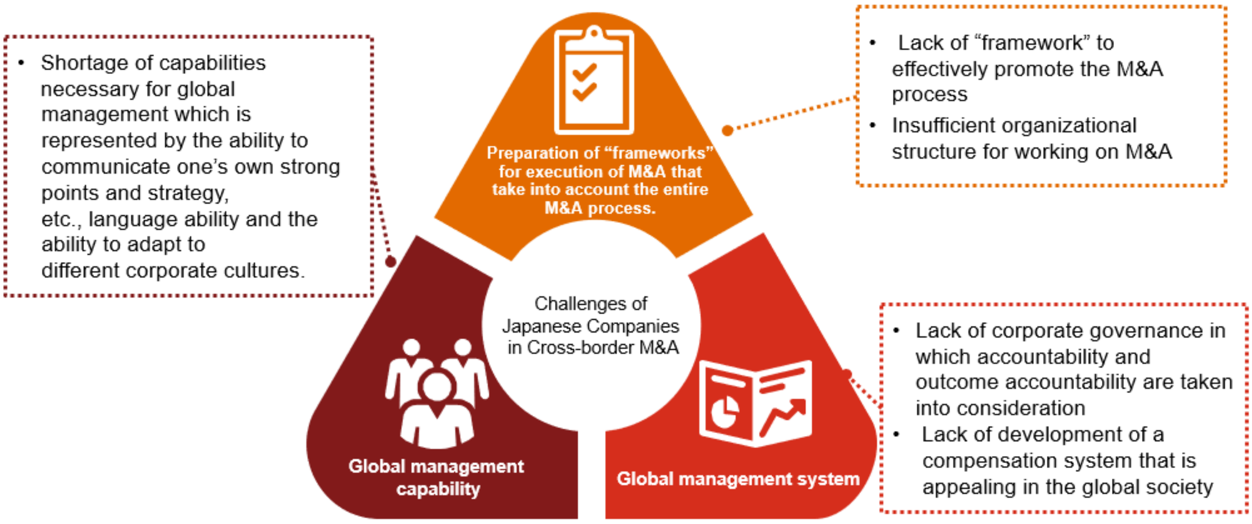
2. Challenges of Japanese Companies and possibilities of overcoming them in cross-border M&A (In-Out)

The challenges which Japanese companies face in securing competitiveness on a global scale through buying out foreign companies are largely summarized into three types.

- Lack of global management capabilities
  - “Communication skills” to clearly convey management philosophy, visions, and strengths of one’s company and the positioning of the M&A case in question
  - “Language skills” required as part of “Communication skills”
  - “Adaptability to different corporate culture” to promote post-acquisition management effectively
- Underdeveloped global management systems and structures
  - Actions for corporate governance
  - Compensation systems that adopt incentive structures and follow the global standards
- Inadequacies in creating “frameworks” with the overall M&A process in mind
  - Clarification of points to be covered in each process of developing M&A strategies, their execution, and PMI.
  - Organizational structure concerning M&A efforts

As cross-border M&A involves acquisition and operation of foreign companies which have been managed in different languages and cultures with different business practices and systems, it is indispensable to build globally accepted management capabilities and introduce systems and structures that are adopted and taken for granted in many countries, which is a huge contrast to cases of domestic M&A. As well, buying companies need a framework of a series of M&A processes from strategies to consideration and execution and to post-acquisition management. With such frameworks in hand, companies will be able to conduct M&A more effectively.

<Figure 2> Challenges Japanese companies in Cross-border M&A



2.1. *Preparation for Global Management Capability and System*

Buying companies need to have certain capabilities, some of which are specific to cross-border M&A not domestic M&A. First, they need communication skills to clearly convey their management philosophy, visions, strengths, and the positioning of the M&A case in question in their strategies to acquired foreign companies, and language skills and adaptability to different corporate cultures as prerequisites for communication skills. Then, buying companies need to have standard systems adopted by global companies in place. If the acquired company already runs such systems, creating a huge gap with the buying company, then the buying company may need to consider changing its own systems in some cases.

<Figure 3> Preparation for global management capability and system

Global management capability	**Communication Skills**	• Ability to clearly communicate one's own strong points, strategy and visions to the purchased company • Persuasive communication ability with clear background and reasons
	Language Skills	• Language ability to communicate in English or local languages
	Adaptability (corporate culture)	• Know-how to assess different corporate cultures • Ability to disseminate one's own corporate culture • Execution ability to realize integration and fusion between different corporate cultures
Global management system	**Corporate Governance**	• Disciplined management system based on accountability and outcome accountability • Transparent financial management and information disclosure system
	Compensation and Incentives	• Compensation system attractive and appealing to globally competent human resources

2.1.1. Global management capability

It is of great importance that companies once again check before doing cross-border M&A whether they have the capabilities to run the target company in question after the acquisition. Without such capabilities to manage foreign companies which use different languages and have different cultures, acquisition itself may be possible but it would be difficult to create value in the PMI phase and impossible to achieve strategic targets set at the time of acquisition. "Nine Actions" mentions that it is important to "Accomplish one's own transformation and enhance global-management capability through cross-border M&A" as presented as Action 8. In this section, we will summarize what elements are specifically required while referring to some cases of foreign companies as well. Of course, companies are not expected to meet all the requirements presented here when they start cross-border M&A but rather they should build capabilities to meet these conditions as they conduct a number of projects and experience global-scale business. However, what is important is that companies execute cross-border M&A transactions by understanding what specific capabilities they do not have and making up for the lack of their capabilities or that companies recognize such lack of capabilities as a risk factor and are determined to deal with it when they perform cross-border M&A.

(1) Communication skills

The Study Group for Japanese Companies' M&A Overseas established by METI in FY2017 highlighted the importance of designing clear strategic M&A stories and the top executives speaking about them. Through overseas round-table talks with foreign top executives of companies bought out by Japanese companies and interviews with foreign companies with abundant experience in M&A, our survey this time revealed Japanese companies' challenge – many of them failed to communicate clearly the positioning of acquired companies in the parent companies' strategies to the management and employees of the acquired companies. On the other hand, many global corporations understand that sharing their visions and management philosophy with acquired companies is of the utmost importance in M&A, especially in the phase of integration, and therefore place this activity at the core of integration efforts. As well, these global corporations, when they seek some action from their new subsidiaries, explain the background and reasons for such demand by putting them into clear words. As a result, acquired companies are clear about why they need to take such action and whether change would be worthwhile (or worth the cost) and participate in integration efforts with conviction and a sense of ownership. About the importance of communicating missions and visions this way, a foreign-affiliated PE fund commented as follows:

"Clear missions and visions make a solid foundation for discussions, facilitating talk about the future. In the case of owner-managed companies, owners tend to have missions and visions only in their heads but need to make them visible to employees too. It is important how to draw out visions from owners and translate them into plain language. Presented with missions and visions, Japanese people often become disenchanted and this is particularly true in the case of a spinout of a large corporation. To bring missions and visions closer to them, you would need leadership and communication." (Foreign-affiliated PE fund)

As visions and strategies are not clearly defined in many Japanese companies in the first place and even employees do not have clear ideas about them, it is not surprising that acquired companies find it difficult to fully understand them. As well, there are many cases where an acquired company grows distrustful of its Japanese parent company because the parent company simply makes demands in actual integration efforts without giving the background or reasons to satisfy questions: Why is a certain task necessary? Where will the task fit in the integration efforts? The following presents some of the many voices we heard from companies which attended our workshops in Japan and Japanese expatriates working overseas concerning the lack of "communication skills" for acquired companies:

"To be honest, we fail to communicate 'our strengths' very well. Rather, we simply hope they understand without us explaining." (Workshop in Japan)

"Expectations Japanese companies have for their subsidiaries are often too vague to be understood even if translated into English." (Workshop in Japan)

"It is important that Japanese headquarters and the management of local subsidiaries build a trusting relationship through direct and frequent communication. Japanese companies should also show consideration for overseas subsidiaries by, for example, not holding a meeting at late night local time. (Europe, expert)

"We ran into an issue where an acquired company in Europe adamantly refused to follow instructions from the headquarters. They said they had no idea why they had to follow what the parent company said. Saying "it's a rule" does not work. Even if we give reasons, they may decide that they do not need to follow us unless they are satisfied with the reasons." (Workshop in Japan)

A possible cause of this issue is a characteristic of Japanese companies, management based on "tacit knowledge," which is relatively more applicable between Japanese companies – they understand each other without using words every time. At a roundtable talk with foreign top executives in Asia, we heard the following opinion:

"As Singaporean employees in general tend to speak their minds on the current situation, a clear explanation for convincing them is a must to get things going. So, Japanese parent companies need to present the management of acquired companies with superordinate concepts such as strategies, background and execution plans so that the subsidiaries' management could be convinced of the business operation policy of their parent companies. In addition, it is advisable for parent companies to share information on global market trends, large projects undertaken in other countries, and innovation among others. That way, you could keep or improve the motivation of the whole group and encourage information sharing in the whole group." (Asia, roundtable talk with foreign top executives)

As well, some foreign companies with abundant experience in M&A said that they had specialists for executing their communication plans, which suggests that they recognize the importance of communication.

"Before closing an M&A deal, a small group of people from our company and the acquired company share a future vision. After closing the deal, we hold a kick-off event with many employees from the acquired company, where all of us share the acquisition's objectives, expected synergy, and a future image. Through such close communication, we think we could ease concerns of people from acquired companies especially in case of cross-border deals. We find value in sharing transparent targets and plans with acquired companies. (US, service)

"At the time of management integration with acquired companies, we develop detailed communication plans for employees, customers, suppliers, etc., and appoint a communication leader for each business." (US, manufacturing)

At our roundtable talks with foreign top executives, many said that when parent Japanese companies wanted to give some instructions, they should spare more time for giving reasons and background for the instructions. At post-acquisition management, "clear communication" must be kept in mind.

At our overseas roundtable talks, some Japanese expatriates and foreign top executives voiced the importance of clever communication and dialogue between top managers starting from Day 1. Continuing a trial-and-error process through such efforts is what is needed to strengthen "communication skills."

"We played a video of our founder speaking about the company's history, and then I (the president of the acquired company) talked about his role after the acquisition and the company's future vision. At a general meeting, I took the stage with the president of our parent company from Japan and gave a presentation. He (the president of the Japanese parent company) spoke of the importance of the acquisition and the importance of the two companies matching each other in terms of people, strategies and cultures. I sent an email to all employees once every or every other week during PMI, communicating what was happening in the company and what I felt about it. In addition, we received goods such as jackets with the two companies' logos as a tangible proof of integration." (US, roundtable talk with foreign top executives)

"Japanese companies are not good at 'Day 1 Communication.' This is especially true of listed companies, which tend to keep things secret until the last minute and make announcements on Day 1. When acquiring an owner-managed company, it is important for the owner to inform his or her employees. As I learned the importance of Day 1 Communication at another company, I am trying to do it properly in my project. We have the parent company send a message on Day 1 or Day 0 and also make sure we have an opportunity for casual communication by setting up a dinner with other executives. As well, breaking the news to everybody including executives at the same time may hurt the feelings of executives, so we give them a little introduction in advance without violating insider trading laws." (Europe, the round-table discussions held for Japanese representatives)

"Our current president sent 20 'Ambassadors' to various countries and created our visions, missions, and values from the grassroots. Acquired companies have their own visions, missions, and values, so Ambassadors are selected from acquired companies as well. That way, the parent company and subsidiaries communicate and understand the values of each other, find things they have in common, update visions, missions and values accordingly, and disseminate them among employees. It is important to provide a forum for discussions on visions." (US, the round-table discussions held for Japanese representatives)

"We grew trust in and understanding of each other by spending around a year for the PMI process. With PMI goals set up by divisions in charge of PMI in each company, senior leaders from us (the acquired company) and the parent company got together and advanced PMI. We and our parent Japanese company held weekly and monthly progress meetings, as part of which we convened a general meeting once or twice as a whole group during PMI and carried out confirmation. These activities turned out to be good opportunities where leaders of operations of our company and the parent company met, understood each other's business, and discussed how to integrate the two companies." (US, roundtable talk with foreign top executives)

(2) Language skills

In cross-border M&A, when parent companies try to communicate with acquired companies, they face two barriers of language and culture, and language is still a huge challenge for Japanese parent companies. This is especially true in cases of acquisition deals by medium-sized Japanese companies (with sales between around 50 billion yen and 100 billion yen), which tend to have few staff who could fully communicate in English and often face a serious challenge in communication after acquisition. In fact, at overseas roundtable talks and interviews with experts, many said they were having a hard time because of poor language skills which were regarded as a hindrance to integration efforts.

"Representatives of the Japan head office do not speak English and always bring interpreters along to meetings. As we cannot have a talk over the phone, communication with them is extremely difficult." (Europe, roundtable talk with foreign top executives)

"Japanese staff do not pick up calls from England, so we have to settle for an exchange of endless emails, an extremely inefficient form of communication." (Europe, roundtable talk with foreign top executives)

"If you want to do business overseas, communication in English is unavoidable. But many Japanese representatives are not willing to speak in English." (Europe, roundtable talk with foreign top executives)

"Employees of our R&D division wish to develop relationships with Japan headquarters but personnel exchange is an unlikely prospect due to the language barrier." (Europe, roundtable talk with foreign top executives)

"In emails, Japanese tend to write bluntly and come on too strong because of their limited language ability. When speaking in person, they speak falteringly but they strike us as less aggressive because we see each other's face. (Europe, expert)

"I learned that waiting for a response is important when communicating with Japanese. As English is not their mother tongue, they need time to think before answering. At first, we thought that they simply didn't understand what we said but that was wrong. I needed to wait for their response. A spell of silence precedes a response. (US, roundtable talk with foreign top executives)

"The English proficiency of Japanese people is not good enough. I make it a rule to ask Japanese expatriates to repeat what I said to see if they understand. Some understand only 60% or so. Missing 40% is a big deal. The key is speaking slowly and giving them time to think but it is also a significant challenge for us. (US, roundtable talk with foreign top executives)

The challenge of language is so serious that companies should consider investment, e.g., employing staff with language skills (including non-Japanese), providing existing employees with language training or subsidizing their study at language schools, requiring language competency for promotion and career advancement, etc. Preparation for cross-border M&A should start from securing a budget for solving the language challenge in a business plan.

(3) Adaptability to different corporate culture

Adaptability of corporate culture is a key factor that makes or breaks cross-border M&A – a perception that is growing popular among both Japanese and foreign companies. According to "Perspectives on merger integration," a survey McKinsey & Company conducted in the past, 25% of the management think that many acquisition cases fell through because of "inadaptability of corporate culture" and 50% of them think that "adaptability of corporate culture" is a factor contributing to the realization of integration benefit.[1] At our workshops in Japan, we also heard from some Japanese companies that they viewed cultural adaptability as one of the key points in cross-border M&A.

"We view corporate culture as a key factor when considering M&A. We have carried out some cases of PMI in Japan and as a rule companies we acquire become our consolidated subsidiaries. For domestic M&A, we try to acquire companies with cultures which match ours as much as possible. When doing cross-border M&A, we will probably need to determine whether the acquired company could accept our culture or we could respect the acquired company's culture." (Workshop in Japan)

"In the sense of how to deal with corporate culture, we should keep in mind that even if we merge two companies, we could not have the best of both worlds. The management need to keep sending out a message about how they want the company to be." (Workshop in Japan)

"It is important to know that if you go overseas, culture that is the precondition for everything is different." (Workshop in Japan)

"While it goes without saying that sales volume, profitability and the like are important criteria when considering M&A, we try to determine whether values of organizations could be fully shared as we and the acquired company start working together as partners." (Workshop in Japan)

"I am interested in due diligence on corporate culture. I think that it may help predict psychological stress to be felt by acquired companies when accepting the parent company's rules." (Workshop in Japan)

"Our company provides cross-cultural communication training." (Workshop in Japan)

While there are various views on what "culture" is, PwC Consulting defines it as "self-sustaining patterns of behaving, feeling, thinking and believing – that determine how we do things around here"[2] and "corporate culture" is a key factor which sets the direction for how the corporate organization should conduct its business. Inadaptability of corporate culture will lead to problems such as conflict and confrontation in the organization, delay in decision-making, lower employee motivation, and talent drain. As a result, integration efforts come to a standstill and the value of the acquired company is damaged, a common case of failure in M&A. The divide in culture between two companies tends to be intensified especially in cross-border M&A, where it is affected by the cultural characteristics of each country in addition to those of each company, so how to overcome the challenges of corporate culture is all the more important. In this survey, we found that foreign companies with abundant experience in M&A as well as Japanese companies were striving to integrate different corporate cultures through trial and error.

"We are not perfect. We sometimes screw up when understanding and accepting acquired companies' cultures. We tend to assume that they are no different from us but that is not true even in M&A in the US." (US, manufacturing)

"The challenge we face is how two different companies could learn from each other and create the best culture for the entire organization. It takes time. Conflict is unavoidable when teams from different cultures work together in a tight schedule. We have to deal with the challenge over a long time." (Asia, finance)

[1] McKinsey & Company, Inc. (2010). Perspectives on merger integration
[2] PwC Consulting (2018). Unlocking Japan's potential - How culture can drive success in post-merger integration

Foreign companies often find some Japanese corporate cultures peculiar. For example, expatriates from Japanese companies typically avoid making decisions by themselves and check with the headquarters every time a decision needs to be made. Overseas round-table participants have brought up this particular organizational culture as a discussion topic a number of times. Japanese expatriates may need to show their commitment with a little ingenuity, for example, by not just saying they need to ask the headquarters but by also adding when they will get back with an answer. At overseas roundtable talks and workshops in Japan we held for this survey, many participants made comments which pointed to the peculiarity of Japanese corporate culture. The following provides snippets of comments from them. (Details are provided in the Column: Foreign top executives' frank opinions on Japanese corporate culture.)

"I find the biggest challenge in conflict or disagreement (how they should be understood). Japanese people are incredibly resistant and avoidant to conflict. Talking about things you should even if you'd rather not is an everyday thing that comes with business management in the US. While we received cultural training to understand why Japanese companies take so much time for decision making, it is difficult to close the gap between the two cultures and there are things we cannot understand or interpret as we ourselves have our own peculiarity in communication." (US, roundtable talk with foreign top executives)

"Japanese corporate culture is very bureaucratic and nothing can be done quickly. Japanese people prefer to proceed with things without discussions at meetings." (Europe, roundtable talk with foreign top executives)

"When the CEO of one of our overseas subsidiaries came to Japan, we talked about the current state of poor cross-cultural communication. He pointed out that Japanese management refuse to accept "difference." For example, difference from a performance target is normally accepted overseas if it is 3% more or less, but Japanese management usually demand that targets be achieved without a permissible range, which leads to a discrepancy in understanding between him and Japanese management. In addition, there is the issue of language, which cannot be solved even by using interpreters because communication through them gives only secondhand information and the speaker's original intention cannot be maintained without understanding the speaker's feelings directly. He complained that he had no idea what Japanese management was thinking. When Japanese speak English, they sometimes fail to give the subject, verb, or object of a sentence or give no background, so it is hard for non-Japanese people to understand what they say." (Workshop in Japan)

"One Japanese cultural problem is 'nodding.' In Singapore, nodding indicates agreement but when Japanese nod they may not always mean agreement." (Asia, roundtable talk with foreign top executives)

On the other hand, Japanese people and companies face another challenge when trying to understand the cultural gap with foreign companies. Japanese tend to lump together cultures of different countries in specific regions, for example Europe or Southeast Asia. They should note that cultural characteristics vary in the same region. At overseas roundtable talks and interviews we held for this survey, some pointed out that culture difference exists inside Europe too, as follows:

"Cultures vary depending on the country even in Europe, so intra-European business integration is not easy. For instance, it is unlikely that a UK company is bought out by a North European company." (Europe, the round-table discussions held for Japanese representatives)

"I think Japanese companies face an extremely high hurdle when buying out European companies. In the US, governance is established and a fixed system is in place, so M&A deals with US companies are completely manageable just by overseeing the local headquarters and assigning a good manager there. In Europe, on the other hand, as each country has its own system developed over a long period of history, they should not be lumped together as "Europe," but establishing good governance in all the countries where a Japanese parent company hopes to operate would be very demanding. Even European parent companies can manage operations by their European subsidiaries as core business only in a couple of countries at best. Creating operations while taking into account the culture and business practice of each country and market is taxing. This complexity, which is even more troublesome for complete outsiders like Japanese companies, is behind the fact that they do not always make success out of acquisition deals with European companies." (Foreign-affiliated PE fund)

Through our interviews for this survey, we have learned that based on their tough experience in the PMI phase, foreign companies with abundant experience in M&A fully understand the importance of cultural compatibility with acquired companies which have different cultures and business practices, and have devised systems to deal with this challenge. At our interviews for this survey, foreign companies shared with us their efforts, from which the following provides four ideas that could be useful to Japanese companies.

[1] Cultural assessment

A key measure which many foreign companies with abundant experience in M&A have taken for integration of corporate culture is starting assessment of corporate culture of potential acquisition targets early, say, from the phase of due diligence. The "assessment of corporate culture" uses indexes which include items such as the decision-making process, means of information-sharing, the concept of personnel evaluation, how failure is viewed, and ways of employee development. M&A-experienced foreign companies stressed the importance of conducting cultural assessment over acquisition targets in order to gain understanding of their corporate culture early.

On the other hand, in cross-border M&A done by Japanese companies, they often try to understand acquired companies' culture during integration efforts. At our roundtable talks with Japanese expatriates and workshops in Japan, very few said they had actually conducted cultural assessment in the past. Reasons may include the issue of priority where closing M&A deals requires too many resources and the structural issue where it is hard to understand the acquired company's culture until they actually start working together after integration. However, by having a certain degree of cultural understanding in advance, parent companies could make necessary preparations for PMI and have a smooth start after acquisition. M&A-experienced foreign companies have adopted cultural assessment as part of due diligence for PMI.

"All members of our integration and HR teams involved in acquisition projects and those who are in charge of the entire project operation check corporate culture of acquisition targets at the phase of due diligence. If the acquisition target is a medium-sized company, cultural assessment is not an officially required process whereas a large company is subject to official cultural assessment. We ask acquisition targets about their decision-making processes and day-to-day operations by using a questionnaire." (US, technology)

"We use a due diligence team for cultural assessment. The team is instructed to assess whether acquired companies' cultures are compatible with ours, and if there is a significant gap, the team is supposed to specify challenges concerning their corporate cultures, concerns, and even positive findings for the purpose of analyzing how to integrate them." (US, service)

"We have developed (proprietary) a cultural survey technique and apply it to see if there is any specific challenge between the time of signing and closing deals. Survey results are used as guidelines when putting together due diligence results. Our HR team and deal team analyze everything concerning daily operations from values to rules to symbolic matters. Details of analysis will be refined between the due diligence phase and signing/closing." (US, manufacturing)

[2] Structures to spread one's corporate culture

Foreign companies with abundant M&A experience have devised their own ways to spread their cultures among acquired companies after acquisition. This trend seems to be especially strong among companies which have superior brands or corporate cultures. Various ways are employed depending on the company, including spreading corporate cultures through promotion activities using video content, providing coaching for the top executives, and conducting regular monitoring among others.

