# Management Consultancies for Mergers & Acquisitions

VERVE

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## ADVANTAGES USING MANAGEMENT CONSULTANCIES FOR MERGERS & ACQUISITIONS

A management consultancy can provide invaluable assistance to help any organization improve its performance working as your advisor. It can focus on the operational aspects of a company, working to improve sales strategies and reduce operating expenses. For example, **VERVE** can serve as an advisor on decision making, from what markets to enter, to conducting the mergers and acquisitions process. **VERVE** works with some of the top financial, technology, communications, manufacturing, and pharmaceutical organizations in the mergers and acquisitions process, also commonly known as M&A.

By raising awareness of the issues associated with M&A, one will note the advantages of management consultancies and how these organizations can help businesses avoid common mistakes that occur during the process. These include improper planning, failing to expedite the discovery process, poor due diligence, neglecting information security, failing to integrate the corporate culture, and paying more than fair value. With poor execution comes a failure to deliver on expectations, leading to post-acquisition problems.

Mergers and acquisitions is an area that represents a solid opportunity for management consulting firms. The opportunity enables a consultant to be indispensable to clients, and to increase client revenue. This sector is booming, in part due to the activity of accounting and auditing firms such as PricewaterhouseCoopers, Ernst & Young, Deloitte Touche Tohmatsu, and KPMG – collectively known as The Big Four.

An advantage of **VERVE** is that it has the expertise of these firms, but is more flexible. Its perspectives are fresh and its solutions are innovative. Clients also have the advantage of forming personal connections with a consultant with decades of industry experience.

**Some current drivers of M&A are:**

- Buyers often see M&A as a strategic way to expand, rather than by other means
- An organization's decision makers may take a bet on the economic value
- Industries such as healthcare, natural resources, and oil and gas are in high demand
- Technology assets can be brought in house, rather than as a partnership
- U.S. firms are looking for resources and talent in emerging economies
- Foreign firms looking to expand in the U.S

## M&A Has Become a Seller's Market

It's not a bad time to be a buyer, but sellers are certainly on the favorable side of the coin. Buyers do have to be diligent in knowing they're getting what they believe they are, and many sellers waited until after the recession to get started. Demand has since increased. With buyers reaching out to potential acquisition targets, which may not even be on the market, one can see that the demand is high. The acquisition process can take years. Sellers, however, are at an advantage given the present trends and conditions.

The trends, of course, do fluctuate. Mid-market deals fell 10% in early 2016, and volume fell from 896 to 655 deals in a year, according to Mergermarket Group. Some sectors were trending towards a buyer's market. Selling

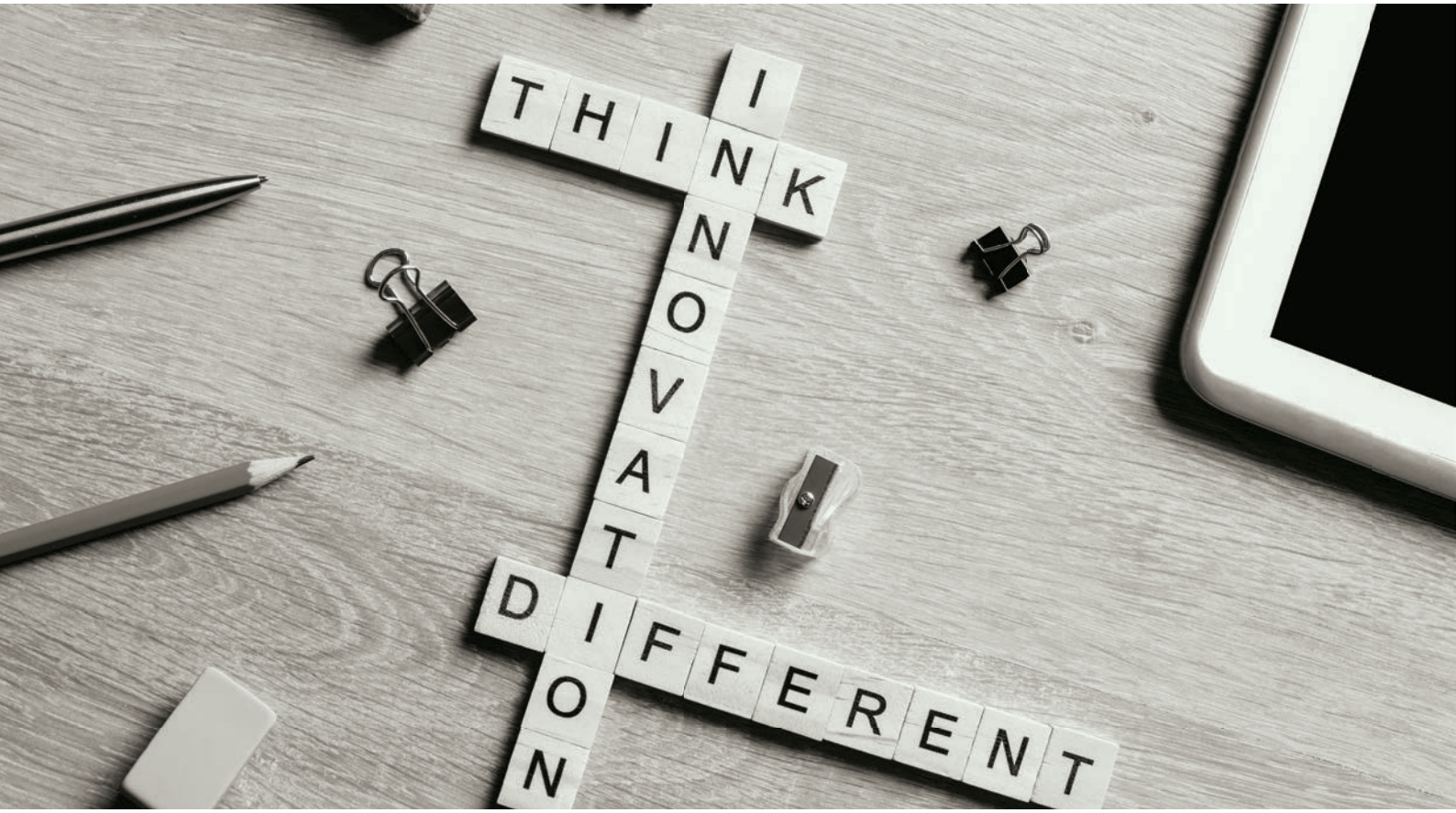
### Exclusive Negotiations Are Getting Shorter

Today, exclusivity may not be granted which is very different from the past. Both parties may show they believe there is a zone of possible agreement, and take a specified period of time to negotiate. They are effectively locked out from discussing the matters with others, so finding better alternatives to a negotiated agreement is less likely, or those alternatives may not be as favorable. For buyers, there's more time to investigate, negotiate, and conduct due diligence. Lockouts during the M&A process can last for a year or more. Non-exclusivity is more financially beneficial to sellers, so they can negotiate with multiple parties.

opportunities, however, are expected to continue to be present. The influencing factors include whether conditions are favorable for sellers in a particular sector, the advantages/disadvantages of working with a strategic or private equity firm, and valuations.

### Healthcare and Technology: Two Hot Industries for M&A

These industries represent the most lucrative sectors for deal-making, even more so than energy. In healthcare, pharmaceutical giants are fueling the growth of M&A. Insurers are looking to scale up as regulation continues to increase. Targets for