"A team of full-time change-management staff is assigned in acquired companies to take care of their employees, planning training sessions, social gatherings, networking lunches, etc. We conduct a survey of acquired companies' employees twice, first 90 days after the completion of acquisition and second 180 days after. Purchased companies' employees start noticing the difference in culture around 90 days after the completion of acquisition, and this change becomes more visible around 180 days after. Information gained this way is used as feedback. As well, we use the service of executive coaching specialists for senior managers who will join us." (US, technology)

“We try to enlighten acquired companies’ employees about what it means to become members of our group through using media and sponsoring sports. At a kick-off event, we play a lot of videos to have acquired companies’ employees understand and feel closer to our brands. We also spend a lot of time on training designed to communicate our corporate culture to acquired companies and to co-create a new one with them.” (US, service)

[3] Diversification of one’s organization

While “diversity management” which aims for greater business performance with talent from different backgrounds has recently started attracting attention in Japan as well, there are still not many Japanese companies that have significantly increased employment of non-Japanese people, partly due to the language barrier. In one of the interviews we did for this survey, one Singaporean company shared its thought-provoking efforts to respond to diversity in purchased companies by assigning many employees from diverse backgrounds to the very department in charge of cross-border M&A.

“We also sometimes face a language barrier and cultural differences in cross-border M&A. However, we understand that language abilities do not necessarily indicate speakers’ intelligence and have formed a diverse team which is very sensitive to cultural difference. We think that is our advantage.” (Asia, technology)

[4] Budgeting for required costs and resources

Many people in charge of PMI seem to have concerns over an insufficient budget and human resources which prevent them from taking concrete action even if issues caused by cultural differences surface after acquisition. On the other hand, some foreign companies with abundant experience in M&A estimate prior to acquisition how much cultural integration will cost and what resources will be needed and include a necessary budget in their business plans.

“Understanding cultural difference is increasingly important. At the deal phase, we assess acquisition targets in terms of their top management, leadership culture, management philosophy, and organizational culture such as whether they are centralized or decentralized. As well, we estimate costs and resources required for overcoming mutual differences and include them in our business plans.” (Europe, manufacturing)

Few Japanese companies implement the above four points, so they could learn a lot from M&A-experienced foreign companies which have adopted programs for corporate culture integration.

Finally, a representative from a US manufacturer who has been involved in over 70 M&A transactions presented the following opinion on Japanese companies based on his experience in M&A transactions with Japanese companies:

“Trying to change the other’s culture is a wrong approach. Their culture should be accepted, which is the premise on which we should make efforts.” (US, manufacturing)

Column:
Foreign top executives' frank opinions on Japanese corporate culture

Words of foreign top executives on Japanese corporate culture carry weight. They may remind us that we are often not aware of things we should be. Foreign top executives of companies acquired by Japanese companies pointed out characteristics of Japanese companies such as "slow decision-making," "ambiguous instructions," "failing to deny clearly," and "avoiding conflict." The first step Japanese companies should take to overcome the challenge of corporate culture is to have self-awareness of their own cultures – how they are perceived by the top executives and employees of their overseas subsidiaries.

Slow decision-making

"Japanese parent companies are slow in making investment decisions. Before we were bought out when I was CEO, it took around a month to decide on an investment but now after the acquisition by our Japanese parent company, an investment decision may take up to around a year. As a result, we suspect we are missing out on business opportunities. Japanese companies are excessively cautious when making investment decisions." (Asia, roundtable talk with foreign top executives)

Ambiguous instructions

"I think Japanese believe that we will follow their instructions blindly. They should give acquired companies clear reasons for their instructions." (Asia, roundtable talk with foreign top executives)

"The biggest favor I want to ask from Japanese people is not to nod or say 'thank you' but to speak frankly. It's hard to figure out what they want." (Europe, roundtable talk with foreign top executives)

Failing to deny clearly

"Japanese are extremely polite, so they sometimes do not say 'No' outright even if they do not agree. Saying a clear 'No' is sometimes more helpful, preventing misunderstanding or miscommunication." (Asia, roundtable talk with foreign top executives)

"Japanese culture is complex. Even though there was no objection in a board meeting, I had to go through many discussions after the board meeting." (Europe, roundtable talk with foreign top executives)

"An answer such as "Let me think about it," is their indirect way of saying 'No.' At first, we received cultural training. We have started learning slowly that necessary action is under way even if a decision is not made in a meeting. They just do not give a 'Big Yes' at a meeting while they keep doing what needs to be done and get things going efficiently. It is just a matter of different styles." (US, roundtable talk with foreign top executives)

2.1.2. Global management system

(1) Corporate governance

Through this survey, we found a number of differences in M&A efforts between foreign companies with abundant M&A experience and Japanese companies, and at the root of such differences is the difference in commitment to corporate governance. In seeking sustainable corporate growth and increased corporate value over the medium- to long-term, Japan's corporate governance code states as follows: "When establishing and disclosing business strategies and business plans, companies should articulate their earnings plans and capital policies, and present targets for profitability and capital efficiency after accurately identifying the company's cost of capital. Also, companies should provide explanations that are clear and logical to shareholders with respect to the allocation of management resources, such as reviewing their business portfolio and investments in fixed assets, R&D, and human resources, and specific measures that will be taken in order to achieve their plans and targets."

However, compared to global corporations, Japanese companies have still less awareness of their accountability to shareholders when assessing and studying cross-border M&A. The table below shows the 2018 corporate governance rankings of countries in the Asia-Pacific region put together by the Asian Corporate Governance Association (ACGA), an investor organization based in Hong Kong. Japan fell from fourth place in the previous 2016 survey to seventh place on the grounds that the legal framework was weak and that no improvement was found in boards of directors.

<Figure 4> 2018 Asia-Pacific Region Corporate Governance Rankings
(Rankings of the previous 2016 survey are shown in brackets.)

Rank	Country/region
1 (1)	Australia
2 (3)	Hong Kong
3 (2)	Singapore
4 (7)	Malaysia
5 (5)	Taiwan
6 (6)	Thailand
7 (4)	Japan
7 (8)	India
9 (9)	South Korea
10 (10)	China

Source: The Asian Corporate Governance Association and CLSA Limited (2018). Corporate Governance Watch 2018.

In fact, in our interviews for this survey, a representative from a foreign-affiliated PE fund which has not expanded to Japan pointed out the following two challenges concerning Japanese companies' corporate governance.

"There is a huge difference between Japanese public companies and their counterparts in other countries in quantity and quality of information they disclose in general. One example is the difference between annual securities reports of Japan and Form 10-K of the US. The Form 10-K has sections where the management give detailed, quantitative and qualitative accounts of business performance, challenges and risks, and future outlook among others whereas annual securities reports give only a brief outline in several pages. Improving annual securities reports is extremely important in increasing management transparency and helping investors make fully-informed decisions." (Foreign-affiliated PE fund)

"There is not much alignment of interests among the board of directors, the management and shareholders, which has consequently led to a poor governance system in some cases, or even caused corporate scandals. Creating an appropriate incentive system for the board of directors and the management will help clarify the company's accountability to shareholders." (Foreign-affiliated PE fund)

In Europe and the US, there is a deep-rooted understanding that companies are owned by their shareholders and people have discussed corporate governance over many years to devise a way to control the management so that they would not make decisions which would damage corporate value. As a result, today, the management is always held accountable for important decisions they make on corporate management.

Accordingly, the management of foreign companies with abundant M&A experience present clear explanations of why a particular M&A deal is needed and how it is important in the company's strategy based on the understanding of corporate governance in order to fulfill their accountability and outcome responsibility for M&A, give great weight to post-acquisition monitoring, and thereby manage outcome properly. In addition, as the management is held accountable for results, they are working under an incentive scheme whereby they are rewarded when they have achieved targets. There is still a difference in enthusiasm for corporate governance between Japanese companies and European or US companies and it has a major effect on M&A efforts.

"When acquiring or selling a business, we try to fulfill our accountability for our strategies." (Europe, healthcare)

"We have an official annual process to review the growth strategy of each business. We compare returns gained from an acquisition and capital cost of the acquired company. We continue to create value as long as returns exceed the capital cost. That is how we evaluate 'success.'" (US, manufacturing)

"In many cases, corporate governance has not been sufficiently instilled (in Japanese companies). The board of directors and the management should seek greater alignment of interests in increasing shareholder value, accept clear accountability, and then build a sufficient disclosure system with transparency." (Foreign-affiliated PE fund)

(2) Globalization of compensation systems

[1] Deviation from the global standard of compensation systems

Japanese companies engaged in cross-border M&A have to cope with a large gap of systems and structures between them and purchased companies after acquisition. Just to comply with local systems and rules, Japanese companies may not have to do much more than utilize expertise of local outside advisers or the like. However, if the Japanese company's systems diverge widely from what is considered normal in global corporations, the company may have to consider changing its own systems. A representative example is "compensation systems." At our overseas roundtable talks, we heard many voices from expatriates of Japanese companies working on cross-border M&A, pointing out evaluation and compensation systems for local top executives during the PMI as a challenge.

"In our case, pay for executives is based on the local compensation systems. I get paid a lot too. Chairpersons of our partner companies are earning upper-middle income but some others are making more. In general, it is impossible to secure fine talent without good pay. As there is a gap in the pay level between Japan and overseas at the moment, I return the difference between what I make now and how much I would get paid in Japan to our Japan office." (Europe, the round-table discussions held for Japanese representatives)

"Understanding of compensation is fundamentally different in Japan and the US. The challenges we have to deal with are how we could make Japanese headquarters as well as the US branch understand this difference and that pay for the top executives in Japan is low. We are tackling these challenges by changing the systems every year." (US, the round-table discussions held for Japanese representatives)

"Compensation is a complicated issue. When we bought businesses from the owners, they received value for their businesses they had created up to that point. They also receive dividends. What is more important is that we understand that they are successful people." (Asia, the round-table discussions held for Japanese representatives)

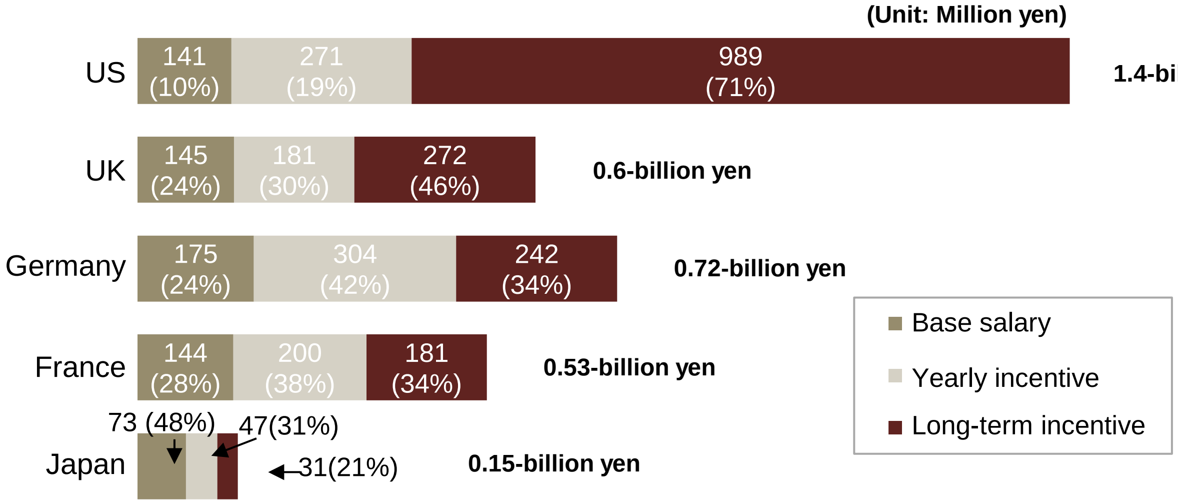
When Japanese companies acquire foreign companies, they tend to do so on the premise that existing top executives of acquired companies will remain in the management after acquisition unless they plan to buy failing businesses or simply succeed companies. Compensation systems will play an extremely important role in retaining existing executives as well. Should Japanese companies fail to retain existing local executives and choose to invite outside local talent for the managerial positions, they would need to offer compensation which is based on the local compensation practice during recruitment negotiations. In any case, compensation systems for top jobs of acquired companies are likely to be a point of issue.

As Japan's personnel evaluation and compensation systems are based on the history of the permanent employment and the seniority system, many Japanese companies still do not allow a large compensation difference depending on the performance although merit-based pay has been introduced in some companies. On the other hand, in many foreign companies, variable compensation systems where one agrees on numerical targets in advance and gets paid compensation which is calculated based on a stipulated method upon achieving the targets is the norm, presenting a challenge for Japanese companies in cross-border M&A.

[2] Deviation from the global standard of amounts of total and variable compensation

The following chart shows compensation levels and percentage of variable compensation in total compensation for Chief Executive Officers (CEO) of companies in five countries including Japan, the US, and European countries from a survey conducted in 2017 by an HR consulting firm, Willis Towers Watson.

<Figure 5> Comparisons of compensation for CEO of companies with sales of more than one trillion yen in five countries: Japan, U S, UK, Germany, and France



Source: Willis Towers Watson (2017). FY2017 CEO compensation comparisons in Japan, US, and Europe[3]

With total compensation levels of US companies and European companies being nearly 10 times and 3 to 5 times as large as those of Japanese companies respectively, the chart clearly shows Japanese companies' low level of total compensation compared to other developed countries. When median values of the compensation amounts are compared, Japanese companies stand at 150 million yen in stark contrast to 1.4 billion yen of US companies. However, the more significant difference than the total compensation gap is found in the percentage of variable compensation in the total compensation. The gap in the total compensation is largely accounted for by the difference in variable compensation which is made up of an annual incentive (bonus) and long-term incentive. As variable compensation makes up around 90% of total compensation in the US, it is easy to imagine the top executives' motivation is greatly affected by variable compensation.

Because of such a huge gap, persons in charge of cross-border M&A at Japanese companies, especially those targeting US companies, seem to be struggling with how to deal with variable compensation of local senior managers. The biggest headache is about granting stock options and stock awards as it is harder to differentiate short-term and long-term incentives without stock awards. However, some Japanese companies seem to have no choice but to pay in cash, considering the problems and cost that come with granting Japanese stocks, according to some comments.

"There are long-term incentives and short-term incentives in the US. We wish we could pay long-term incentives in stock but we have no choice but to pay in cash instead. Then, there will be little difference in long-term incentives and short-term incentives. While employees of companies we have acquired so far understand this, it is true that we are, as yet, not offering as competitive long-term incentives as US companies. Short-term incentives are designed based on the year's budget but long-term incentives cannot be designed the same way. We have not developed incentives for long-term service. We considered going public too, but the cost would be exorbitant. (US, the round-table discussions held for Japanese representatives)

3 Footnote: Created by Willis Towers Watson based on information released in each country. Survey subjects of each country are as follows: US: Median value of 253 'Fortune 500' companies with sales of 1 trillion yen or more; UK: Median value of 52 'FTSE 100' companies with sales of 1 trillion yen or more; Germany: Median value of 25 DAX companies with sales of 1 trillion yen or more; France: Median value of 31 'CAC 40' companies with sales of 1 trillion yen or more; Japan: Total amount is a median value of consolidated compensation of 74 companies with sales of 1 trillion yen or more among top 100 companies in terms of market capitalization. (The breakdown (percentage) is calculated by using an average of 58 companies which released consolidated compensation information (excluding outliers)); Long-term incentive includes retirement bonuses for a single year.
*As for yen converstion rates, average TTM of the year 2017 was used. (1 dollar = 112.19 yen, 1 pound = 144.51 yen, 1 euro = 126.67 yen)

“The previous owner was a PE fund, which paid compensation in stocks but when we bought out the company, the management didn’t want Japanese stocks, so compensation has been changed to cash. The headquarters also welcomed the change because it would cause a lot of problems to give Japanese stocks to non-Japanese people. We wish we could pay in stocks for increased motivation but the US management does not see a benefit, considering the laborious processes involved.” (US, the round-table discussions held for Japanese representatives)

“We have introduced a global stock award system, under which Japanese stocks can be granted to employees anywhere in the world. In our recent acquisition, we provided our company’s shares as stock options to the local management and general employees. However, things are not that simple. Under the Japanese laws, if stock options are exercised, new stocks will be granted, which will result in a time lag of four days. If you want to change stock options into cash, exercising them, receiving new shares, and selling them takes at least two weeks, an extremely stressful process. But this is unavoidable. Legislation is under way to introduce a number of systems in Japan but they have merits and demerits too. If a new system is instituted which makes Japanese stocks attractive enough to retain US employees or Japan’s stock award system is improved, it will help our future M&A efforts. As stock awards are the norm, especially in Silicon Valley, I hope we will be able to compete in this respect. As well, stock awards can be offset with tax withholding in the US but not in Japan. So exercising options will require a large amount of cash. As a result, Japanese stocks are not useful as a means of compensation.” (US, the round-table discussions held for Japanese representatives)

With the differences as described above, there are very few cases where compensation systems of Japanese headquarters can be applied as in compensation negotiations with the senior management of acquired companies. It is likely that Japanese companies are undertaking compensation negotiations with local top executives by taking into account compensation and incentive they have received in the past for every cross-border M&A case.

[3] Need for global common compensation systems

Practically speaking, compensation levels have to be individually decided for each region because the labor market and employment practices vary depending on the country. However, it is useful to establish clear policies and rules and set up global common guidelines for deciding compensation levels based on specific benchmark data. In so doing, companies should also decide KPI to which variable compensation is indexed in a fair manner as variable compensation accounts for a major part of total compensation overseas.

If the level of compensation for the top executives of Japanese headquarters is significantly lower than that for foreign top executives, it may lead to a decline of motivation of the management of Japanese headquarters and overseas subsidiaries. As well, without a unified compensation system, it will be hard to attract excellent non-Japanese talent from the outside for top jobs or to appoint managers of acquired companies as senior managers of regional headquarters or Japanese headquarters. Therefore, compensation systems need to be reviewed globally including those of Japanese headquarters in order to eliminate the compensation level gap for the management. In that case, it is also important to set up global common KPI which is universally applicable to all regions and standardize systems of performance evaluation and target management while a certain compensation level is adopted for each region.

At our round-table discussions held for Japanese representatives in Europe, we heard the following comment concerning the need for revision of compensation systems of Japanese headquarters:

“I think high compensation is a must when trying to secure decent human resources in order to compete globally. Companies which compete globally will also need to develop compensation systems from the global perspective.” (Europe, the round-table discussions held for Japanese representatives)

There are three specific merits in building global compensation systems which cover Japanese headquarters. They are as follows:

i. Securing excellent overseas managerial talent (global leaders)

As business is increasingly globalized, some Japanese companies have recently embarked on global management by inviting foreign talent to top posts. In the meantime, their compensation, which is considerably larger than that of Japanese top executives, is reported as “exorbitant compensation,” attracting public attention every so often. However, attracting excellent managerial talent with global management capabilities requires offering commensurate compensation, as expatriates of Japanese companies working overseas commented.

“In our company, the head of the global business division and the top of the legal department are stationed in Japan. With secondees like them in the office, the Japanese headquarters, which accepted them, is changing rapidly. As our approach to things can change, I hope to see more (personnel exchange). But few want to go and work in Japan for a long time. So, if someone is willing to go, we need to pay what they deserve.” (US, the round-table discussions held for Japanese representatives)

“After all, it is money that attracts people. If you want to compete on a global stage, then you should consider (redesigning the system of) compensation.” (Europe, the round-table discussions held for Japanese representatives)

As high compensation for top corporate executives is an issue of public concern in the US and Europe too and compensation levels vary depending on the region, regionality should be taken into account when deciding compensation levels. However, it is required for Japanese companies to increase variable compensation which is a key difference from foreign companies and to establish globally competitive compensation systems in order to secure excellent overseas managerial talent (global leaders).

ii. Maintaining and improving motivation of the top executives and future candidates for executive positions of Japanese headquarters

In many cases, compensation for Japanese top executives of Japanese headquarters does not go up even when the company has recruited foreign talent to top posts with higher compensation. In fact, it is not surprising to see in Japanese companies the reversal phenomenon of compensation where compensation for non-Japanese directors is higher than pay for the CEO of headquarters or directors of overseas acquired companies are getting paid more than senior executives and managers sent from Japanese headquarters. This anomaly may cause a decline in motivation of Japanese top executives and future candidates for executive positions. In our interviews for this survey, a representative from a foreign-affiliated PE fund and a Japanese expatriate stationed in an acquired company commented as follows:

“One of the major issues Japanese companies face when they go overseas is about compensation. If Japanese top executives have a mentality questioning the higher pay for presidents of subsidiaries they bought out from the get-go, they develop frustration over the imbalance between compensation and performance and tend to blame the local executives without reason when something goes wrong. If Japanese companies find it hard to change the enterprise compensation system all at once, they may have to do so gradually by starting from globalizing only part of the organization or introducing global compensation standards to globally competitive businesses while making moderate change to other businesses operating only in Japan. (Foreign-affiliated PE fund)

“I have been stationed in the current company for four years but I’m getting paid less than my subordinates, so I feel undervalued. As I’m not eligible for our incentive program either, I wonder if the company is worth devoting myself to.” (Europe, the round-table discussions held for Japanese representatives)

Japanese companies should consider how the inequality of compensation affects the motivation of senior managers including expatriates sent from Japan and future candidates for executive positions. Just by establishing global common guidelines, companies could increase fairness and transparency of compensation systems and help maintain and improve managers’ motivation.

iii. Bringing about a sense of unity by setting global common targets

If KPI is set for each region and each company and variable compensation is paid accordingly, the top executives and employees of each country or each company may seek local optimization, failing to aim for global optimization as part of the group. By introducing global common structures for performance evaluation and target management, a company will be able to apply common KPI to managers of different countries and entice them to work towards the group's goal. As well, transparency and fairness can be enhanced globally.

Introducing a global common stock award system entails many problems but stock awards are an effective long-term incentive measure as they play a symbolic role in fostering the sense of increasing the corporate value of the enterprise.

[4] For Japanese companies achieving globalization of compensation systems

The following provides a case of a foreign-affiliated PE fund we interviewed which was working on the transition of the compensation system of a Japanese company to a more variable-compensation-focused system. When the fund acquired a Japanese major manufacturer, the fund gave priority to nothing else but change of the manufacturer's compensation system. This was because the fund decided that it would be unavoidable for the Japanese manufacturer to change its compensation system in a bid to pursue cross-border M&A.

"When we invested in the Japanese manufacturer, we had to first change its compensation system. If the manufacturer acquires firms in the US or Europe without changing the compensation system beforehand, jealousy and envy would be inevitable." (Foreign-affiliated PE fund)

When changing the compensation system, the fund came up with KPI that would be a basis for variable compensation and invested in IT to share the KPI among the group, thereby developing management accounting and IT systems.

"We discussed what KPI should be a basis for yearly bonuses, long-term bonuses, and stock options that are according to the performance. In our case of this Japanese manufacturer, criteria are divided into three layers according to the person's job class – the top management to be evaluated on performance of the entire company based on EBITDA, department heads based on performance of their businesses, and employees based on achievement of individual targets. However, without determining common KPI and designing a rough scheme which dictates what kind of short-term or medium- to long-term compensation should be paid according to the person's job class based on the said common KPI, the Japanese manufacturer would not be able to present common targets to acquired companies upon M&A and suffer a delay in cultural integration too. Therefore, we were committed to taking care of this matter at first, immediately before and after the acquisition over a year-and-a-half period. (Foreign-affiliated PE fund)

"As our efforts would go down the drain without a common compensation system and targets being shared, we do not look at financial accounting of each region but 'EBITDA of the group' which can be shared in the group and 'numerical targets each person is responsible for.' For this purpose, management accounting and IT systems have to be integrated. Public companies tend to put the use of management accounting data as an indicator on the back burner as they give priority to systems to disclose financial accounting data every quarter. When we, a PE fund, have bought a public company and privatized it, the company no longer needs to disclose quarterly financial results, so we can direct more resources to IT for the development of management accounting information systems." (Foreign-affiliated PE fund)

Japanese companies may find useful ideas in this case as the PE fund not only set KPI, the basis for variable compensation, but also invested in management accounting IT infrastructure to manage the KPI when introducing variable compensation. With regard to compensation, the same foreign-affiliated PE fund also pointed out in the interview that companies in China, South Korea, and other Asian countries are increasingly introducing variable compensation systems that are comparable to those of US or European companies.

“Compensation mechanisms are an extremely important factor. While talk of compensation is often viewed as an addition or as showing the speaker’s greed in Japan, Japanese companies may fall behind if the management do not lead the change, believing that compensation is a crucial factor in the management system. As Chinese companies are pursuing economic returns and globally competitive South Korean companies are increasingly adopting systems that are comparable to US or European companies’ Japanese companies may be the most conservative and underdeveloped.” (Foreign-affiliate PE fund)

Let us repeat that Japanese companies engaged in cross-border M&A need to change compensation systems by introducing the global standard structure in which one agrees on numerical targets in advance and gets paid compensation which is calculated based on a stipulated method upon achieving the targets or receives only base compensation if they fail to achieve the targets.

2.2. *Preparation of a “Framework” for Execution at each stage of the M&A Process*

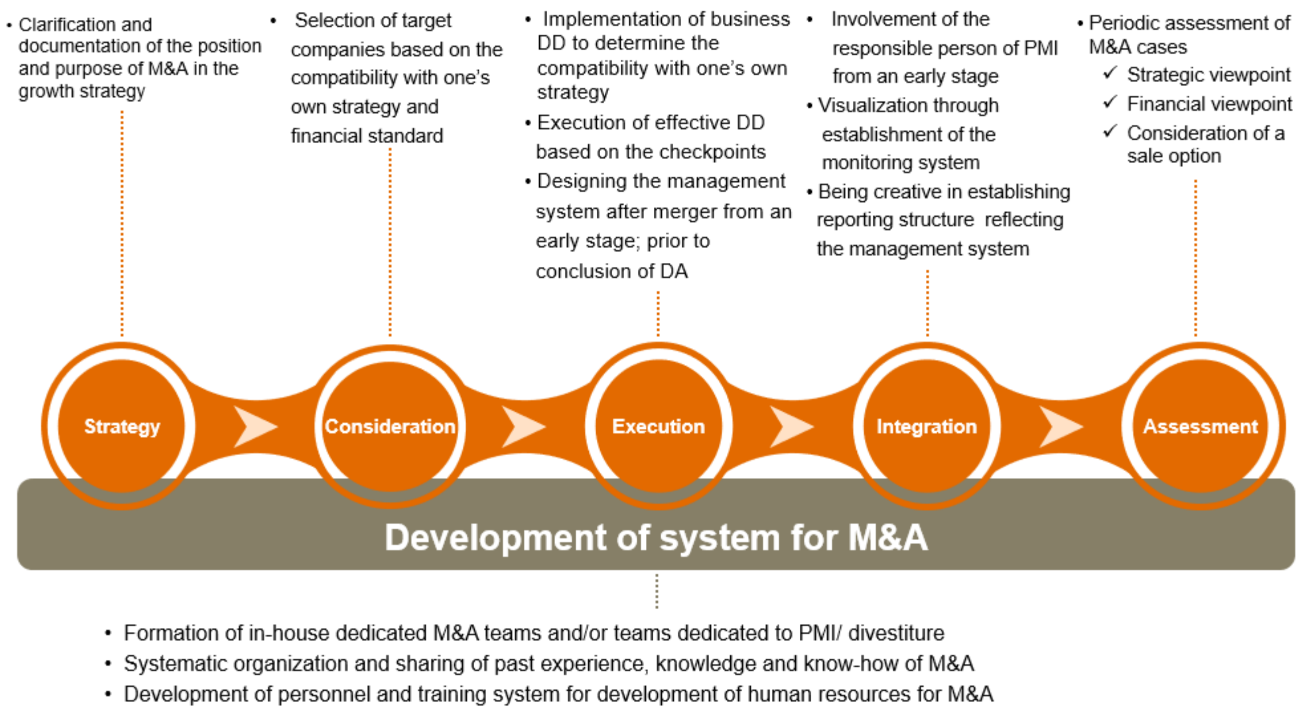
- Stick to the basics and do what is expected as expected -

Based on the past success and failure of deals, many foreign companies with abundant experience in M&A have crystalized key points to cover in M&A strategies, execution, and each process of PMI. They can be summarized as “Stick to the basics and do what is expected as expected.” For example, a European manufacturer which we interviewed for this survey clearly specifies what kind of consideration should be done in each M&A phase and a decision-making process by the management. In other words, the manufacturer has established a process for M&A and does not consider M&A as a special project, but rather carrying it out as part of a day-to-day operation. Many Japanese companies still view M&A as special, therefore failing to have their own “frameworks.”

Japanese companies which intend to use cross-border M&A as their growth strategy should put together key points learned from their own M&A experience in advance so that they could advance M&A efforts efficiently while covering all the bases. The following presents tips for “framework” creation which were selected as helpful for Japanese companies from opinions gained at interviews and overseas roundtable talks with M&A-experienced foreign companies and workshops held in Japan.

We should also note that as challenges and points to be covered vary depending on the M&A project, companies need to keep updating their “frameworks” constantly based on experience.

<Figure 6> Preparation of a “Frameworks” for Execution at each stage of the M&A Process



2.2.1. Clear positioning of M&A in growth strategies

M&A is recognized as an effective means for Japanese companies to grow fast against fierce global competition. By using M&A, companies can draw a growth strategy without being constrained by limited management resources they have at the moment. The advantage of M&A is especially significant in cases of acquisition of foreign companies, as the buying company can gain access to overseas markets that would be hard to enter by itself and quickly secure a network of business partners including local customers, gain approval and authorization for business, human resources, infrastructure, etc. However, M&A is not just a matter of funds, but an investment activity which requires a lot of management resources in consideration, analysis, execution, and subsequent operation management and also an advanced economic transaction which comes with risk. Accordingly, a company needs to give objective explanation to stakeholders in and outside of the company that planned M&A is in alignment with the company's growth strategy, so active involvement and commitment of the company's top executives will be required. As recommended in "Nine Actions," companies need to articulate reasons for choosing M&A as a growth strategy, objectives of M&A, reasons for choosing particular acquisition targets, and an assumed post-acquisition growth story.

Foreign companies with abundant experience in M&A we interviewed for this survey consider M&A as just a means to realize their growth strategies, not necessarily aiming for M&A-oriented growth. Rather, they examine whether to go for a particular M&A deal by comparing it with organic growth through their existing businesses. With this in mind, it was interesting to see some global companies were giving a higher priority to organic growth by existing businesses than inorganic growth through M&A. To deal with resistance from internal stakeholders who believe that growth strategy can be realized with existing businesses, these companies are choosing the most appropriate means by having management planning divisions and business divisions compare and analyze the two options of aiming for growth with existing businesses or implementing M&A as ways to realize business strategies. The following voices from global companies show their views on M&A strategies:

"There is nothing better than being able to choose organic growth in our business. We start from our business strategy and ask each business division to analyze the two options of organic growth and inorganic growth and to discuss which option is better for achieving business targets." (US, manufacturing)

"We give priority to organic growth but understand that we need to strike a balance between organic growth and inorganic growth. Business divisions prefer a growth strategy based on organic growth in many cases. As the corporate division, we discuss business returns with business divisions and sometimes choose inorganic growth." (Europe, manufacturing)

"The corporate management planning team works closely with the strategy committee and reports directly to the Chairman of headquarters, thereby coordinating M&A strategy and global strategy. Growth is at the core of our strategy, in which M&A always plays a key part. As well, when the management planning team has found a specific business field or region which our company may want to foray into for growth, the management discusses whether the company should opt for organic growth or inorganic growth." (US, service)

Refusing a preconceived idea that M&A is necessary, foreign companies with abundant experience in M&A start from examining which means would be the best for their growth strategies by involving business divisions.

On the other hand, some people argue that Japanese companies lack strategies when doing M&A. In fact, a considerable number of companies fail to clarify their M&A objectives as corroborated by the result of one of our survey questions for companies which participated in workshops in Japan: Asked if respondents agree to the statement, "Your company has set up 'a vision or how the company should be' after careful consideration, made clear a 'growth strategy/story' to realize the vision, and considers cross-border M&A to realize it," 20% of the respondents said "Neither agree nor disagree," 10% said "Somewhat disagree," and 2% answered "Strongly disagree." Some companies which participated in workshops in Japan gave several comments to the effect that the positioning of M&A in their strategies is not clear.

"As our company's problem, the medium-term management plan is vague. Now, at the phase of strategy development, we have no roadmap that closes the gap between our 'current state' and 'ideal state.'" (Workshop in Japan)

"We are not clear in which fields we can grow or how we can grow with our products. I'm afraid that we still lack a sense of danger that we are getting nowhere without relying on others (inorganic growth). I'm striving to convince the management of this issue." (Workshop in Japan)

"In the projects we are currently considering, we are focused on how our business departments which are doing business only in Japan can go overseas, lacking a larger picture of what we should buy based on what strategies and what company we should make alliances with." (Workshop in Japan)

One of the reasons for Japanese companies' M&A strategies being unclear is that during the rapid economic development until the early 1990s, the market itself was expected to grow and strategies were less important. As the domestic market continues to shrink in recent years, companies have been forced into considering competitive strategies including the advance into overseas markets for their survival while some Japanese companies which are not yet familiar with strategic management may have embarked on cross-border M&A hastily without careful examination of their strategies. In addition, as pointed out by a foreign-affiliated PE fund in one of our interviews for this survey, saying, "corporate leaders of some Japanese companies are more interested in avoiding making a wrong judgement or failure than enhancing shareholder value," they don't think it is necessary to give shareholders explanations of strategies and objectives of cross-border M&A, which may also be one of the reasons for their unclear M&A strategies. As companies are expected to deal with corporate governance in Japan too, the top executives of Japanese companies will be increasingly required to clarify why they have to go for M&A and where M&A fits in their growth strategies and fulfill their accountability to shareholders.

The following provides a quote from an interview with a European manufacturer regarding how the top executives should be involved in M&A strategies:

"To take into account an objection from internal stakeholders, our company listens to what business divisions have to say, and then if returns from existing businesses are low, the management planning/strategy department decides to go for M&A in some cases." (Europe, manufacturing)

The European manufacturer we interviewed for this survey commented on the importance of the top executives considering and deciding on M&A strategies as follows:

"The top executives present the direction of the company's strategy. Based on the strategy from the top executives, heads of business departments have to consider how they should deal with changes in the business environment. Business departments set clear directions of their businesses and the R&D department constantly assesses what kind of new technology will be needed in future." (Europe, manufacturing)

It is important for the top executives to present M&A strategies clearly based on the company's growth strategy while making a point of working closely with business departments that will run acquired businesses.

2.2.2. *Defining M&A objectives*

If a company decides that M&A is necessary for its growth strategy, the objectives of M&A should be self-evident. Foreign companies with abundant experience in M&A clearly define what they try to achieve through M&A. Companies we interviewed for this survey all articulated the objectives of their M&A. These objectives vary depending on the company's business and the environment it is in. The following provides some details from their interviews.

The objectives of M&A can be largely divided into five categories based on what we heard in our interviews for this survey with M&A-experienced foreign companies. The five categories are: 1) Vertical integration, 2) Area expansion, 3) Acquisition of products/management resources, 4) Transformation of one's company, and 5) Starting new business, and M&A-experienced foreign companies use appropriate approaches for risk assessment and integration while keeping in mind that difficulties and important points vary depending on the objective.

<Figure 7> Objectives of M&A

Category	Details	Risk level	Degree of Integration
Vertical integration	Supplement and enhancement of value chain functions of existing business	Low	High
Area expansion	Expansion of geographical business area of existing business	Moderate	Moderate
Acquisition of products / management resources	Enhancement of product portfolio and pipeline of existing business, or acquisition of technical capability, production capacity and human resources	Moderate	Moderate
Transformation of one's company	Advancement of status in the industry through acquisition of large-scale company in the same business field. Self-reform of the company is required.	High	High
Starting new business	Participation in a completely new business in which the company has never been involved	High	Low

(1) Vertical integration

Vertical integration aims to complement the value chain of an existing business. As it will take place in the same industry, the company is able to have a deep grasp of the business to be acquired, so the M&A risk is not very high. Usually involving integration of operation processes and IT systems, vertical integration is a category where companies tend to aim for synergy.

“We have set a clear target on the supply chain we currently outsource.” (US, manufacturing)

“We want to do business closer to end-customers by creating a value chain that extends downstream.” (Asia, manufacturing)

“We think acquisition to complement one’s supply chain entails the lowest risk.” (US, manufacturing)

(2) Area expansion

Area expansion aims to geographically expand the area of an existing business through acquisition of companies and businesses in other countries or regions. Area expansion involves risks such as legal and tax systems and business practices of countries where foreign companies or businesses to be acquired are located. As companies or businesses to be acquired have different corporate cultures from the buying company, it is important to let the buyer’s corporate philosophy and principles sink in acquired companies by valuing communication. As the integration of operations is more likely to be limited to some functions such as procurement and IT, the degree of integration is usually not very high.

“To achieve top-line synergies in various product categories, we planned to expand geographically through acquisition.” (US, service)

“By clearly presenting strategic objectives, we hope to prove our worth and establish business foundation in regions where we currently operate, and to expand our business into other parts of the world.” (Asia, finance)

“We are a domestic company but looking at global companies as our acquisition targets. We don’t need integration very much, so we manage integration by ourselves. What needs to be integrated is business philosophy and treatment of personnel.” (Asia, manufacturing)

(3) Acquisition of products/management resources

Many foreign companies with abundant experience in M&A acquire other companies for this purpose, more specifically, enhancing product lineups and pipelines in the same industry and securing new technology, production capacity, and human resources. Companies doing M&A of this category are often found in the technology industry and the pharmaceutical industry where fast development is an especially important factor for success. While M&A of this category takes place in the same industry, acquisition often targets companies which handle technology the buyer does not have, therefore entailing greater risk than M&A cases of “(1) Vertical integration.” While M&A-experienced foreign companies often conduct M&A transactions of this category, the degree of integration tends to vary markedly depending on the company, industry and each M&A transaction. An American technology company stressed the importance of acquiring products and technologies, commenting as follows:

“To close the gap between products and technologies in our portfolio, we carry out M&A. We regularly analyze technologies required in the future, and try to find opportunities for inorganic growth in areas where we have determined that our own capabilities are not sufficient for growth.” (US, technology)

Another US technology company aims to secure technologies needed in future and people who have them through M&A, and made the following remarks:

“Fast access to market is of critical importance. If an acquisition target can produce good results a year earlier than we could, then it would be easier to justify our decision to buy their business. On another note, the number of engineers is more important than money. Quality and the number of engineers we could get through acquisition outweigh financial data.” (US, technology)

(4) Transformation of one’s company

There are fewer cases of M&A for this purpose, more specifically, the buying company acquiring larger companies in the same industry in a bid to expand its scale and raise its position in the industry. In M&A cases of this category, the buyer can expect to see economies of scale easily due to the size of an acquired company, and integration advantage stemming from streamlining redundant functions. On the other hand, the buyer may have to change its own corporate strategy, organization, and business structure as well. An Asian manufacturer which we interviewed for this survey said the company’s acquisition of a larger company in the past once weakened the company’s financial basis. As acquisition of this category entails extremely great risk, careful consideration is advisable.

“A company should not buy a larger company – a lesson we learned from our past M&A deal.” (Asia, manufacturing)

(5) Starting new business

In M&A cases of this category, companies aim to enter a business field where they have little experience. They try to find value in future possibility in the fast-changing business environment, even if the new business is little related to their existing businesses. In many cases, acquired companies are not integrated with their buyer due to the difference in business, and managing acquired companies tends to involve great risk as the buying company does not have expertise or knowhow concerning the acquired business. There are cases of success and failure in M&A of this category, as in the following comment by a US manufacturer:

“In some cases, we buy out a company that has little to do with our existing businesses. Such acquisition may turn out to be sometimes a success and sometimes a failure. What is even more difficult is obtaining approval from the management, especially when the investment is in a new field. As managing companies in such acquisition cases will require support from the existing management of acquired companies, we make a point of assessing them.” (US, manufacturing)

As well, existing business departments may also oppose M&A of this category, so the decision is sometimes led by strong leadership of the top executives. As another feature of M&A of this category, buying companies often use outside advisers who have expertise in related industries and technologies in order to assess the business of acquisition targets.

Column:
How is M&A with startups different from regular M&A?

As technology advances, as seen in the advent of AI (artificial intelligence) and IoT, there is a growing global trend of acquisition of and investment in startup companies by business corporations with a view to introducing outside knowledge and technology. For instance, Facebook, the leading social networking site (SNS), acquired the developer of a photo-sharing app, “Instagram,” at around one billion dollars in 2012. It was not long after the app was launched in October 2010, and the developer was a startup with only 13 employees at the time of the acquisition. Today, Instagram alone is estimated to be valued at more than 100 billion dollars (approximately 11 trillion yen), around 100 times the amount paid for the acquisition. Obviously, this is one of the cases of successful M&A with a startup.

In the meantime, in M&A with startups, apart from the difficulty of finding the right investment target or assessing its business, there are many cases where Japanese companies fail to acquire a startup, (beaten by other bidders in acquisition prices) or, even if acquisition is successful, struggle to integrate the acquired startup because regular integration efforts are not applicable. The following discusses marked differences companies face when conducting M&A with startups compared to regular M&A cases, presented by phase, before or after acquisition.

(1) Pre-acquisition phase

In the pre-acquisition phase, M&A with startups is different from regular M&A in four key ways. Companies which actively make a minority investment (small investment) in startups often do so through corporate venture capital (CVC), hence taking different acquisition procedures from regular M&A cases.

[1] Sourcing potential targets

In investment in startups including minority investment, it is important how to find opportunities of investing in fine targets in the fierce investment competition by venture capitalists and CVC funds. In the environment where startups are created every day, trying to meet various needs with innovative ideas, it is not easy to find promising investment targets that match one’s strategy. Companies need to obtain information on innovative technologies and excellent human resources ahead of others and such information is accumulated by venture capitalists and entrepreneur communities. Unavailable publicly and offered by few outside advisory firms unlike information for regular M&A, such information is often only accessible through a human network. Therefore, companies have to work on how to develop a network for finding fine startups.

A US technology company we interviewed for this survey voiced the importance of grass-root local network building to find promising startups as investment targets.

“Collecting local information is extremely valuable. People exchange many ideas in cafes and the like. They will be very helpful. Small talk may turn out to be useful. As network building is extremely important, we sometimes join venture incubation sessions. We sometimes gain good ideas on such occasions.” (US, technology)

“(Asked how the company finds startup investment targets,) I have spent so much time establishing direct contact with candidate companies. I have met around 200 companies so far. As our CVC is specialized in the technology field, it is not difficult to approach startups or set up meeting opportunities. People I see in person are sometimes the top executives, sometimes not. LinkedIn is also quite useful in finding candidates. Sometimes I meet new people through a bank’s introduction.” (US, technology)

In Silicon Valley in the US, a “venture ecosystem” has been formed, in which entrepreneurs, incubators, corporations, universities, financial institutions, and public institutions are linked with each other, creating venture companies one after another, which then attract fine talent, technologies, and funds, and continue to grow. In recent years, ecosystems with distinctive characteristics have been created in other parts of the world including Israel, driving economic growth through mutual networking by startups and a partnership between industry, government and academia. Some foreign companies with abundant M&A experience we interviewed for this survey shared their experience in forming their own ecosystems in a bid to attract promising startups.

"We have developed our own ecosystem, supporting growth of startups. Our customer network would be useful for startups. To support their growth, we need to offer something that helps expansion of their businesses. As startups are likely to have acquired enough funds, now they must want to expand their customer bases. We gave similar advice to a Japanese major company in the past." (US, technology)

"We are a platform company. Startups seek not only funds but also knowhow and relationships that help grow their businesses. We have knowhow to make the right business judgement at the right time and can provide startups with guidance and advice concerning codes of conduct." (Asia, technology)

Japanese companies engaged in startup investment will be required to play a part in building an innovation ecosystem by offering startups their resources such as people, goods, money, information, and networks. A European manufacturer we interviewed for this survey offered advice for Japanese companies engaged in startup investment.

"Investing in startups is not easy. We hold exhibitions and the like where startups could present their own technologies and find investors. Japanese companies should look at the US as a model case where companies are focused on discovering promising startups without much caring about their financial positions. In the US, companies act as incubators, attracting startups, investing in them, and getting returns if they have succeeded. Japanese companies should go and see how American companies are engaged in startup investment. Then, they should understand US companies are not relying on a miracle when looking for fine startups. If Japanese companies develop the same kind of structure, startups will come their way. If Japanese companies do not have such a structure, they should first go to the US. US companies are very open." (Europe, manufacturing)

[2] Quick decision-making

As startups are usually approaching multiple investors at the time of financing, a slow investment decision is likely to lead to a loss of the investment opportunity. Targets that look promising to anybody find buyers or investors quickly. At a roundtable talk we held overseas, a participant said that they had had a hard time making a decision on a startup investment as it had been examined through the same process as used in regular M&A.

"I was involved in a case of acquisition of a startup. As the case was examined in the same framework as in M&A cases of regular business companies, I had a lot of trouble convincing and gaining approval from the management." (Europe, the round-table discussions held for Japanese representatives)

In some cases, companies start from building a relationship with a startup or making a minority investment for the purpose of acquiring information, and then move on to acquisition in phases. Some foreign companies we interviewed change the way they handle M&A cases according to the purpose, for example, by having set up CVC as separate companies which take care of minority investment in startups while having M&A divisions of the headquarters in charge of processing cases of majority investment (aiming to acquire more than 50% of shares) for the purpose of business takeover/acquisition. Some other companies have set up multiple CVC funds to properly deal with startups of different stages. Startup investment through CVC is becoming popular in Japanese companies too. While it is unavoidable to go through the headquarters' decision-making process when the headquarters provides funds to CVC, once CVC is funded, faster decision-making can be expected as the decision-making process completes inside CVC. We are expected to see more and more Japanese companies start using CVC when buying out startups in order to make quick, flexible investment decisions according to the investment's purpose and the target startup's characteristics.

"We use CVC when investing in a business field that is new to us. Our investment is limited to minority investment, between around 5% and 10%. Our M&A department at the headquarters usually deals with 100% acquisition only. Regular M&A and venture capital investment differ greatly in the process. In regular M&A, acquisition deals are closely examined and decided on by the investment committee from strategic, tax, and legal perspectives due to the significance of acquiring a business while in venture investment, very small capital is involved and new technology and research and development matter more. Regular M&A and venture capital investment are judged based on different criteria." (Europe, manufacturing)

"We established CVC a couple of years ago, which is managed separately from the M&A division of the headquarters. We have intentionally set up a high information barrier (firewall) between the headquarters and CVC. I have personally worked with our CVC in some deals and found that it is totally different from the headquarters. Our CVC only deals with minority investment and the M&A division is involved only in cases of a business acquisition. As startup investment first aims to get to know the investee's business, it starts from minority investment, which may grow over time according to the growth stage of the startup. In some cases, CVC acquires startups as well." (US, manufacturing)

"Different companies are in charge of our investment in startups depending on whether the startup is in the early stage or the later stage. This has enabled us to contact a wide range of startups." (US, technology)

[3] Cannibalism with existing businesses

The more disruptive (inviting creative destruction) the technology of an M&A target startup is to the buyer, the more likely a conflict with existing businesses is. This is because the introduction of the startup's technology would cause cannibalization with the buyer's existing technology and businesses, leading to friction in the company. In some cases, researchers and engineers of existing business divisions may lose their jobs. Foreign companies with abundant experience in M&A we interviewed for this survey offered the following comments:

"(Asked how internal friction caused by the introduction of new technology is managed,) virtually all decisions are made by the top management. Heads of business departments are responsible for how to grow business based on the change in the business environment. While the R&D division has to constantly assess what kind of technology is required, strategic decision outweighs everything else and is made by the top management." (Europe, manufacturing)

"(Asked how to deal with engineers who think they can develop the same technology that the company aims to obtain through business acquisition,) that issue is discussed in the beginning at the planning phase where we decide whether to go for organic growth or inorganic growth. Sometimes the answer is clear. Engineers have pride in their skills. After all, it comes down to a matter of time and cost. We can win them around if acquisition of other companies quickens development by a year or two. Sometimes, it is cheaper to buy than develop by ourselves. When I try to gain support from engineers on a business acquisition, I make a point of explaining the merits of intellectual property or the like which engineers want to develop and invest in. I think of myself as an ambassador between deals and engineers – an approach without which I cannot win their trust. (US, manufacturing)

[4] Valuation

With regard to M&A with startups, valuation is not easy as future uncertainty is high. This is because determining business plans, which will be an input for discounted cash flow (DCF) valuation, is extremely difficult in the circumstances where there is no market or competition as yet. Some foreign companies with abundant experience in M&A we interviewed for this survey also commented on the difficulties and characteristics of business assessment and valuation of startups.

"Everybody is struggling (with valuation of startups). As there is nothing else we can rely on, we base our valuation on the maturity of startups and what they can do. As their business plans are next to worthless, DCF is almost inapplicable to valuation, so we need to apply some KPI. If there is a similar case, valuation using multiples can be useful. In the case of seeking not a business itself but the target's capabilities through acquisition, buyers need to do sufficient business due diligence. Strategies and business models that acquisition targets plan to develop must be sustainable." (Europe, manufacturing)

"We determine the market value of a target startup by questioning what the source of its value is and what it is investing money in. We may not get information we want but make a valuation with a range of data. We also recognize the importance of the speed of commercialization. Acquisition of a startup which has not made a profit may be justified if it can speed up commercialization of something by a year." (US, technology)

(2) Post-acquisition phase

Startup investment is different from regular M&A in some ways in the post-acquisition phase as well.

[1] Monitoring

Some startups will not soon be profitable, so evaluation after acquisition is also more difficult than regular M&A as in the case of the pre-acquisition valuation. The following comment was given by a Japanese expatriate sent from Japan to a startup.

"Valuation is difficult in the IT/technology industry. At the time of acquisition, the startup had been considering outside financing, which would be hard to justify from a common-sense view. We submitted a five-year plan to the headquarters, which is a cross we have to bear every year, otherwise our plan would be pointless. The gap between numbers the headquarters want to see and our on-the-job perception continues to grow. Although our yearly growth rate is getting better, we suffer from an increasing gap as the plan assumed a J-curve growth." (Europe, the round-table discussions held for Japanese representatives)

As well, many startups do not like being closely monitored, so a monitoring approach that is different from regular M&A cases is needed. In addition, a buying company may need to question whether it should monitor the acquired startup as its subsidiary or integrate the startup with a business department in its headquarters, as heard in our interview in Europe.

"Agile IT companies do not like to make a detailed report to the headquarters. As well, the post-acquisition integration approach varies depending on the situation. If a company acquires its core business, the buying company will integrate the business with itself. But if a company acquires a startup for their new technology, then integration with the buying company may kill the startup. For example, a startup acquisition case of a German major IT company ended in failure because the company integrated the startup with itself. However, without integration, buying companies will not be able to realize synergy or apply new technology. There is no right or wrong answer. Companies are required to act appropriately according to the case. Investing in technology companies is all too difficult." (Europe, manufacturing)

[2] Assessment of success and failure of M&A cases

When companies seek M&A with startups, they place great importance on strategic significance, e.g., synergy with existing businesses, as well as the financial aspect concerning investment returns. As M&A with startups entails greater risk than regular M&A and has a higher rate of failure per case, success and failure of startup M&A cases should be assessed in a different way from regular M&A cases.

Some foreign companies which actively invest in startups and participated in our interviews for this survey pointed out the difficulty of assessing failed cases, saying that they were dealing with it in their efforts for business portfolio management or by using non-financial information as KPI.

"We also need to improve our assessment of failed cases. For example, an American major IT company adopted the portfolio management approach in which the company had no qualms about selling businesses that were unsuccessful after acquisition. We are not accustomed to divestiture or dismissal of employees. If an acquisition has turned out to be a failure, we will move on to the next plan. I think it will take some time before our company will introduce the business portfolio management approach." (US, manufacturing)

"We have adopted the business portfolio approach. In each portfolio, we set up the appropriate percentage of startup investment. As the technology life-cycle is very short, not everything succeeds. For this reason, our integration team keeps track of the post-acquisition developments." (US, technology)

"To assess deals, we use the approach of OKR (Objectives and Key Results). OKR consists of four categories: "Technology," "HR," "Business, market, and customer benefit" and "Finance." Some deals fail, so we do not always satisfy these four criteria. If we meet three criteria of "Technology," "HR," and "Business, market, and customer benefit," then financial returns will come our way." (US, technology)

[3] Human resources retention

As we are increasingly seeing the coined word “Acqui-Hiring,” many companies are buying startups with a view to securing fine talent belonging to startups. In general, a startup tends to have a small number of employees and relies on specific people, so if such key people leave, achieving the initial acquisition objective will be quite unlikely. In startup investment with a view to acquiring talent, human resources retention matters more than in regular M&A cases, as corroborated by the following comments by experts who participated in our interview for this survey.

“If a company wants to undertake an acquisition to secure talent, it should set retention of key people as a KPI and make an assessment accordingly. The company must be clear about what it wants to achieve through M&A.” (Europe, expert)

“In the case of acquisition in a new business field, we want the existing management of acquired companies to remain. We prepare a retention package for them and incentivize them to stay positive. Typically, some of the management agree and help us convince others to remain too, but a few will leave anyway.” (US, manufacturing)

2.2.3. How to select target companies

If the objective of M&A is clear enough, requirements for acquisition targets will be clear too. When selecting acquisition targets, foreign companies with abundant experience in M&A put top priority on strategic adaptability and also apply financial criteria. In addition to strategies and financial strength, some companies also value cultural adaptability, as in the following comment by a European company.

"We first assess targets in terms of a strategic fit, technological capability, and culture. A good strategic fit is at the core of M&A, so we put more focus on developing an overall business case than financial planning and assess strategic rationality prior to making a basic agreement with acquisition targets. After strategic assessment, we assess financial value and plans. As we often face a challenge in IT integration, we also investigate what kind of technologies acquisition targets have. In addition, as we have a unique corporate culture, we value cultural assessment." (Europe, service)

With regard to acquisition candidates, foreign companies with abundant experience in M&A constantly analyze markets, forming ideas of ideal M&A targets based on their strategies, updating long lists and short lists accordingly, and waiting for acquisition opportunities. Some people say PE funds are especially closely monitoring their potential investees, as they are expected to be sold in the future.

"We make a point of monitoring three acquisition targets at all times. The key is how to access and build a relationship with them. Through this effort, we will be able to better understand targets." (Asia, manufacturing)

"We make a list of target companies. But as most information we want is unavailable publicly, our job at the M&A department is to monitor whether we can access information of target companies. We also track daily information available in markets, but we obtain most information from investment banks. To obtain information such as when a target will go on sale, we use outside advisers." (Europe, manufacturing)

While companies usually present their acquisition requirements to investment banks or the like and exchange opinions in search of acquisition candidates, some of them, when sourcing investment projects with US Silicon Valley technology startups, actively participate in networking events or share views with their alliances, thereby keeping in touch with potential startups and building relationships in which a negotiated transaction is possible, as in the following comments:

"As we want to fully determine strategic adaptability to acquisition targets, we carry out negotiated transactions more often than auction transactions." (US, service)

"We avoid auction transactions as much as possible, trying to talk with acquisition targets in negotiated transactions by leveraging relationships with them. Negotiated transactions allow more flexibility in deals." (US, technology)

"When selling a business, we usually prefer an auction transaction for a higher price, but in the case of buying a business, we seek a negotiated transaction." (Europe, manufacturing)

While many companies are more generally in favor of negotiated transactions to avoid rising bids in bidding processes, some companies, in pursuit of time efficiency, prefer bidding through disciplined deal processes to negotiated transactions, as follows:

"M&A is not possible unless acquisition targets want to sell themselves. As well, relationship building for negotiated transactions takes too much time." (Europe, healthcare)

"I always seek auction transactions. Our corporate culture values transactions with greater discipline. We know that family business owners prefer negotiated transactions, but we place great importance on discipline in deals, which enables us to focus on important matters and execute transactions in limited time." (Europe, healthcare)

In any case, companies which have done many M&A cases are watching eagerly for opportunities to approach acquisition targets after investigating and analyzing them.

When deciding acquisition targets, some Japanese companies which attended our workshops in Japan select candidates by thoroughly analyzing markets, competition environments, and strengths and brand values of the potential targets, and envision a post-acquisition future. As well, even some Japanese companies with no experience in M&A analyze industry and actually visit potential candidates, thereby creating a shortlist.

"We informed investment banks and the like on industries, deal size, and regions we target. As a result, we now obtain information efficiently but have recently found that just by waiting, we are unlikely to obtain more relevant information. So we have created a longlist and a shortlist and make it a rule to visit around 10 companies including funds when we are overseas on business. We have developed awareness that doing nothing is a risk." (Workshop in Japan)

"In the acquisition we did last year, we obtained technology we would need in future and that technology was owned by the target company only and could not have been bought by waiting. We started keeping an eye on this company when a fund bought it out and we actually worked with the company too. Our top would often visit the fund as well, so we were able to obtain information on the company at an early stage. When the company went on sale, the fund had informed us about the takeover auction beforehand, so we were able to fully prepare ourselves. The unwavering intention of our management for the acquisition throughout was also a key factor." (Workshop in Japan)

"To impress on acquisition targets our interest in acquisition deals with them, we actually perform transactions with them. If they are suppliers, we buy products from them, or if they are retailers or wholesalers, we sell products to them. Without telling them we are interested in a straightforward manner, conversations with our business partners or between the top executives may reveal things we would not otherwise get to know. It is always better to know things before acquisition than after acquisition." (Workshop in Japan)

In the meantime, many companies which attended our workshops in Japan voiced concerns about active information collection for target selection based on their strategies.

"We do not have a clear strategic step to create a longlist or a shortlist in the pre-M&A phase. We tend to leap at deals brought in by others and create stories later." (Workshop in Japan)

"We have a tentative list but have not been able to discuss matters of organic or inorganic growth based on a strategic roadmap with a clear end goal. For the past couple years, we were able to push through our ideas under the pretext of setting up a beachhead for overseas business, as our overseas sales were less than 1%." (Workshop in Japan)

"As it is very difficult to gather information on companies overseas, unlike companies in Japan, we practically have no choice but to rely on deals introduced from the outside." (Workshop in Japan)

Companies should follow examples of foreign companies and Japanese companies discussed above which actively look for acquisition targets by defining the objectives of M&A based on their strategies and then approaching investment banks and engaging in network building on a regular basis accordingly.

Column:
Is M&A in emerging countries difficult?

Apart from developed countries including those in North America and Europe, many companies find emerging countries where high economic growth is expected attractive and view them as M&A target markets when considering cross-border M&A.

As developed countries have stable markets and well-developed investment environments including legal systems compared to emerging countries, they are considered to have lower country risk. In addition, as competitors have already established their presence in developed markets in many cases, a green field investment would face high entry barriers and M&A could be an effective means of market entry in terms of quickening the overseas business development process.

On the other hand, as emerging countries often have investment regulations on M&A itself or by industry in the first place, and many companies have poor governance systems in place, M&A cannot be an effective means of market entry and many companies make green field investments or start from joint ventures with local companies. However, if it is clear how to deal with regulations, M&A could be an effective tool in establishing a presence in local markets quickly.

As there are important points particular to M&A cases in emerging countries, compared to M&A cases in developed countries, and many participants in our workshops held in Japan showed their interest in M&A in emerging countries, the following provides some key points based on opinions from experts:

(1) Legal regulations: Do not apply Japanese common sense.

As legal systems including M&A-related laws in emerging countries are often not on a par with the counterparts in developed countries and Japanese companies could face unexpected challenges if they try to apply the common sense of Japan or other developed countries, it is important to make a levelheaded judgment on what is possible and what is not based on local legal systems. Japanese companies should proceed with consideration while making up for what they lack by understanding local unique systems and practices well and then hiring outside advisers who are well informed about the local circumstances

(2) Business practices: Do not fully rely on a particular information source.

As obtaining market data or the like is difficult in some emerging countries and businesses are often dependent on individual expertise, companies sometimes have to rely on information from particular individuals, when investigating acquisition targets. As the government has a huge influence in an emerging country, these individuals are often people in the plutocracy or leading figures who have connections to the government. However, companies are advised to be aware of the risk of relying on particular individuals. There are actual cases where a company was executing a project by communicating with a local leading figure, when one day, out of the blue, that person was arrested. In emerging countries, it is true that it is sometimes hard to drive a business forward without working with influential people. However, as an alternative way, companies should work on projects by using multiple information sources, for example, people in and outside of the company who are knowledgeable about local business.

(3) Acquisition of Family-owned Business: Building of relations of trust with the business owner is essential

In the case of M&A in emerging countries, acquisition of a family-owned business is relatively common. In fact, many of the participant companies in Asian round-table discussions emphasized the importance of building a relationship of trust with business owners, while many of them have experience in acquisition of family-owned businesses. This is because, in the case of family-owned businesses, the centripetal force of the owner is quite substantial in the company and the company's business itself depends heavily on the owner's abilities and human network. Some people say that they strive to retain the owner within the company as a minor shareholder so that such an owner will continue playing a role in the management to enjoy the results from the growth of the company in the future.

"There is a tendency in Asian countries for many businesses to be family-owned. For business acquisition in Asian countries, I believe that the most important point for successful acquisition of business is how we can have the business owners put trust in the top management in Japan." (Asia, the round-table discussions

held for Japanese representatives)

"The current company was originally established by the president of the local company in 2008. When due diligence was conducted on this company in 2012, the president was directly working for sales and marketing and his wife was in charge of accounting. Until relationships of trust with them were built, they never listened to us. Thus, in order to gain their trust, I tried to spend as much time as possible with them such as having dinner with their family or having a fun time together over the weekends. Unless relationships of trust have been built, any important point will never be discovered." (Asia, the round-table discussions held for Japanese representatives)

"The acquisition target was a family-owned business and the owner was acting like Superman. Every single management decision was made by him no matter how large or small." (Asia, the round-table discussions held for Japanese representatives)

"In the case of acquisition of a family-owned business, they often dare to leave the ownership of the company in the owner's possession. In some countries, the founder of the company is requested to remain in the company as a minor shareholder so that his centripetal force can still be exercised." (Asia, the round-table discussions held for Japanese representatives)

(4) Business Management: A substantial gap with ordinary management level of Japanese companies

In the case of family-owned businesses, etc., there are cases where the profit ratio is superficially high. The fact that administrative costs of such family-owned business are lower than those of usual Japanese companies may be the reason for such a high profit ratio. In such a case, it must be taken into consideration that additional administrative costs are required if, after the acquisition, they manage such a company at the same level as the management of other subsidiaries of their own. The following comments of participants (Japanese resident officers) in round-table discussions held in Asia describe concrete examples of the management level of acquired companies in emerging countries:

"First of all, neither profitability management nor a double-account system existed in the company. Only a cashbook was available for internal management of the company and neither BS nor PL was used by the management. I had no choice but to close the account in such an environment." (Asia, the round-table discussions held for Japanese representatives)

"Even an IT network was not available in the local office, and I started the job from journalizing in excel format. There was no Japanese resident officer, just me dispatched from Japan. There was a local staff taking care of something that looked like accounting, but no one was able to understand the so-called normal settling of accounts or budgets." (Asia, round-table discussions among Japanese resident officers)

"Rather than implementation of such a high level management as "KPI", we, first of all, did not even have a common language as management staff of the company. Such circumstances may not be common in all Southeast Asian countries, but I experienced such circumstances in that particular country. (Asia, the round-table discussions held for Japanese representatives)

"There were many unclear points in the account ledgers. Even a copy machine was not available in the office. The management level was so poor that the payment for purchase of a copy machine was made in cash from the president's pocket." (Asia, the round-table discussions held for Japanese representatives)

As presented in the above, M&A in emerging countries have unforeseen problems due to their immaturities. Before starting to consider M&A, it is important to understand and take into consideration such risks that are different from those in advanced countries.

2.2.4. Business Due Diligence to Check the Adaptability to the Acquirer's Own Strategy

For execution of M&A, it is important to check if such M&A is in line with the acquirer's own growth strategy and to clarify the positioning of the M&A as stated in "2.2.1[A3][Wコ4][i5]. Clear Positioning of M&A in Growth Strategies". To check the adaptability to the acquirer's own strategy, it is required to understand the environment to which the company to be acquired belongs, namely, market, competitive situation, winning style in the industry and KSF (Key Success Factor), etc. Therefore, business due diligence is important to be implemented in order to understand the position of such a company in an objective and impassive manner on the basis of actual facts. Particularly in the case of cross-border M&A, it is more difficult to understand the business to be acquired because of asymmetry of information and language-related issues compared to the cases of domestic M&A. Thus, the risks posed by execution of M&A is considered to be relatively high, and an adequate amount of time is necessary to be allocated to business due diligence.

Overseas companies with rich experience in M&A focus not only on the traditional purpose of due diligence, namely assessment of critical risks to determine whether or not to proceed with the acquisition, but also on business due diligence to check the adaptability to the acquirer's own business strategies. Such an attitude of overseas companies was demonstrated through the interviews, and this represents the fact that those companies put considerable emphasis on the adaptability between their own strategies for growth and M&A. During the course of such interviews, we received the following comments as their concrete opinions:

"The CEO considers that the process of due diligence is so important, and 95% of the time used on the deal should be spent on due diligence. Among various due diligences, business due diligence is considered especially important. Important points to be checked in the course of due diligence are the acquisition target's understanding of the market, business analysis and adaptability to the acquirer's own organization; these points are the target of business due diligence. (Europe, healthcare industry)

"In the event of acquisition of a company in the same business field, we have our own staff of our business division with a deep knowledge of the market and industry be involved in due diligence to understand the business of the acquisition target. Depending on the project, there may be a case where the staff of the business division who participate in due diligence will assume the management responsibility of the acquired company." (USA, manufacturing industry)

Among participants in the domestic workshop, there were comments that they consider business due diligence to be very important.

"Business due diligence is conducted in every case without fail. Business acquisition will not be successful if there is no strategy. Therefore, the acquisition target will be carefully checked including the point if the company meets our strategy and what type of customers they have. If the business field to be acquired is in the manufacturing industry, technical capabilities, etc., are also important factors and will, of course, be carefully checked in the course of due diligence. Business due diligence is conducted at first, thereafter, legal and financial due diligence will be conducted. There was a case where business due diligence concluded that the acquisition would not strengthen the business strategy of our own and, because of that, we declined the deal." (Domestic workshop)

"Although financial, tax-related and legal items are generally the basic items for due diligence, our company puts first priority on business due diligence. Working groups are established respectively for strategies, R&D, IT and, if needed, for operations. Each working group consists of members from the business division as a main player and an outside consultant as needed." (Domestic workshop)

On the other hand, in overseas round-table discussions among foreign top executives of companies that were acquired by Japanese companies, there were such comments as follows. In these cases, insufficient due diligence by the Japanese companies caused insufficient basic understanding of each other on respective businesses and, as a result, such insufficient basic understanding has become an issue at the stage of PMI:

“Due diligence conducted by a Japanese company was focused on financial and legal due diligence but business due diligence was not conducted with adequate human resources and amount of time.” (Europe, round-table discussion among foreign top executives)

“Because of the lack of understanding by the Japanese parent company on the local business, during the course of decision making on an additional investment after the integration, such lack of understanding hindered them from understanding the necessity of the investment.” (USA, round-table discussion among foreign top executives)

“The Japanese parent company sometimes gives the local company a sales target that is extremely difficult to achieve. Profit margin, productivity, growth ratio and business chances of the business are different depending on the business environment and countries (e.g., between advanced countries and emerging countries). The parent company is requested to accurately understand the business environment for each country on a global basis. (Asia, round-table discussion among foreign top executives)

Likewise, there were such comments from the participants in the domestic workshops as follows. Namely, the importance of business due diligence is not always well understood:

“I experienced multiple cases of business acquisition in the past. A condition that I often found in those cases was insufficient business due diligence. The monetary value involved in those acquisitions was not so large and it could be a reason for such insufficient business due diligence. No outside advisor for business due diligence was appointed in many of the cases from a cost-related point of view. I have recognized from such experience that the decision whether an outside advisors should be appointed or not is a difficult question for us.” (Domestic workshop)

Lastly, in the course of actual implementation of due diligence, not only simultaneous responses to multiple tasks but also quick decisions on many points found during due diligence are required. Under such circumstances, the parties concerned tend to prioritize the process-related issues because of the necessity to make the situation well organized. As a result, they may often be caught up in a misunderstanding as if the realization of M&A were the true goal of due diligence. However, the more important the project is for the company, it becomes more important to return to the original point to ask “Why?” Namely, we have to ask ourselves, “Will the company to be acquired be adaptable to our strategy for growth?” and “Will the acquisition contribute to promoting our strategies?” It is very important to keep reminding ourselves about the reason why we implement this particular project and if we have a clear answer to such a question.

2.2.5. Effective Way of Due Diligence

To analyze an enormous quantity of information and to put it in order smartly within a limited amount of time, it is effective to clarify the points to be verified in the course of due diligence beforehand. For example, when any consulting company, law firm or accounting firm is hired for legal or financial due diligence, the points to be verified should be identified beforehand. If an outside advisor is hired for due diligence without preliminary agreement on the points to be verified, the advisor will conduct various analyses to manage every kind of risk. Thus, a report of hundreds of pages will be prepared but the report prepared in such a manner may not always be well focused and is sometimes vague. Many of the participants in domestic round-table discussions expressed their concerns about this point.

"We have tentatively started due diligence without having any concrete idea or consciousness about post-acquisition actions." (Domestic workshop)

"In the case of a project in Southeast Asia, business due diligence was conducted by the in-house staff, while financial, legal and tax-related due diligence were outsourced to experts outside the company. We collected as much information as possible from local accounting offices and law firms. However, we felt it to be a problem that we could not judge the quality of such information until the last moment." (Domestic workshop)

"The results of due diligence were reported by all eight teams and each team took 30 minutes. However, the procedure to submit such reports to a management meeting is troublesome work in many cases. Many people are involved in the process and the negative spiral starts to delay the decision further, though nobody knows the reason for such a situation." (Domestic workshop)

Because of such facts as above, it is important to start due diligence after the points to be verified in due diligence are preliminarily discussed and the priority of risk factors, etc., that must be clarified during due diligence are identified. Some comments given during the interviews this time are presented below. These comments seem to be useful to conduct due diligence effectively:

"Before the start of due diligence, we always conduct preliminary due diligence regarding the business to be acquired. Preliminary due diligence includes the industry analysis of the target business and development of the financial model of the business plan, as well as assessment of human resources and technology in a simplified manner for determination at an early stage." (U.S.A., technology-related industry)

"We make it a point to accept the fact that due diligence can never be perfect. Because it can be corrected after the acquisition." (U.S.A., technology-related industry)

"Due diligence usually takes eight weeks. We spend the first four weeks only for internal discussions on any potential factors that may force us to abandon this deal." (U.S.A., technology-related industry)

"There are some areas where we must not make an erroneous decision. They are areas for compliance, employees and the environment, etc. We spend a lot of time on these areas because any erroneous decision in these areas may result in damaging the brand value." (U.S.A., manufacturing industry)

"An assessment shall be made in terms of both risks and value and they shall be quantified. Then the CEO will make a decision whether risks are affordable or not from comprehensive viewpoints." (U.S.A., manufacturing industry)

"For effective use of time, we put the focus of agendas to be discussed during due diligence on cross-divisional issues that exert an influence on other divisions and on issues that may be a deal killer." (Asia, manufacturing industry)

During overseas round-table discussions, Japanese resident officers of Japanese companies commented that the parent company would not acquire any company until all issues identified in the course of due diligence had been cleared and would insist on the complete solution of all such issues. Because of such an attitude of the parent company, once due diligence is started, the complete solution of any and all issues becomes imperative, though such complete solution is not practically possible. In some cases, it seems that Japanese companies set the goal of due diligence as the minimization of risks. However, the true purpose of due diligence should be to continuously recognize and acknowledge the purpose of M&A and to compare the amount of value and risks derived therefrom in a quantified manner to facilitate the decision making. It would be safe to say that on one would be able to proceed with any discussion making if they are concerned about every single issue found in the course of due diligence.

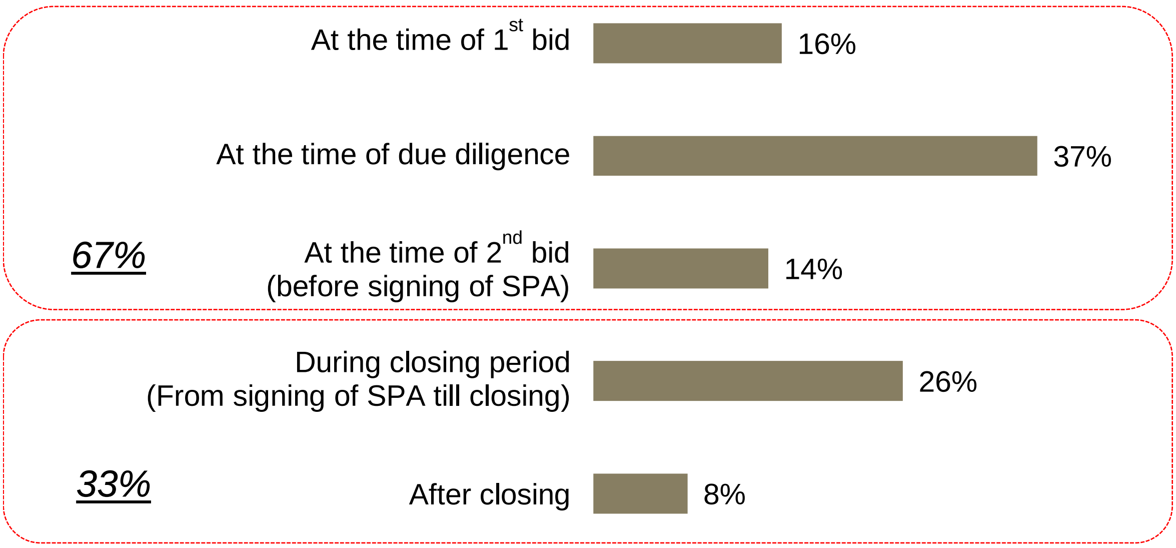
2.2.6. *Early Development of Plan for Post-acquisition Management System*

It is one of the features of overseas companies with rich experience that they conduct due diligence aiming for establishment of a management system that works immediately after Day 1 for post-acquisition business management and value increase of the acquired company.

(1) Actions taken for PMI from an Early Stage

When the M&A deal is completed and closed, the operation under the new shareholders will immediately start from Day 1. Therefore, it is necessary to make preparations, in which the post-acquisition management system is duly taken into consideration, before the closing of the deal. According to the result of a questionnaire survey conducted on the participant companies in the domestic workshop, Japanese companies start preparation for PMI at the timing shown below. In response to our question about the time when they started preparation for PMI, approximately 67% of the participant companies answered that they started preparation before SPA (Stock Purchase Agreement) was concluded. Thus, the importance of the preparation for PMI seems to have been understood and acknowledged and necessary actions seem to have been taken by many companies.

<Figure 8> When was the PMI effort started toward integration (Day 1)?



Source: Summary of answers to preliminary questionnaire in domestic workshop (refer to the footnote regarding individual comments on the items of the said questionnaire)[4]

On the other hand, among participant companies in overseas round-table discussions and domestic sorkshops, there were also some concerns about the early start of preparation for PMI as mentioned below:

"It is desirable that PMI will start as early as the stage of pre-acquisition, but Japanese companies did not do so. Unless they have a well-prepared plan for PMI, they should not go ahead with M&A." (Asia, round-table discussion among foreign top executives)

4 As an individual comment on the said questionnaire items, many participant companies mentioned "governance and structuring of organizational system". Such a comment represents the fact that a preliminary study on the management system was considered important. In addition, some minor comments were also given by some participant companies such as planning of synergy effects, setting up of a merger committee and system integration planning.

"I knew from books and lectures that due diligence shall cover PMI planning all the way through. However, I have no idea how such due diligence can be structured successfully or how continuity can be kept through the stage of PMI." (Domestic workshop)

"As for PMI, I learnt that preparation for PMI shall start as early as due diligence as a preliminary PMI. However, after all, we could make no preparation till the closing of the deal because we could not agree on various conditions." (Domestic workshop)

Through interviews with overseas companies with rich experience in M&A, we learnt that, in most cases with very few exceptions, they carefully make "preparations taking into account post-M&A management" during the implementation phase of the deal before signing an agreement.

"Members of an integration team will be appointed at the time when the deal is finalized right before the signing. The team consists of talented members such as persons who have been involved since the due diligence process or a person who has been working as the leader of a subcommittee." (U.S.A., manufacturing industry)

"We started development of the integration plan before the Stock Purchase Agreement was signed. At the end of the plan development, more desirable situations for the future are drawn up and detailed design such as divisional goals for the integration are also planned. Soon after the agreement is signed, this future vision is shared by all the top executives of the acquired company." (U.S.A., service industry)

"The PMI team has been involved from the due diligence phase. The integration team includes a team of experts who work exclusively for change management. This team develops a concept of communication between the two companies and supports the top executives to materialize "the change" that we are seeking, and has been working for the preparation of such concepts and plans since the early stage of the deal." (Europe, manufacturing industry)

"At the stage before signing, a high level post-acquisition integration plan will be developed" (U.S.A., technology-related industry)

"We consider that separation and integration that occur in the course of M&A create the Real Value. Therefore, we have a dedicated team for separation and integration, and the team will be involved from the early stage of deals of either acquisition or sell-off. The involvement in PMI is a perfect job for the team." (Europe, healthcare industry)

We also received the following opinions regarding PMI-related issues from a foreign-affiliated PE fund:

"The problems that Japanese companies are facing are not shortcomings in so-called legal and financial due diligence. But Japanese companies do not seem to have accumulated adequate know-how on issues such as how business operation can be managed, how competent the management staff of the acquired company are, how to evaluate them and how actual replacement of such personnel can be implemented." (Foreign-affiliated PE fund)

"Due diligence is not required simply for legal and accounting purposes but detailed due diligence is required to be conducted with PMI taken into account." (Foreign-affiliated PE fund)

In the meantime, we have also found that some companies develop a general concept of PMI before they start due diligence. If such concepts exist beforehand, it helps the efficient progress of due diligence by giving a guideline based on such concepts towards successful implementation of PMI. This can be considered as an example of the case where PMI was always kept in mind during the course of the deal. The concrete comments on this case are as follows:

"Based on our past successful and unsuccessful experiences in M&A, before any concrete action for due diligence is taken, we study the early stage draft of post-acquisition integration policy, in addition to examination of the adaptability of the acquired company with our strategy, assessment of compliance-related primary risk and structuring of project promotion system including appointment of advisors. Thereafter, we report to our top executives." (Europe, manufacturing industry)

(2) Culture Assessment

As mentioned in "3.1.1. Global Management Capabilities (3) Adaptability to different corporate culture", many overseas companies that have rich experience in M&A conduct culture assessment during the stage of due diligence to understand the culture of the acquisition target. This is probably because many of such experienced overseas companies know from their past experience that, in relation to the implementation of management integration at the stage of PMI, they will face unexpected obstacles in the course of actual implementation of PMI, unless an integration policy, in which the culture gap between their company and the acquisition target is duly taken into consideration, is developed. On the other hand, while some participant companies in the domestic workshop pointed out the importance of corporate culture, there was no company that had made any such efforts to understand the culture of the acquisition target at the stage of due diligence. In this relation, the efforts made by overseas companies with rich experience in M&A are useful reference for Japanese companies.

(3) Development of Measures to Generate Synergy

A synergy effect means, in the case of an M&A deal, creation of new value through integration of management resources that the acquirer and acquired company have respectively. In the cases of M&A in recent years, the importance of a synergy effect seems to have been widely understood. However, judging from the comments of participant companies in the domestic workshop, it indicates that many Japanese companies have difficulties in realizing a synergy effect. One of the reasons for such a situation is because synergy is conceptual in many cases and it is difficult to find a concrete and achievable synergy.

However, as mentioned in "3.2.1 Clear Positioning of M&A in Growth Strategies", the purpose of M&A is to achieve the growth of the acquirer. Therefore, it is the key how a new value can be created after the acquisition through integration of the respective strength of the acquirer and acquired companies. Realization of a synergy effect is an indispensable factor to make the value of the acquired company higher than the value under the previous management. Thus, before a decision for acquisition is made, it is quite important to examine and study the synergy carefully and to develop an achievable strategy for post-acquisition operation.

[1] Difficulties in Development of Synergy-related Strategy

In relation to development of synergy-related strategies, first of all, it is difficult in many cases to identify the area where the potential synergy exists. Various reasons for such a situation can be considered, but some examples are as follows:

- Even if synergy analysis is conducted in the course of due diligence, under actual circumstances, only a limited amount of information and a limited amount of time are available for such analyses (especially, the potentiality of synergy is difficult to be quantified)
- If business due diligence, etc., are not properly conducted during due diligence, it will result in insufficient understanding about the business of the acquired company. Then the development of a synergy plan becomes difficult.
- In order for the division or persons in charge of M&A to conduct synergy analysis, sufficient coordination with the business division that performs actual business activities is required for the evaluation of the synergy effect. However, in some companies, there was a case where such coordination was not smoothly performed.
- Many cross-border M&A are targeted at acquisition of new businesses or markets. Therefore, the potential of a realistic synergy effect is limited.

As a matter of fact, some participant companies in the domestic workshop also commented that planning of a synergy strategy was not easy.

"At the planning stage of acquisition of business that has a complementary relationship with the acquirer's own products, it was easy to say that the acquisition would generate synergy. But it does not happen in reality. Although we thoroughly know our own products, we do not have much knowledge about the products of others, of which marketing and selling styles are also different. We expected at the time of the planning stage that we would be able to materialize a synergy effect soon, but things did not always go right" (Domestic workshop)

"In our projection, no synergy could have been quantified. Because synergy was not clearly defined, it could not be even measured. I know that's how we can develop the method to quantify any synergy and how to realize such a synergy will be the problem" (Domestic workshop)

As above, it seems that there are various challenges in the planning of synergy strategy. In addition, synergy itself is often quite vague and may easily become a factor to raise the acquisition price. Because of such facts, some Japanese resident officers of participant companies in overseas round-table discussions expressed such comments that they basically do not believe in synergy or that they would execute an acquisition without taking synergy into consideration.

"I have no belief in synergy. Every company has an unavoidable limitation in its competence and the purpose of M&A is to supplement such limited competence." (Europe, the round-table discussions held for Japanese representatives)

"M&A provided us with a new business. Rather than reflecting any synergy effect in the acquisition price, we only take into account how much time and money we will have to spend if we start the acquired business from scratch." (Europe, the round-table discussions held for Japanese representatives)

[2] Case Examples of Synergy Assessment by Overseas Companies with Rich Experience in M&A

Interviews with overseas companies with rich experience in M&A indicated that, before making any decision on acquisition, those experienced companies thoroughly examine and investigate the potential of synergy to determine with clear eyes whether new value creation is achievable or not through a post-acquisition synergy strategy. When they decide to proceed with the acquisition, they develop a synergy strategy and quantify the benefit thereof. In addition, they also discuss the responsibilities and systems in relation to the implementation of a synergy strategy in advance. Namely, they pay attention from an early stage to the planning of a synergy strategy taking into account the implementation thereof during the PMI phase.

"The leadership of synergy assessment will be taken by the M&A team. They will decide how the synergy will be measured during the due diligence period and define how the responsibility will be taken. The business division will be responsible for identification of synergy. The M&A team monitors the topline synergy. After the closing of the deal, a workshop will be organized among the people including those from the acquired company. Then both parties will discuss the synergy and substantiation thereof in the workshop." (Europe, manufacturing industry)

"In the course of processing the deal, three to five value driver items will be identified. Before signing the deal, those items are quantified and an action plan for each value driver will be developed. Thereafter, the allocation of responsibility for each value driver-related goal and achievement of tasks will be decided and shared among the parties concerned, and then the Integrated Task Plan will be prepared according to the order of priority." (U.S.A., healthcare industry)

"We have eight to nine functionally divided subcommittees for due diligence and integration. With regard to synergy effects, those subcommittees are responsible to identify each area utilizing their expertise therein. After the deal has been closed, the purchased company shall take responsibility for synergy management." (Asia, manufacturing industry)

In the meantime, there are also Japanese companies that effectively take the synergy effect into consideration from the stage of due diligence. The following were comments of Japanese resident officers of such companies during overseas round-table discussions:

"Based on a clear understanding on who the key top executives are, three to four sessions of business due diligence were held after the LOI was signed in addition to usual due diligence. The business situations as well as the synergy potential were discussed among 60 to 70 persons from both parties, including those from divisions of sales, R&D and manufacturing in addition to all corporate staff. The discussion continued for three months from LOI to DA to discuss every possibility so that every effort for synergy can start from Day 1." (U.S.A., the round-table discussions held for Japanese representatives)

In consideration of the approaches taken by overseas companies with rich experience in M&A, it seems that the point to which Japanese companies should pay special attention in terms of synergy-related issues is an organization-related issue. Namely, it seems that an appropriate and responsible person is not involved in the synergy-related issues in a timely and well-organized manner. The order of priority in responsibility for quantified results[A6] is different between Western global companies and Japanese companies. Ambiguous responsibility, which is typical in Japanese companies, may have resulted in insufficient discussion on synergy issues. Therefore, when a synergy effect is reflected in the acquisition price, a person who is responsible for PMI should be involved in the course of synergy evaluation. And any synergy that is baseless or has not been examined precisely should not be reflected in the acquisition price. Concerning early involvement of a person who is responsible for PMI, please also refer to "3.2.7. (1) Clarification on Responsible Person for and Division in Charge of Post-acquisition Business Operation and Early Involvement of such Persons and Divisions", where comments and opinions of overseas companies with rich experience in M&A and participant companies in domestic workshops, etc., are presented.

As described in the above, it is important to examine the synergy in advance. However, how far the synergy effect shall be reflected in the acquisition price at the stage of actual price negotiation is a different issue. If synergy is evaluated and reflected too high, it may result in a too expensive purchase. Especially, if acquisition is a given fact and uncertain synergies of which realization is doubtful are counted for no reason but only to disguise the acquisition price as a justifiable one, such an approach will never lead to successful M&A and should be avoided.

Having said that, however, if the acquisition price does not reflect any synergy, it may not create an incentive to motivate the acquisition target to sell the said business. Therefore, how far the synergy shall be evaluated and reflected in the acquisition price is a difficult issue and shall be addressed very carefully.

[3] Topline Synergy and Cost Synergy

Synergy can be broadly classified into topline synergy that influences the top line (i.e., sales amount) and cost synergy that relates to costs (expense). Generally, topline synergy contributes to sales increase through cross-selling (sales of respective products of acquirer and acquired companies to respective customers), etc. However, it is often influenced by customer needs, market trends and competitive environment, etc., which are dependent on external conditions in practice. Therefore, the possibility for realization of topline synergies is vulnerable compared with that of cost synergy. Cost synergy contributes to cost reduction in both acquirer and acquired company by way of efficiency improvement of overlapping work and joint procurement, etc., through integration of procurement services. Cost synergy has much more chance to be achieved compared with topline synergy because, in many cases, cost synergy consists of elements that are dependent on the efforts by acquirer and acquired companies. Also, cost synergy is often considered as a quickly achievable (Quick Win) target.

What we learnt through interviews with overseas companies with rich experience in M&A is that they always make concrete strategies for synergy through in-depth investigation and understanding on the nature of topline synergy and cost synergy, respectively. For example, one healthcare company in Europe commented as follows:

"Cost synergy from expansion of scale is easy to create. "Sales is vanity and profit is healthy." A robust cost base [A7]*of the acquisition target is prepared at first, and reduced costs therefrom are used for future investment. An acquisition proposal submitted to the CEO describes a detailed synergy plan of each cost code including benchmarks for the industry." (Europe, healthcare industry)*

As shown in the above, the strategies for cost synergy, which is relatively easy to be addressed, are carefully discussed at the stage of due diligence. Also, in the case of a company from the service industry in the U.S., it commented as follows:

"We pursue topline synergy that has the greatest impact among synergies. Its high challenging level makes the planning and measurement thereof more important. Generally, when a sales increase plan is developed, the plan focuses on successful cross-selling in most cases. On the other hand, in the case of cost synergy, it can be measured and achieved more easily. In the case of one company that we acquired in the past, we discussed how we could adopt the business model of the acquired company to provide better services under a more efficient mechanism." (U.S.A., service industry)

Thus, they discuss synergy strategies based on investigations on the feasibility of both topline synergy and cost synergy.

In the meantime, for the development of a synergy strategy in cross-border M&A, attention should be paid to the fact that cost synergy is not always simply easy to realize and topline synergy is not always difficult, as described in the above. In case of domestic M&A, the acquisition target is doing their business in the same country or area as that of the acquirer's business, and cost synergy becomes easier to be realized through integration of functions, etc. But in the case of cross-border M&A, it means an expansion of business to an area with which the acquirer is unfamiliar. Therefore, the cost synergy is prone to become less easy to be realized also from the geographical point of view. On the other hand, however, there are fields, where the purchasing power as a group can be utilized, such as the field of procurement and/or IT-related infrastructures. Therefore, with regard to cost synergy, field-specific investigations should be made carefully.

(4) Investigation on human resources of the acquisition target

With regard to the management of the acquired company, it is quite an important issue for the acquirer, as a shareholder, from Day 1 and onward, to consider to whom the management responsibility of the company should be assigned. In this relation, when a post-M&A management system is discussed and structured during due diligence, key persons of the acquisition target are necessary to be identified. In the case of overseas companies with rich experience in M&A or a foreign affiliated PE fund, they consider the identification of such key personnel in the acquisition target to be very important. Therefore, they determine the framework of the team that implements the operation of the acquired company from Day 1 onward as early as during due diligence. Some comments received during the interviews are presented below:

"The important thing is "Human Resources" after all. "Human resources-related decision" is a point to be focused on in the course of due diligence. At the time of due diligence, personnel subject to screening shall be classified into "yellow, green and red" or the like to be evaluated and alternative staffing plans for each classified assignment shall also be discussed. Thus, the transfer plan of personnel can be decided as early as immediately after the acquisition or even at the stage of signing of the deal. It is common sense among overseas companies that the lineup of senior management will be changed when the shareholders are changed. Therefore, if there is no change for months after the acquisition, Japanese companies may be misunderstood to be an easy organization. Just like legal and financial due diligence, human resources due diligence should also be conducted without any hesitation." (Foreign affiliated PE fund)

"If he/she is an owner/executive of the acquired company and has the ability for reasonable discussion, such a person shall be retained by all means. If the management is not capable of sharing the same value, such a person shall be changed in a manner that would not make him/her lose face." (Foreign affiliated PE fund)

The above-mentioned foreign affiliated PE funds make a strict distinction between administration and execution of management. Because they adopt the style to leave the execution of management to the acquired company, they make decisions on human resources-related affairs of the acquired company with a stoic and rational attitude. In this regard, the following are comments from overseas companies with rich experience in M&A:

"In the course of due diligence, employees of the acquisition target are interviewed. This is because the human resources of the acquisition target is one of their important assets. The details of their employment agreement are also checked." (U.S.A., technology-related industry)

"In the course of human resources due diligence, personnel necessary for value creation are identified, and a retention package for such core personnel will be prepared." (Asia, manufacturing industry)

"In the course of the deal, an interview session with human resources of the acquisition target will be held. Human resources-related factors have become very important so as not to lose the know-how of the acquisition target." (Europe, manufacturing industry)

"Human resources are screened in the course of due diligence. Top management of the business unit has actually interviewed with key management personnel for the screening." (Europe, knowledgeable person)

As commented on in the above, they make investigation and determination on human resources through human resource due diligence, etc.

It has also been recognized by Japanese companies that investigation and determination on human resources including the top executives of the acquisition target are very important in terms of post-acquisition management. For example, one company that participated in the domestic workshop commented, "The personnel, who will be involved in the management of the acquisition target from Day 1, attends the management presentation made during due diligence, so that the quality of key personnel of the acquisition target can be accurately understood from an early stage of the acquisition." On the other hand, there were comments that indicate difficulties in understanding the capability of key personnel and existence of such comments represent the fact that there is still a substantial number of companies that consider such investigation and determination to be a difficult task. By the way, the following comments refer to the case of acquisition of a startup by one company that participated in round-table discussions in Europe:

"Because the main target of the acquisition was not the product but rather "human resources" of the company, executive staff of every office in European countries were retained. But this resulted in the creation of an unproductive situation due to functional duplication among those countries." (Europe, the round-table discussions held for Japanese representatives)

There were also comments that indicate the difficulties in retention of human resources.

2.2.7. Visualization of Purchased Company through Monitoring

One of the PMI-related issues raised by many of the persons in charge of M&A from a Japanese company that participated in domestic workshops is how the post-acquisition monitoring of purchased companies should be implemented. Post-acquisition monitoring of purchased companies is indispensable to check if the synergy effect that was expected at the beginning of the acquisition has been realized as planned, and to check periodically if the profit target is achieved. If such a plan or target is not achieved, the monitoring will also facilitate an investigation of the reasons for such unsuccessful results and to find possible countermeasures for such unsuccessful situation. To ensure the monitoring of the purchased company, two major actions were taken as follows by the overseas companies with rich experience in M&A with whom interviews were conducted this time:

(1) Clarification on Responsible Person for and Divisions in Charge of Post-acquisition Business Operation and Early Involvement of such Persons and Divisions

It is not very rare that M&A are taken care of by the planning division of the headquarters and, as soon as the M&A is completed, the responsibility for post-acquisition PMI is transferred to the business operation division. In this relation, however, there were some comments in domestic workshops that, if the responsibility for the management of the deal is transferred from the planning division to the business operation division, it makes the responsibilities unclear regarding achievement of the synergy effect and the business plan, which were originally discussed at the time of execution of the acquisition. This means such a situation that, even if the synergy effect could not be realized eventually, nobody would be questioned about the responsibility. Such cases where monitoring was implemented just for formality reasons have actually been occurring. In addition, if any personnel who was not involved in development of an acquisition plan is assigned to a position in charge of post-acquisition integration, it may pose a risk for such personnel to lose a sense of ownership over the complete integration of the said project.

"As for the monitoring of any business acquired in the past, it was implemented to some extent at the beginning but has eventually been left to the choice of the business operation division." (Domestic workshop)

"The business operation division may have a feeling that all their tasks have been completed as soon as acquisition was completed or the business was purchased. Unless they are able to demonstrate the fact that the monitoring is properly implemented, the same old pattern will be repeated. It is not a question whether the target has been achieved or not, but it is important to confirm that the monitoring has been implemented in a proper manner." (Domestic workshop)

"The business operation division has all authority with regard to their project but has no obligation to pursue a synergy effect. Unless this point is tackled, the situation will never change." (Domestic workshop)

"We sometimes see such cases where the planning division executes the acquisition and quickly passes it onto the business operation division for post-acquisition PMI. However, it is difficult to define the appropriate manner of the transfer of the acquired business from the planning division to the business operation division." (Domestic workshop)

"I feel the wall of the business operation division is very high, though it should be addressed in a cross-sectional manner on a company-wide basis. There were cases where the business operation division was reluctant to be involved from their standpoint, because it was not their own project planned by themselves originally. We acknowledge that coordination between the headquarters and the business operation division is our own challenge." (Domestic workshop)

"Monitoring of synergy has not been implemented properly. There is a substantial gap between the plan for the synergy effect developed at the time when the acquisition was planned and the same prepared in the course of the PMI promotion phase." (Domestic workshop)

"It ends up in an argument about responsibility including the point whether the local office should be responsible for unsuccessful achievement of the synergy plan." (Asia, the round-table discussions held for Japanese representatives)

"As persons in charge of business management are changed, the monitoring becomes only for the sake of formality and loses its original purpose. The situation may have become so bad that no problem can ever be predicted but can be found after the occurrence." (Domestic workshop)

It was observed among overseas companies with rich experience in M&A that, for the purpose to instill a sense of responsibility for the business to be acquired even before the closing of the deal, they proactively had a responsible person of the division in charge of the post-acquisition operation be involved in the deal from an early stage of the acquisition. In this way, it makes the person in charge feel easier to be involved in the acquisition process with "a sense of ownership" from the planning stage to the stage of integration work. As one of the common cases of failure, there can be a case where too large synergy potential is reflected in the business plan with anticipation for a highly competitive auction price level. If it is clear at the stage of due diligence that the person who makes the plan for the acquisition will also assume responsibility for the operation of the acquired business, it will certainly help the person in charge behave more properly in the course of determination of the business plan and acquisition price.

"Once a responsible person for integration has been appointed, we make it a point to have such a person be involved in the process of due diligence as a responsible person for the post-acquisition operation. On the other hand, however, in a case where the execution of acquisition has not been finally decided, it is too early to announce the appointment of a responsible person for the integration. Namely, the official appointment will be announced at the time of signing of the acquisition agreement while also taking into account the day-to-day affairs. When we set up a team for integration, we focus on securing competent personnel." (U.S.A., manufacturing industry)

"We have a talent pool specialized for integration and sell-off of business. They work only for integration and sell-off of business. Typical issues to be addressed in the course of integration and sell-off of business are related to IT, finance, human resources, manufacturing and suppliers. Once the decision has been made on sell-off or acquisition of a company, we always have the person in charge be involved in the project from an early stage." (Europe, healthcare industry)

"We, the M&A team, develop a concept for integration to make a proposal for the integration process including the schedule thereof. Investigation on synergy is led by the M&A team. The team makes a decision in the course of due diligence on the method to measure the synergy and appoints the person who assumes the responsibility for realization of the synergy. However, identification of synergy items is taken care of by the business operation division. The M&A team monitors the topline synergy but the responsibility for realization thereof is taken by the business operation division. (Europe, manufacturing industry) (Repeated comment)

It is safe to say that the first step in building a monitoring system is to have the business operation division, which is responsible for post-acquisition operation, be involved in the planning (budgeting) of the business to be monitored from the stage prior to signing of an acquisition agreement in anticipation of the issues during PMI. Although both corporate divisions (including the department specialized for M&A) and divisions for business operation are equally involved in PMI-related affairs, it is important to clearly define and expressly agree on the roles and responsibilities of respective divisions.

(2) Establishment of Monitoring Process

In relation to monitoring of the acquired company, it is indispensable to establish a system that has a mechanism to collect accurate and timely information on earning conditions of the said company through the effective utilization of reports and meetings. In the event of delay in data/information collection or low accuracy in profit control, it potentially causes a situation where no practical measures can be taken in a timely manner and problems are left unaddressed. During the domestic workshop, some participants commented that they were able to understand the importance of monitoring but still had difficulties in setting up a structure that would function successfully.

"It is ideal that KPI is appropriately set and a monitoring system is set up together with an administrative accounting structure. But the reality always differs from the ideal situations."(Domestic workshop)

"We consider that common system architecture is important to materialize the visualization. It is desirable to promote thorough visualization, which is not realized yet. Therefore, with regard to the financing-related functions, etc., Japanese staff are dispatched to assume the role to make a report on numerical aspects to the company's resident officers in local offices." (Domestic workshop)

"Unless a common system architecture is established, measurement and follow-up of a synergy effect seem to be difficult. Monitoring may not be feasible without an integrated IT system such as SAP. In view of the importance of visualization of the acquired company, it is a big challenge for Japanese companies." (Domestic workshop)

Among the overseas companies with rich experience in M&A with whom interviews were conducted this time, there were a substantial number of companies that had established rules and/or structures for post-acquisition monitoring in a quantitative manner of the synergy and business plan that were investigated or developed at the time of acquisition. In Western countries, they have relatively strong consciousness about corporate governance and thoroughly implement management of segment-specific business earnings. One of the factors for their attitude would be because they have well-established structures and rules for quantitative measurement of achieving profit targets established at the time of acquisition, aiming for the fulfillment of accountability to shareholders.

"We have an official annual process for the review of the growth strategy of each business. We make a comparison between the return we gained from the acquisition and the capital cost of the acquired company. As far as the return exceeds the capital cost, it means we are successful in value creation. This is our way to assess the success." (U.S.A. affiliated, manufacturing industry) (Repeated comment)

"We monitor the synergy and the business plan. For continuous monitoring, reports are also made one year, three years and five years after the acquisition, which also works as a continuous learning process. Cost synergy in administrative functions can be achieved in one year; on the other hand, topline synergy requires time until realization. We are trying to make an assessment of respective synergies in terms of financial impact." (Europe, manufacturing industry)

"We conduct assessment and measurement of the deal in terms of both financial and strategic aspects by using score cards, which will be reported to the top management. In our cases, the deal is aimed not for the cost synergy but for the growth synergy. The achievement level of synergy is followed up based on KPI to review the performance of the deal." (Europe, manufacturing industry)

"We consider the monitoring of the deal to be important. This is because the monitoring of the deal will provide the deal committee or those responsible persons who actually made decisions with feedback, so that such persons are able to make even better decisions in the future. The points that have been noted during monitoring are reflected in the playbook of the M&A process, as needed." (U.S.A., healthcare industry)

As mentioned in the above, it is important for every company to establish a structure, system and infrastructure for monitoring the integration effects after executionof M&A in a periodical and quantitative manner. Under the circumstances where the importance of corporate governance is strongly reminded, there are many points that Japanese companies have to learn from the past case examples overseas from the viewpoint of obligatory requirement of publicly listed companies.

2.2.8. Ingenuity in Reporting to Parent Company

Also among Japanese companies, as a part of management of affiliated companies, it is usual that administrative divisions of acquired companies are required to make a report on a regular basis. Especially in the case where the sales amount of the acquired company is ranked in the top 2/3 or so of the composition ratio to the consolidated sales amount, overseas subsidiaries will also be subject to an assessment of the business operation process level under J-SOX. Then, it results in an increase of the number of issues to be addressed in relation to internal control of the acquired company. In case of cross-border M&A, the acquisition target is often an unlisted company or a medium-sized company and the administrative accounting of such a company has often been processed on a different level. Thus, the local staff of the acquired company may often raise an objection in relation to the reporting to the headquarters in Japan. Concerning reporting to the parent company, among others, "Volume and Granularity of Information" and "Budget and Human Resource for Establishing Reporting System" are the two major challenges.

(1) Volume and Granularity of Information

Japanese companies tend to require every single piece of information to be reported to the headquarters, and this causes frustrations for local management staff and persons in charge. As a matter of fact, the acquired company's staff in charge cannot respond to such a requirement, and Japanese resident officers dispatched from Japan may sometimes have no choice but to do that occasionally. Actually, in this relation, Japanese resident officers dispatched to the purchased company in Europe from Japan and the Japanese company's person in charge who participated in the domestic workshop commented as follows:

"The volume of KPI is huge. But local companies have local KPI. Because we are a company in the service industry, it is more important to build a consensus with the acquired company to think about the future strategy rather than the past results. The acquired company did not manage the company in anticipation of the future growth. To have those staff be accustomed to our business style, we have tried to set up a reporting system through constant communication with each other. The eyeline level of monitoring has been adjusted to the level of local staff." (Europe, the round-table discussions held for Japanese representatives)

"Requirements from the parent company in Japan are taken care of by Japanese resident officers. While the most popular requirement by the parent company is a request for various data, they never explain the reason why they need them. I am wondering if utilization of RPA (Robotics Process Automation) may improve the situation." (Europe, knowledgeable person)

"The acquired company has a complaint about the fact that the level of control of subsidiaries by Japanese companies is too precise, and Japanese resident officers are forced to absorb their frustrations. In the case of our company, we sometimes receive different instructions on a single issue depending on the dispatching divisions. For unreasonable or impossible requests, we told the headquarters that they were unreasonable or impossible, and we lowered our response level to answer only those which were really needed." (Domestic workshop)

"Even after the acquisition has been completed, the level of reporting required by the parent company is unreasonably precise. In addition, the parent company in Japan is not able to answer the question about the reasons why they want such details." (Europe, the round-table discussions held for Japanese representatives)

"In the case of our company, we regularly review the reason why we need such a management style. We always explain with reasons the necessity of Japanese staff as a coordinator." (Domestic workshop)

On the other hand, there was a comment from local top executives of an overseas company acquired by a Japanese company with rich experience in cross-border M&A as follows. In this case, they started with reporting of minimum contents and enriched the report step by step:

"At the beginning, the requirement for reporting was limited to a few items, and the items were increased step by step. I think it was a good approach." (Asia, round-table discussion among foreign top executives)

Especially in the case of emerging countries, there are such companies that have no experience even in profitability management or do not even have BS/PL. Therefore, it is important to understand the actual situation of the acquired company, to carefully select really required information and to provide the acquired company with necessary support to facilitate their reporting in an appropriate manner.

"First of all, the company was not doing profitability management and did not even have a double-account system. Only a cashbook was available for internal management of the company and neither BS nor PL was used by the management. I had no choice but to close the account in such an environment. The job of the Japanese resident officer was to work with the headquarters to fill the gap. However, there was no support at all from the headquarters. In the local office, even an IT Network was not available and I started the job from journalizing in excel format. There was no other resident officer dispatched from Japan but me. There was a local staff taking care of something that looked like accounting, but no one was able to understand the so-called normal settling of accounts or budgets. No local staff was able to speak English and communication was limited to body language. Rather than implementation of high level management such as governance and KPI, we, first of all, did not even have a common language as the management staff of the company." (Asia, the round-table discussions held for Japanese representatives) (Repeated comment)

When the reporting system of the parent company is adopted by the purchased company, it is important first of all to tell clearly the reason why such reporting is required and to explain the background and reason for such a requirement. Such an explanation needs to be an understandable one to the people of the purchased company. It must be understood and noted that, unlike the case where both parties are Japanese, they do not have any business practices like implicit knowledge or sensing the atmosphere. In consideration of the management ability of the acquired company, it will be necessary to show certain ingenuity such as to start with limited numbers of items to be reported and to enrich the report step by step.

(2) Budget and Human Resource for Establishing Reporting System

Even if the location of the acquired company is in advanced countries, unlike the case of Japanese companies, there are cases where local staff do not passively follow the instructions from the parent company but demand additional budget and human resources for the increased man-hours. Especially in the case where compliance with J-SOX is required, it should be noted that it results in an occurrence of temporary expenses.

"The requirement for the reporting creates a need for additional expense. After the acquisition, it is our duty to submit a report to the parent company every month, and it never ends. We are required to cover the cost of reporting by the value generated from synergy." (Europe, round-table discussion among foreign top executives)

"I have been in charge of J-SOX-related reporting. Although we are just a small-scale company, we are required to comply with J-SOX because we are classified as an important subsidiary. J-SOX has a lot of requirements and requires us to employ a few additional staff just to fulfill such requirements. Writing down all procedures, rules and code of conduct is quite a bit of work. It is a heavy burden for such a small company like us and causes difficulties in our performance of day-to-day affairs." (Europe, round-table discussion among foreign top executives)

"Although it is obvious that J-SOX has a substantial cost impact including the advisor's fee, the parent company keeps asking us "the reason why the profit target has not been achieved"." (Europe, round-table discussion among foreign top executives)

Although it depends on countries, overseas companies usually have a job description that specifies job assignments of respective divisions or persons. In the event of any additional job that is not specified in the job description, negotiations for salary adjustment or employment of additional staff may be required in some cases because of the change in the scope of work. Some participants in round-table discussions held in the course of this survey mentioned some examples of difficult cases which were caused by such differences in working practice. In addition, in Germany, some people mentioned their concern about the government's requirement for an application for overtime work. They say that such a requirement for application creates difficulties in responding to additional job requirements through overtime work.

“Everything in the U.S.A. works based on the job description. We have a clear job description and all decisions are made according to the scope described therein. Although the scope of work may also relate to pay reviews, it is always important to respond based on a clearly specified job description.” (U.S.A., the round-table discussions held for Japanese representatives)

“We (Germans) are not allowed to work overtime even for just two or three hours. To work longer than ten hours a day, we have to get special approval. Japanese top executives are requested to understand the German laws and regulations.” (Europe and U.S.A., round-table discussion among foreign top executives)

In Japan, if there is any additional work which is not originally scheduled, we have a dominant culture to manage to get it done with the given resources without demanding any additional staff. Because such a culture is so popular among the companies, even if any additional job requested by the headquarters is not done as per the headquarters’ expectations, it will be difficult for the headquarters to understand why the additional job has not been done yet irrespective of instructions, or why an additional job always involves additional expense. It will become necessary for the persons in charge of PMI in cross-border M&A to take the working practice of the acquired company into consideration to have an attitude to respond flexibly.

2.2.9. Speed up of Decision-Making Process by Transfer of Power

(1) Participation of Parent Company that Interferes with Quick Decision Making

As is described in the column titled "Foreign top executives' frank opinions on Japanese corporate culture", Japanese companies typically take longer for decision making compared to overseas companies. Such a fact may impose a limitation on the transfer of power to the acquired company and eventually increases the involvement of the parent company in decision-making process. Thus it could be a factor to interfere in responsive decision making in the local office. In round-table discussions among foreign top executives of the acquired company and Japanese resident officers, there were actually such comments that the limited decision-making authority granted to the local office has been delaying the decision making, and that the scope of authority has still to be defined.

"Whenever the Japanese parent company makes any decision on investment, they take too long time. When I was the CEO of the company before the acquisition, such decisions were made in about one month. Now, after the acquisition by the Japanese company, it takes more than one year in some cases. I fear that we may have lost business chances because of such a situation. Japanese companies seem to be too careful and cautious in investment-related decision making. (Asia, round-table discussion among foreign top executives) (Repeated comment)

"Communication in a broad sense, such as how decisions shall be made or how power shall be transferred, was the issue. According to the common sense view in Europe, decision making by Japanese is slow. In terms of the same in the U.S., it is too slow. In general, Japanese are poor in communicating and slow in decision making. It is a problem that their hesitation in the transfer of power adds complexity to the hierarchy of the decision-making process to cause further delay in decision making." (Domestic workshop)

"We received the rules on corporate governance soon after the acquisition, but they were just comprehensive rules on authority. Thereafter, we got a list prepared in Excel format. Now we have been told that the rules will soon be reviewed because of a new acquisition. Rules on authority are ambiguous." (U.S.A., round-table discussion among foreign top executives)

(2) Example of Overseas Company that Proactively Implements Transfer of Power

We found a case where an overseas company with rich experience in M&A proactively transferred power to the purchased company to facilitate prompt and flexible decision making. Such proactive transfer was implemented taking into account the purpose of the acquisition and the company size of the purchased company. Such an effort tends to be made more intensively especially for the acquisition of a startup, etc., which involves acquisition of business areas that are new to the acquirer. When any authority is transferred to the local company, it does not mean that the parent company just leaves everything to the local company but means that the parent company implements in accordance with clearly defined rules and based on the scope of authority that has been agreed through communication with local top executives.

"We take actions according to long-term strategies and neither causes stress for local top executives nor hurries them up. Therefore they trust us with a sense of security. We have never dismissed any single employee of the purchased company and all their top executives are still retained. Authority has been granted to the purchased company, and we do not get involved more than needed. While the priority of risks are determined by the parent company, the authority to control them is still in the hands of the subsidiary." (Asia, manufacturing industry)

"We are the top executives of a startup and discuss with team members the scope of responsibility and their expectations. Negotiations at an early stage are required. Dialogue is very important. As far as they are trustworthy, we entrust the job to them. Then, the top executives and team members of the acquired company have a feeling that they are treated as valuable persons. We need to avoid any delay in the integration process. The first priority is to put the product on the market." (U.S.A., technology-related industry)

"The most difficult issue in relation to the support of the acquired company is how the management style shall be structured. Generally in case of small-size companies, human resource-related decision making is a job for the top

executives. After the acquisition, in place of the top executives of the acquired company, we make decisions on human resource-related affairs as the parent company. We have a list in which the power granted to General Managers of the Human Resources Department and Financing Department are specified. By way of spending a lot of time for the explanation to the acquired company about such a list in the course of implementation of acquisition plans, we have been making efforts to share the same understanding about the management style including human resource management between the acquired company and us." (U.S.A., service industry)

"Although it varies depending on the level of integration, we discuss with the acquired company after the acquisition agreement is signed about rules and principles that they shall observe as one of our group companies. Through such a discussion, both companies can share the same understanding regarding negotiable and unnegotiable matters for each function. Such discussions are held by the integration organizer office in an integrated fashion. (Europe, manufacturing industry)

In addition, when any power is transferred to the local company, the responsibility for achieving targeted KPI should also be transferred together. As presented in "3.2.7. Visualization of purchased company through monitoring", there are case examples of overseas companies that are making efforts for visualization of business through setting up of a monitoring process. When we interviewed foreign affiliated PE funds, they mentioned the importance of monitoring after transfer of power.

"We monitor the synergy and the business plan. As continuous monitoring, reports are also made one year, three years and five years after the acquisition, which also work as a continuous learning process. Cost synergy in administrative functions can be achieved in one year, on the other hand, topline synergy requires time until realization. We are trying to make an assessment of respective synergies in terms of financial impact." (Europe, manufacturing industry)(Repeated comment)

"(In response to our question, "As a foreign affiliated PE fund, how do you bolster the acquired Japanese company?") Whether the power can be transferred or not. In many cases, Japanese companies adopt micro-management for the acquired company. However, what they have to do actually is business visualization by introducing a related system. Once it has been done, it depends on whether or not they can leave management to the local staff." (Foreign affiliated PE fund)

(3) Case Example of Japanese Company Making Efforts for Transfer of Power through Trial-and-Error Process

In round-table discussions held in Asia, there was also a Japanese company that had been proactively making efforts for transfer of power. The company not only established clear rules on the authority of the acquired company but also adopted an IT system for obtaining approval of the headquarters in Japan to facilitate the decision making of the local company. Such an attitude was highly appreciated by the top executives of the local company.

"At first, the parent company sent a concise regulation of authority consisting of three pages to us. Then, two or three years after the acquisition, an electronic system was adopted for the approval process and all decision making can now be done through the system. The system is quite important for us. Even if we cannot identify the appropriate division in charge, from which we need to get the approval of the headquarters, the system supports us to find an appropriate procedure." (Asia, round-table discussion among foreign top executives)

On the other hand, a knowledgeable person we interviewed for this survey made a comment that pointed out the difficulties in the transfer of power as follows:

"Japanese companies are not very good at building the governance system[A8] *structure based on the logic of the purchaser's side. The key to success is to tell only the "vital point" and to have the local management staff manage the rest by themselves as much as possible. The "vital point" means whether they want to control or not. Among Japanese companies that execute M&A, there are two types of company, namely, a company that tries to control the acquired company and a company that leaves everything to the decision of the acquired company after the acquisition." (Europe, knowledgeable person)*

In the case of the projects in which the said knowledgeable person was involved, they say that the decision on large-scale investment is not finalized by the local company but they always make it a point to have the headquarters in Japan be involved in the decision-making process even if it may require more time and more personnel.

"In relation to corporate governance, there are also some rules, which the acquired company is required to inevitably observe from the standpoint of the headquarters in Japan, such as the decision-making standards. The monetary value of each project of the acquired company's business is large. Although it is quite undesirable for the acquired company, the decision for large projects requires approval as high as board of directors approval. For example, in the country where I am now stationed, the decision-making process needs to go through a decision by the local company, the decision by the related business operation division, approval by the investment committee of the headquarters, preliminary approval by the vice president in the management council, approval by the audit committee and board of directors approval. Namely, it requires as many as about ten decision and approval steps, etc. The coordination of such troublesome processes is taken care of by Japanese resident officers and any compromise has never been made to relax the rules. Because the temperament of the top executives of the acquired company was unknown, no relaxation of rules was considered from the beginning." (Europe, knowledgeable person)

If transfer of power is implemented excessively, it may create a situation where an investment decision that does not coincide with the headquarters' business strategy or that may pose unforeseen risks can be made. Thus, the transfer of power often involves such difficulties and the direction toward admitting an extensive transfer of power is not always desirable. Such circumstances make it more important for the acquirer to discuss and agree with the local top executives on the extent of the transfer of power.

2.2.10. Enhancement of M&A Capabilities and Externalizing Knowledge

(1) Project Implementation System

Overseas companies with rich experience in M&A integrate M&A into their strategy and work on M&A in their own frameworkin a manner like operating under usual conditions as if it were a part of routine operations. Many of them place M&A division in a position closely related with the company's management strategy, such as a position under direct control of the CEO or a position linked with strategy-related divisions. Most overseas companies with rich experience in M&A with whom we interviewed this time have a division dedicated to M&A with typical numbers of staff in the range of 5 to 20, though the numbers of dedicated staff varies depending on each company. There is a technology-oriented company with an extraordinary organization for M&A with as many as 150 staff. They work on M&A of startups in Silicon Valley on a daily basis to materialize one acquisition case every week. There are also substantial numbers of companies that have a team dedicated to PMI in addition to the team taking care of the deal. Namely, many companies consider PMI as an important part of M&A. Once the deal is launched, a suitable structure for the project is built depending on the phase of the project. Such an organization will eventually involve as many as 100 to 200 people in total including personnel from the corporate division who are participating as part-time staff and multiple staff from the business operation division including the one who will assume post-acquisition responsibility. The most important point to be understood in this instance is that the leader who assumes post-acquisition responsibility is involved from an early stage of the deal and such a situation is consistent throughout the pre- and post-acquisition period from the stage of due diligence all the way through the signing of an acquisition agreement. Some examples of efforts made by overseas companies with rich experience in M&A, which had a well-structured M&A organization, are presented below:

"When we study the deal, we get experts of the industry or the function of the acquisition target. Such experts have respective abilities for assessing every aspect of the business to be acquired and are organized for 15 to 18 function areas. The deal team assumes responsibility for all communication and overall management of the project." (U.S.A., manufacturing industry)

"The business operation division is deeply involved in all the selection of acquisition targets, due diligence, development of a business plan and presentations on capital investment. The business operation division has a very strong sense of ownership because they are virtually responsible for the acquired business after the acquisition." (Europe, healthcare industry)

"I have been consistently involved in the deal from the starting stage of the deal up to the integration. The consistency in responsibilities is a key issue during the course of the deal. By the way, more than 100 persons have been involved in due diligence." (Asia, financial industry)

If the project is so large that it involves more than 100 persons, it is important to clarify roles and responsibilities. The M&A division is exclusively responsible for the project management and has clearly declared that the business operation division is responsible for execution of the deal and post-acquisition management. One company from the manufacturing industry in the U.S. mentioned during an interview that, because M&A always involves a high level of risks and the responsibilities related thereto are huge, an adequate incentive provided for the leader of post-acquisition management is the key to motivate such a leader to strive for the success of the project. Together with issues raised previously in relation to compensation and incentives, such comments mentioned in the above contain a point that provides Japanese companies with a thoughtful suggestion in relation to execution of M&A-related work that involves a high degree of risk.

"It is also important that an adequate incentive is provided for persons involved in the deal. Otherwise, they have no reason to work excellently. We have noticed that this is a very important point. It is important to find appropriate persons with appropriate talent and skill and to set up an appropriate system under which such persons are motivated to work proactively." (U.S.A., manufacturing industry)

(2) Human resources for PMI

While overseas companies with rich experience in M&A have been devoting many human resources to M&A, it was quite a contrast that Japanese companies expressed their concerns during the domestic workshop about the shortage of human resources as a very fundamental issue that may override organizational structure issues.

“The challenge of our company in relation to PMI is shortage of human resources to be dispatched to the local company. Because of reasons such as language problems and many staff not interested in overseas businesses, the number of staff who are prepared to accept overseas assignments is limited.” (Domestic workshop)

“We currently have ten executive officers dispatched from Japan but are told that there are no more resources to be dispatched additionally. The parent company in Japan has depleted the human resources that are necessary for post-acquisition activities to create synergy.” (U.S.A., the round-table discussions held for Japanese representatives)

“In the case of our company, it is usual that Japanese resident officers will seldom be back in Japan but are often shifted form one office to another among overseas offices.” (Domestic workshop)

“We have depleted all competent staff and have no one for any large-scale acquisition. The acquisition deal can be closed with support from an outside advisor, but post-acquisition work needs to be performed by ourselves. We have no competent staff, though.” (Domestic workshop)

“We should not rely on Japanese staff any more. Unless foreign staff of the acquired company are educated on Japanese culture, any success in acquisition is difficult to be realized. If cross-border M&A is considered as an engine for future growth, the key issue to be addressed first is human resources.” (Domestic workshop)

With regard to PMI, in addition to such issues on the shortage of human resources as above, it is also important to identify types of staff that can be assigned to the position in the acquired company. Firstly, there was a comment that the position, to which a Japanese resident officer shall inevitably be assigned, is a position that assumes responsibility of administrative affairs such as CFO. This is because a person in such a position is capable of communicating based on numerical data and information, in addition to the ability to understand corporate governance-related affairs that are important from the standpoint of the headquarters. There is also a comment that a desirable person should have the basic ability to understand diversities and an excellent ability for communication to effectively co-work with overseas staff with a different cultural background. In addition, it was also pointed out that, to integrate its own business with the business of the acquired company, such a person should also have the ability to analyze the overview of the company’s business including both strong and weak points from a comprehensive and panoramic viewpoint and an ability to communicate the results of such analysis to the acquired company. Other than the above, there was also a comment from a Japanese resident officer dispatched to an Asian company that he had been trying to establish a relationship of trust with the local company through family-like relations even during off-duty hours. It seems that the ability to have intimate communication like this is also one of the credentials of human resources taking care of PMI. The following are comments from participant companies in overseas round-table discussions and knowledgeable persons regarding divisions of overseas offices and human resources to be dispatched thereto for PMI-related affairs:

“The post for which a Japanese staff is most desired is the CFO. Financial affairs can be expressed numerically based on standardized accounting criteria and, therefore, are easy to be communicated compared to other fields, where some difficulties are foreseen.” (Europe, knowledgeable person)

“Everything about management has been reflected in and incorporated into the methods of budget planning and the PL preparation. Only a well-experienced staff can prepare them in line with the policy. The staff we recruited two or three years ago were persons who had experience in such work at an overseas subsidiary.” (U.S.A., the round-table discussions held for Japanese representatives)

"The required qualification is an ability to understand diversity and sincere consciousness in all aspects. These two are eligibility requirements for not only Japanese resident officers but also locally recruited staff. Persons with such abilities give others a comfortable feeling through working together. It is important to find such a person. As soon as such a person is found, everything starts going well." (Europe, knowledgeable person)

"All resident officers from Japan were working for the Sales Division. I wish a Japanese resident officer were assigned also to the Finance and Accounting Division." (U.S.A., round-table discussion among foreign top executives)

"From Day 1, a Japanese technical staff should have been assigned to the factory in the U.S. as a contact person for smooth communication between Japan and the U.S." (U.S.A., round-table discussion among foreign top executives)

"The parent company dispatched one Japanese to the acquired company as a resident officer and he was open-minded with excellent communication ability. He used to be at very high post in Japan and, therefore, had a certain level of authority for decision making. Thus, he supported the acquired company in an expeditious manner." (Asia, round-table discussion among foreign top executives)

"We have an expert in sales as well as an expert in marketing. However, we have no one that has the ability to take an overall panoramic view of the business to understand the actual situations." (Europe, the round-table discussions held for Japanese representatives)

"I made an effort to be a close family friend with the owner by spending time together on weekends to establish a relationship of trust with him." (Asia, the round-table discussions held for Japanese representatives)

(3) Decision Making

Agility is indispensable in decision making during the course of M&A. At the same time, we have to be very careful because it is "an expensive purchase". Because many Japanese companies adopt a collegial system, this would be an issue in many cases. During the domestic workshop, there were the following comments:

"At a preliminary stage of cross-border M&A, the business expansion overseas is often categorized as an issue which is "agreeable in general but not agreeable on details". Among multiple numbers of persons in the company having decision-making authority, there are both proponents and opponents and consensus formation within the company is quite difficult. It is challenging to persuade the opponents. For example, if the ratio of domestic business is high, the question will be how the consensus for business expansion overseas can be gotten internally." (Domestic workshop)

"In our company, building of a preliminary consensus for investment is important, and the person in charge has to visit every director to persuade them. I always try to clearly explain during such a visit about the benefits that respective business divisions will gain. In this relation, I sometimes make such a busy business trip for three days and no nights to Germany. It is really a tough job for a person in charge who always has a very limited amount of time." (Domestic workshop)

In consideration of such things as above, decision made in a top-down style and the decision-maker's involvement in the course of negotiations are sometime brought up as issues to be addressed. In this relation, some comments from overseas companies with rich experience in M&A, which can be a good reference, are presented below:

"Depending on the scale of the M&A deal, approval by the CEO or by the board meeting may become necessary. However, such approval is required only for deals of the largest scale." (U.S.A., technology-related industry)

"The team leader of the strategy team directly discusses with the CEO and CFO to make a top-down decision for acquisition. In the past, there was a committee for an acquisition deal, which, however, allowed too various opinions to be presented. Therefore, the number of persons who discuss an acquisition has been narrowed down. The culture of our organization is based on a centralized system. Therefore, it is not impossible but very seldom that a small-scale acquisition proposed in a bottom-up style is materialized." (Europe, healthcare industry)

"We developed our approval process for M&A by trial and error. There are two approval processes. One is for a strategy policy at an early stage of the deal process and another is for the execution stage of the deal." (Europe, manufacturing industry)

Among overseas companies with rich experience in M&A, there are many companies that have set up an investment committee for decision making. Such efforts and systems for prompt decision making as mentioned above would be a good reference for Japanese companies.

(4) Externalizing Knowledge on M&A-related Experience and Know-how

To promote negotiations on the deal more effectively, there are cases where the division dedicated to M&A takes roles such as compilation of a playbook of M&A in which knowledge, know-how and methodology acquired from experience in past projects are marshaled systematically, provision of tools and templates required in the course of the process and implementation of training programs. The following are case examples of efforts made by overseas companies with rich experience in M&A:

"We have built up competency for corporate integration by compiling a playbook for due diligence and global communication. When due diligence and corporate integration are conducted, the playbook is used as a reference to identify items to which attention should be drawn. Such an approach works quite well. We also have a system in which team members can record any specific challenges. In view of the fact that the due diligence teams are always composed of members from different locations, these tools are useful for coordination of teams of various functions." (U.S.A., service industry)

"We developed "national level guidelines for corporate integration". These guidelines describe the overall picture of the integration process at a national level and specify important principles in relation to integration. While respective countries flexibly allow the integration, they still have some key basic rules that should be observed in such a flexible framework. Depending on circumstances in each country, they do not force the companies to follow systems or regulations that are not well-suited to the country." (U.S.A., service industry)

"We have a toolbox for M&A available anytime. The process of due diligence is standardized but the sequential order of the process is flexible to some extent. The toolbox is updated on regular basis." (U.S.A., technology-related industry)

"We have judgement criteria for M&A-related matters. Some of them have been documented but some are yet to be documented. A capability map that displays core competence required for the deal is also available. A development plan for each individual is prepared every year and training programs are conducted for modeling and case studies of the business plan. In addition, we occasionally make a personal change such as transfer of personnel to the finance department so that they will have the chance to experience various projects." (Europe, healthcare industry)

A European company with rich experience in M&A pointed out that an M&A-related playbook and templates are useful for members who are involved in M&A for the first time. But they also commented that it is not good to adhere to those tools too consistently because M&A always require flexibility. On the other hand, the following opinions were also presented in the domestic workshop:

"We are caught up in execution of day-to-day work and can seldom have time for summarization of know-how." (Domestic workshop)

"I enter all data related to my job into the system so that anyone in the company can follow up any job. However, this does not mean that we have a to-do list of items to be confirmed in the course of due diligence. Therefore, such data are entered as needed at my own discretion with advice from outside. I wish there were a master, but I have no time." (Domestic workshop)

Based on the above opinions, it is supposed that, because of the shortage of human resources, there are substantial numbers of companies that are yet to be able to launch any effort for accumulation of know-how by summarizing the outcome from their experience in M&A. On the other hand, however, there are some companies that have been making efforts for effective improvement by developing a playbook and templates.

"Because we have no staff who have the ability to take care of M&A-related affairs appropriately, we are thinking to make use of some work instruction manuasl. We currently receive support from outside advisors to develop a playbook and PMI management tools to set up a competent organization." (Domestic workshop)

Column: Job Rotation Does Not Fit into Cross-border M&A?

It is common among Japanese companies that they employ a system to reshuffle personnel regularly in a certain period of time. Such a system for job rotation has various purposes such as to educate executive candidates through experience in various types of work in and outside the company and to have younger personnel experience working in multiple different divisions to examine their adequacy. Especially, an assignment to a post in an overseas office has a positive aspect to foster an ability to be a global executive officer. However, particularly with regard to cross-border M&A, some issues were presented in overseas round-table discussions and domestic workshops as follows:

(1) Accumulation of Knowledge about the Targeted Country

For development of overseas business, it is important to have deep knowledge on the market, customs and culture of the targeted country and the same is applicable to the case of cross-border M&A. For example, although all countries in Europe may often be lumped together as "Europe" from the perspective of Japanese people, respective European countries have their own history and business practices and they are different from each other. Therefore, it is beneficial for companies to continuously educate their people on knowledge about respective countries and to retain such educated personnel. Knowledgeable persons in Europe say that the job rotation system of Japanese companies has resulted in hindering systematic education and retention of human resources, who have knowledge about the targeted country where the business is being developed and have the ability to coordinate with the headquarters.

"If the job rotation system could be abandoned, it would enable Japanese companies to accumulate knowledge on business practice and culture of European countries. It's regrettable to lose such a chance. It may be necessary for Japanese companies to revisit the job rotation system." (Europe, knowledgeable person)

"During the phase of PMI, serious and function-specific discussions should be made among experts. The current Japanese job rotation system limits the level of experience and knowledge attainable within the time constraints due to the limited duration of the job assignment. And such a situation will be perceived by the acquired company as a lack of continuity. Therefore, it would be advisable that the job rotation system shall be reviewed including the possibilities for replacing loaned staff with staff recruited on a global basis." (Europe, knowledgeable person)

In addition, with regard to the fact that Japanese resident officers are transferred every few years because of the job rotation system, there were such opinions as follows from foreign top executives of the companies acquired by Japanese companies that participated in round-table discussions in Europe:

"The periodical rotation of Japanese resident officers always causes difficulties for me. I give them an explanation on basic knowledge, etc., such as local laws and regulations, which are necessary for starting business in Germany. Every time the Japanese resident officer is transferred, I have to repeat the same from scratch."(Europe, round-table discussion among foreign top executives)

The above may be a problem relating to the handover process of the job to the newly assigned staff, but it is actually tough work to relate every detail about local business practice, etc.

(2) Motivation of Japanese Representative after Returning to Japan

When a Japanese company acquires an overseas company, the Japanese company often dispatches its Japanese staff to support the business management conducted by upper management such as the CFO or COO. In overseas round-table discussions among Japanese resident officers, they commented that, although the assignment to such a position would involve substantial difficulties, they thought their work was very challenging and rewarding in view of the importance of responsibilities as management staff of an overseas company and the value of various experience that they could gain during the assignment.

"I was involved in both due diligence and PMI. I have been stationed in the U.K. alone as the person in charge of PMI-related work. Because this is my first experience in business management, I think every single moment is a chance for me to learn. I feel my job here to be rewarding." (Europe, the round-table discussions held for Japanese representatives)

On the other hand, when they are transferred back to Japan as a result of job rotation, it seems there are cases where they experience decreased motivation because of a relatively lower level of responsibility in Japan compared to those which they assumed as Japanese resident officers. There was a comment that such a person might resign after returning to Japan or even before returning to Japan, which is very regrettable.

"Even if I return to Japan, I will not be able to make use of knowledge that I acquired with difficulty during my assignment in an overseas office. I have no desire to return to Japan (so far). There is a substantial number of staff that resign due to such a reason. And this hinders the company from accumulating knowhow. It is rather difficult to find growing companies that are effectively utilizing human resources with experience in overseas offices." (Europe, the round-table discussions held for Japanese representatives)

It seems that treatment of respective Japanese resident officers is different depending on each company. But it might be necessary to consider measures to keep their motivation high, such as assigning staff returned from overseas assignments to a higher post with more responsibility. Treatment of Japanese resident officers after their return to Japan could be one of the issues that should be considered, and one of the possible measures would be utilization of a personnel system like a leadership development program which is adopted by global companies.

(3) Development of Human Resources for M&A

Handling of M&A-related affairs requires negotiation skill and management abilities in addition to expertise in financial and legal matters, etc. Namely, it requires more comprehensive and high level knowledge and skills compared to other types of work. Because of such a nature, the Japanese personnel system, which rotates personnel in a short period, is not suitable for M&A. If, in the future, M&A is promoted as a company strategy, it would be necessary for such a company to seriously review the possibility of longer rotation intervals or even abolishment of the rotation system between business divisions. In addition, because development of human resources for M&A will also facilitate development of future top executives of the company, selection of personnel and the term of assignment (period of rotation) need to be decided from the standpoint of long-term development of human resources when any person is assigned to a post in an acquired company.

3. Challenges and Prospects of Japanese Companies and Business Environment from the Viewpoint of the Inward Direct Investment Situation

Japanese inward direct investment still remains at a low level for its large economic scale compared to those of other countries. While there are some conceivable causes for such a low level, it has been pointed out in interviews this time with overseas companies with rich experience in M&A, foreign affiliated PE funds and knowledgeable persons that difficulties in language and communication, unique business practice and unique management systems of Japanese companies, etc., could be the factors that hinder investment in Japan. It was also pointed out that an inflexible human resources market and personnel systems, etc., compared to those of other countries had influenced investments in Japan. These issues are common to the issues which Japanese companies encounter in the course of cross-border M&A. The fact that the concept of strategic sell-off of business is not popular yet among Japanese companies can also be one of the factors for such a low level of inward direct investment.

3.1. Challenges and Prospects of Japanese Companies and Business Environment

What are obstacles and enticement for overseas companies' investing in the Japanese market? Japanese companies and the business environment are investigated hereunder from two different viewpoints based on the result of interviews with overseas companies with rich experience in M&A, foreign affiliated PE funds and knowledgeable persons.

3.1.1. Challenges of Japanese Companies and Business Environment

In "3.1. Preparation of Global Management Capabilities and Systems", we discussed "communication ability", "language ability" and "adaptability to conform to a different corporate culture" as capabilities required by companies for cross-border acquisition and for post-acquisition management of acquired companies. These points can be considered as common problems in business transactions with overseas companies in the domestic market. How do overseas companies look in terms of enticement for Japanese companies to invest? With regard to the value of Japanese companies and the Japanese business environment as a target of investment, we received the following comments through interviews with overseas companies with rich experience in M&A, foreign affiliated PE funds and knowledgeable persons:

(1) Challenges of Japanese Companies

When an overseas company conducts any business activities with a Japanese company, or conducts any business jointly with a Japanese company as post-acquisition cooperation, business practice and cultural aspects of the Japanese company will be a big obstacle. For example, the decision-making process, such as collegial systems and the consensus-building process, which is unique to Japanese companies and takes a lot of time, often becomes an obstacle in business operation of overseas companies. The following are comments received in the interviews this time.

"In the course of business operation with Japanese companies, cultural aspects generate serious difficulties." (U.S.A., manufacturing industry)

"Japanese people try to understand everything correctly from the beginning. I guess they had better be a little more flexible." (U.S.A., manufacturing industry)

“When the deal is negotiated, the decision-making speed will be one of the important points. However, the decision-making speed of Japanese companies is by any means not responsive and may possibly be an obstacle for the seller. My understanding is that decision making of Japanese companies is deliberate and prompt decision making is not necessarily their first priority.” (U.S.A., manufacturing industry)

Misunderstanding in communication due to differences in language and culture is also a problem for overseas companies to conduct business operations in Japan. In this respect, there were the following comments:

“It seems to be a problem that there are not many human resources that speak English.” (Asia, knowledgeable person)

“Problems in Japan are culture and language. There are not many Japanese who speak English.” (Asia, manufacturing industry)

“Because of the Japanese language barrier, the necessity to recruit Japanese speaking staff will be an obstacle, when the investment comes to the execution stage.” (Asia, technology-related industry)

“You do not have to hesitate to say no. You just have to make clear whether it’s yes or no.” (U.S.A., manufacturing industry)

The points referred to in the above suggestions by overseas companies, etc., are common to challenges that Japanese companies are facing in relation to cross-border M&A, namely, the lack of communication ability, language ability and adaptability to a different corporate culture. For example, an overseas company acquired by a Japanese company considers the corporate culture of Japanese companies to be very unique, and points out that the difference in corporate culture such as “time consuming decision making process” and “behavior to circumvent conflicts” will be a challenge for them while implementing PMI jointly with the Japanese company. With the progress of globalization, Japanese companies are required to establish a system that allows communication in the English language and to have objective understanding on their own organization and corporate culture. And such system and understanding, etc., are required not only when Japanese companies penetrate into the global market through cross-border M&A, etc., but also when they carry on business in the domestic market jointly with overseas companies.

On the other hand, there were opinions that, while time difference and language are problemss in doing business in Japan, it is not a problem unique to Japan but just a natural situation for business operations on a global basis. If it is viewed from not only a Japanese but also from a global business standpoint, the difference in language and culture is a common challenge existing in any company in any country. It will be required to respond to such challenges without hesitation like overseas companies and to keep a challenging attitude. Foreign affiliated PE funds also pointed out that Japanese companies have management-related challenges. This matter will be discussed in detail in the next section but the fact that the system of the top executives to undertake responsibility for an increase of shareholder value is relatively fragile compared to U.S. or European companies can be considered as one of the factors of such a problem.

“It is very seldom that a Japanese top executive has a concrete idea about “how to manage his/her company” and they don’t have an autonomous target.” (Foreign affiliated PE fund)

“While there are many Japanese companies that provide good merchandise and good services, there are also many management executives that do not manage their company well.” (Foreign affiliated PE fund)

“In general, it can be seen occasionally that the top executives have little awareness of an increase of shareholder value. Instead, they seem to be paying attention not to make any mistakes during their term of office.” (Foreign affiliated PE fund)

“As the age of the top executives become higher, career-related incentives become less effective for such top executives to be motivated to take risks proactively.” (Foreign affiliated PE fund)

(2) Challenge of Japanese Business Environment

First of all, the closed nature of the market and the mobility of human resources are pointed out as challenges with regard to the business environment. Because of the fact that an absolute majority of business conducted in the Japanese market by Japanese companies is conducted in the Japanese language, the Japanese market is considered as a difficult market to enter for overseas companies. Whenever any overseas company actually launches any business or co-work with a Japanese company in Japan, the language barrier will come up. Although they make efforts to recruit people who speak both Japanese and English, they will soon face the problem of low mobility of human resources in Japan. There was a comment on a case where penetration into the Japanese market was eventually abandoned because of the difficulty in recruiting suitable personnel.

"It is my understanding that the Japanese market has a closed nature." (Asia, technology-related industry)

"While Japan has human resources with a high level of education, it is not an attractive market for overseas companies because of the low mobility of such well-educated human resources." (Asia, knowledgeable person)

"The employment system and inflexibility of the labor market in Japan are shackles for foreign affiliated companies." (Asia, knowledgeable person)

"Competent human resources enter large companies and small and medium-sized companies, which account for 99% of the total number of companies in Japan, seldom have human resources that have the ability to conduct global management because of the lack of mobility of human resources." (Foreign affiliated PE fund)

"In the U.S. and Europe, MBA assumes a role to increase the number of CEO human resources with a high sense of management while being conscious of "strategy", "organization" and "human resources". There is a good ecosystem that is capable of recruiting human resources on a global basis and connects them with each other, but such a system is not available in Japan." (Foreign affiliated PE fund)

It was also pointed out that the reason behind the slow progress of mobilization of human resources is the Japanese unique personnel system.

"No structure to match the pension system or a compensation system with the mobilization of human resources has been developed yet." (Foreign affiliated PE fund)

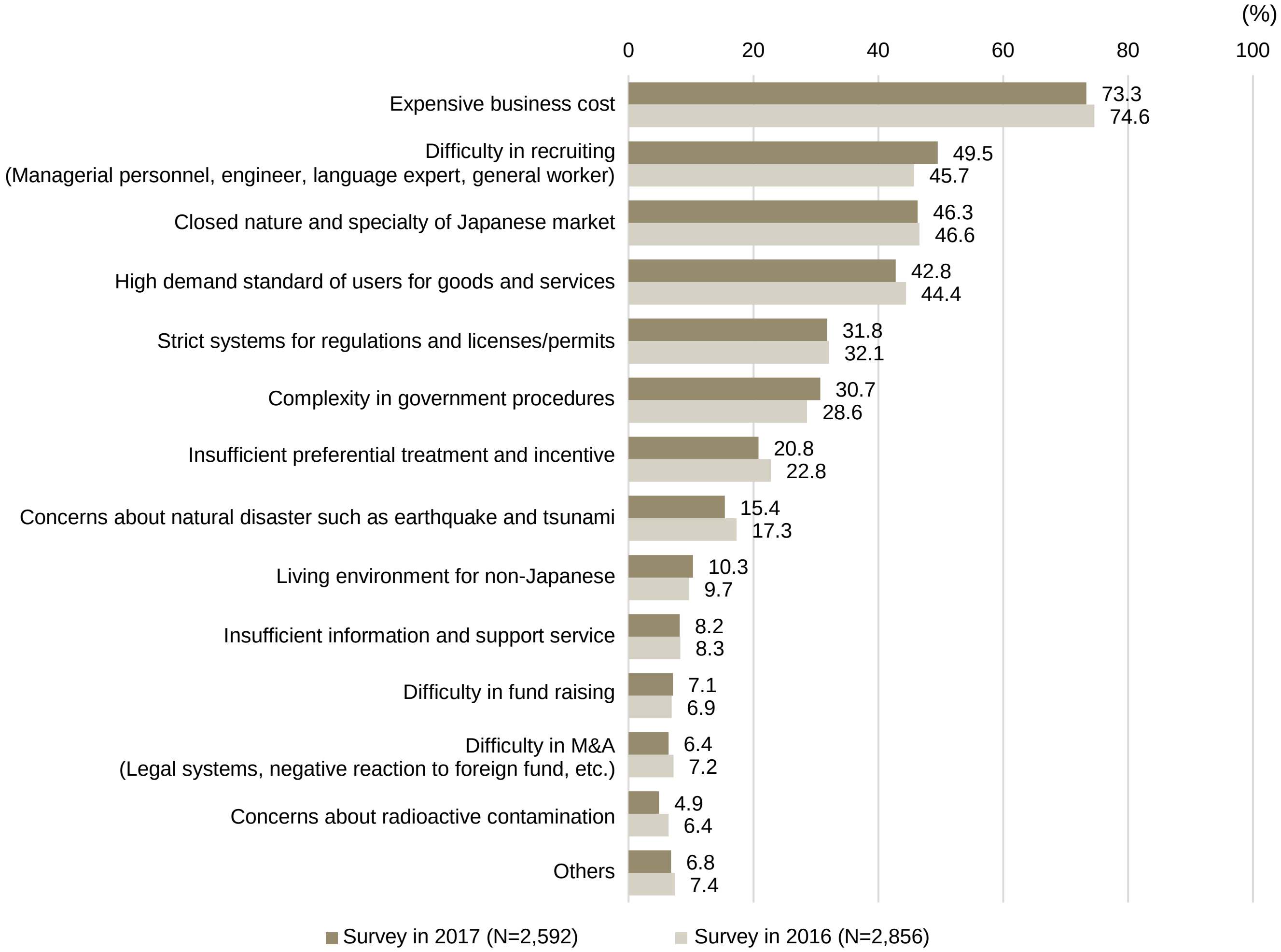
"The personnel system in which the position in the company is advanced with age is just unique to Japanese companies." (Foreign affiliated PE fund)

The result of an interview with a European manufacturer that typically represents the closed nature of Japanese Out-In M&A is presented below. It describes the actual situation where overseas companies are facing difficulties in entering into the Japanese market because of very limited chances to get information on Japanese companies regardless of their strong interest.

"We implement M&A on a global basis but have one country where we are not favored with a chance for M&A yet; Japan. M&A projects in the Japanese market seem to have a closed nature. I hope someone will tell us how to get information on Japanese companies that are available for acquisition." (Europe, manufacturing industry)

By the way, the comments that we received through interviews this time are consistent with the below-mentioned figure of "Obstructive Factors in the Course of Business Development in Japan" from the trend survey by the Ministry of Economy, Trade and Industry conducted on foreign affiliated companies.

<Figure 9> Obstructive Factors in the course of Business Development in Japan



Source: The Ministry of Economy, Trade and Industry (2017). The 51st Survey of Trends in Business Activities of Foreign Affiliates (surveyed in 2017)[A9][Wユ10][i11]

As mentioned in “3. Japanese Companies’ Challenges and Possibilities of Overcoming them in Cross-border M&A (In-Out)”, many global companies have a strong sense of corporate governance. Therefore, for the purpose to fulfill accountability to shareholders, they declare their goal of profit plans and capital policy, in which capital cost is also considered, to review their business portfolio or to make decisions on investment. For the purpose to ensure that executive compensation functions as an incentive that facilitates sustainable growth of the company in a sound manner, the compensation system is designed to reflect business performance in an objective and transparent manner. In addition to cash compensation, it is common that stock-based compensation is also provided. Compared to such circumstances, however, it has been pointed out that the sense of corporate governance has not been sufficiently disseminated into Japanese companies. And such circumstances can be considered as a factor that generates challenges in the Japanese business environment.

“Further penetration of the sense of corporate governance is necessary. The board of directors and every top executive should have stronger awareness and responsibility toward enhancement of shareholder value, and, therefore, they should set up a transparent and adequate system for information disclosure.” (Foreign affiliated PR fund)

Reform of personnel systems and corporate governance systems such as mobilization of human resources, pension plans and compensation systems are impossible to be achieved in the short term. However, if fundamental reform of such systems is planned so that Japanese companies can acquire global management capabilities, drastic reform of those systems backed up by the government are required. Globalization of Japanese companies will also facilitate activation of foreign investment in Japan.

3.1.2. Expectations on Japanese Company and Business Environment

It is a fact that overseas companies place expectations on Japanese companies and the business environment, while both of them face some challenges. When any business deal is made with overseas companies entering into the Japanese market, it would be important to recognize the fact that Japanese companies have aspects that are highly valued by such overseas companies. The below are comments representing expectations for Japanese companies and the business environment.

(1) Expectations on Japanese Companies

In view of human resources with high education levels, high work quality and high technology levels of Japanese companies, overseas companies have high expectations for cooperation with or investment in Japanese companies. Especially, the technology-related areas still seem to be taken by other countries as the strong point of Japan.

"It is my understanding that Japanese companies have advantages of highly educated human resources and technology supported by such resources." (U.S.A., manufacturing industry)

"Because they have deep knowledge about India and have been helping India, I have respect for Japan. Japanese companies also have the highest level of technology, therefore, I have a strong desire to do business with them together." (Asia, manufacturing industry)

"As is the case with Indian people, Japanese people have a long-term vision and a sense of worth deeper than monetary value. Therefore, among various JVs, successful ones are only those established with Japanese companies." (Asia, manufacturing industry)

"With regard to Japanese industries, we are interested in the field of data centers or technology-related areas such as AI/machine learning/software services." (Asia, technology-related industry)

"Japanese companies have excellent technologies and they are the most reliable suppliers among our business contacts." (U.S.A., manufacturing industry)

"The important advantage of Japanese companies is the high degree of loyalty of employees to their companies." (Foreign affiliated PE fund)

"Very high expectations are placed on Japan (in terms of investment potential). During the last 20 years or less, Japanese companies have substantially gained a reputation for their excellent quality. Thus Japan is gaining a high rating again as a potential country." (Foreign affiliated PE fund)

Under such circumstance, those competent human resources have contributed eventually to the creation of excellent goods and services and, at the same time, have helped gaining trust on intellectual properties.

"There are many Japanese companies that are capable of providing excellent goods and services." (Foreign affiliated PE fund) (Partially repeated comment)

"With regard to intellectual properties, a stronger sense of trust has been put on Japanese companies compared with other countries." (U.S.A., manufacturing industry)

The following are comments from foreign affiliated PE funds:

"In terms of excellence and quality, Japan is number one in the world. In particular, the quality of personnel working for middle management or lower is excellent and many of such companies have a margin for further growth depending on how their top executives manage their companies. " (Foreign affiliated PE fund)

As seen in the above, the comment is quite encouraging. Companies are recommended to investigate again on their own strong points.

(2) Expectations on Business Environment

Overseas companies put a high rating on the business environment in Japan in view of its market size and maturity. In addition, because of the increasing number of businesses subject to potential business succession problems or projects carved out from large-scale companies, foreign affiliated PE funds consider Japan as an attractive market. Therefore, investment chances for foreign affiliated PE funds into Japanese companies are expected to increase.

"Because of its market size, Japan is always a strategically important market for our company." (U.S.A., service industry)

"It is an attractive and sophisticated market. In addition, the labor quality in Japan is also excellent." (Asia, knowledgeable person)

"It has a very well-matured business culture. Thus, we consider that the business environment is good. " (U.S.A., healthcare industry)

"With regard to Asian counties, we often hear negative information. We, however, seldom hear negative comments about the Japanese market." (U.S.A., service industry)

"The idea to utilize an investment fund for business succession has become popular in Japan. We often hear the story that they would prefer to sell off their business to an investment fund rather than selling to competitors. Such a trend seems to be disseminating not only in Tokyo and Osaka but also to local areas, and to continue over the coming 10 or more years as the population ages." (Foreign affiliated PE fund)

"Very high expectations are placed on Japan (in terms of investment potential). Japanese companies have gained a high reputation for their excellent quality and Japan has been recognized again as a potential country. Subsidiaries of large companies are about to start their activities. We feel a step-by-step movement of PE funds toward playing a role as a successor of business without a successor. Such a movement used to be dull but is now gradually becoming active." (Foreign affiliated PE fund) (Partially repeated comment)

The number of projects carved out from Japanese large companies and projects for business succession will continue increasing. Behind such a movement, there is dissemination of the Japan version of the Stewardship Code that has facilitated the enhancement of value of invested companies from the standpoint of investors, and there is an increased ratio of stock held by non-Japanese investors, who put more emphasis on ROE by adding increased pressure on listed companies for enhancement of company value. Because of these facts, such a trend of the parent companies/headquarters to investigate the possibility of carving out of their subsidiaries or business units will be accelerated. On the other hand, under the current situation in Japan, which they call "Mass Close-down Era[A12][5]", 1.27 million small and medium-sized companies currently have no successor, and the ages of the top management of more than 60% of such companies will exceed 70 in 2025. Thus, the number of companies that look for a successor will never decline. Establishment of a global standard would be one of the measures to overcome such dramatic changes in the situations that Japanese companies are experiencing, while accepting investment from overseas including those of a PE fund.

5 Footnote: Nihon Keizai Shimbun (2017) Footsteps of Mass Close-down Era, 1.27 million Small and Medium-sized Companies "with no successor" (Morning paper on October 6, 2017)

3.2. Management Reform through Accepting Foreign Investment

As a trigger for Japanese companies to shift their management style to global management, it may be effective to accept investment from an overseas company. Case examples where management reforms were implemented through accepting foreign affiliate PE funds as shareholders are presented hereunder:

(1) From Domestic to Global

A company in a local area in the healthcare industry had no top management successor and had a challenge with business succession. The company has grown to a company with yearly turnover of 16 billion yen and approximately 600 employees in 20 years from its establishment. Under such circumstance, the founder of the company decided to sell all the shares of the company to a foreign affiliated PE fund to develop themselves into a global company from a domestic one and to ensure sustainable growth through business expansion into overseas markets, which has been the desire of the founder.

Because of the fact that the company has grown under the strong leadership of the founder, the staff were accustomed to perform their jobs compliantly in accordance with the decisions made by the top management, and such a style was the corporate culture of the company. After they were brought under control of the foreign affiliated PE fund, they have been exposed to the pressure of checking functions under the strict corporate governance system and have been placed in a position where they are required to make commitments and take responsibilities for success. While they have assumed such new roles, an incentive mechanism under a pay-for-performance system has also been adopted. Thus, the corporate culture has been changed to a style that the staff take autonomous actions proactively. To put it concretely, the president appointed from outside the company appointed the CFO as well as heads of other departments such as personnel, R&D, production and sales from outside the company in a prompt manner and changed the salary system, which used to be in order of seniority, to an achievement-based system. Thus, a fair and transparent personnel system, in which those who achieve results will be rewarded, has been established. As a result, the management staff newly appointed from outside the company and long experienced management staff who supported the company for many years are now working together to build a new culture. In such a new culture, a proactive attitude is encouraged, successful achievement is rewarded and even failures are reflected in a positive manner for the future. The participation of a foreign affiliated PE fund as an outside board member and tough questions therefrom also enhanced their management capabilities and advanced their preparation to be a global company.

The said company utilized the brand and network of the foreign affiliated PE fund to expand its overseas sales channel. The vverseas sales ratio, which was approximately 5% at the time when the company was acquired, was increased to more than 10% in three years from the time when the PE fund participated in the management of the company. The company has now grown to be able to forecast an overseas sales ratio over 30% in the medium- to long-term, and the shift to a global company, which has been the desire of the founder, is now under way.

(2) Reform through Enhancement of Strategy, Organization and Human Resources

One local food manufacturing company accepted investment from a foreign affiliated PE fund as a part of the business succession process because they did not have any successor. Before such an investment was made, the 65-year-old president did not disclose even the PL figures to any divison managers and other lower-ranked personnel and the company was managed only by the president’s micro-management, which was still effective. After such an investment, they established an image of a desirable situation after 10 years of the company, and developed “strategy – business plan – action plan” backward from such an image. Then reform of management, organization and human resources started and corresponding financial plans were developed. They established a medium- to long-term goal to expand sales and marketing area, which used to be limited within the local area, to a nationwide level and thereafter to a global level. To put it concretely, the following measures were taken:

- Concentrated investment and full-scale entrance to the business of mixed vegetables packaging (construction of new plant)
- Enhancement of marketing and branding
- Management of sales result through budget setting
- Change of sales activity-related practice from sales activities in the style of go-direct/return-direct to a sales management system based on data and regular sales meetings
- Recruitment of the top executives and management staff from major food manufacturing companies

They also started measures for “visualization” and they are now able to share real-time information on their business activities such as sales, manufacturing and budgeting. Thus they have established a system under which they can implement the PDCA (plan, do, check, and act) cycle to check what is happening now, to think what action is required next and to implement actions to be taken. They will study the possibility to expand their market to Asian countries in the future to make a step toward globalization.

(3) Globalization through Cross-border M&A

In the case of a major manufacturing company that has accepted an investment by a foreign affiliated PE fund, they promoted cross-border M&A of the European and U.S. companies to advance authentic globalization. The first reform was implemented on the personnel and compensation system. When the U.S. or European companies are acquired and the top executives and employees of such companies become members of a Japanese company group, difference in compensation between U.S./European companies and Japanese companies, which is caused by the difference in average compensation levels between them, is considered to cause a decrease in motivation of the top executives and employees of the Japanese company that is the world headquarters of the group. Under such circumstances, a common KPI was set based on EBITDA to adopt a yearly and long-term flexible compensation system. The right to stock options was also granted for employees, as a long-term incentive. Then the administrative accounting system and IT system were enhanced and integrated so that they could easily understand how much the “appropriate amount of EBITDA of the business group” is and how much the “appropriate amount to which the person in charge has to assume responsibility” is in relation to the preset KPI. They spent a period of one year for such efforts as above and, thereafter, they proceeded with the acquisition of the European company. This acquisition was very strategic. Namely, they analyzed strong and weak points of both companies for every business field and established a policy that the company having stronger advantages should take the initiative in the business operation. There were some business field for which value could be enhanced by the merger of the companies, and the acquisition was executed on the basis that the company will eventually be sold off. It seems difficult for Japanese companies to make such a dynamic deal without involvement of an overseas company. It may not sound perfectly reasonable for Japanese companies to acquire any company on the basis of sell-off thereof or to have personnel of the acquisition target be appointed as the leader thereof. Through such intrepid reform, the said company is about to achieve reform toward an authentic global company.

Regardless of the fact that they are foreign capital affiliated company, the majority of the staff are Japanese who work in offices in Japan and have expertise in management of global companies. Therefore, it can be considered as one of the effective measures to accept a PE fund that is performing business operations on a global basis as a partner to achieve the reform of management toward a global company.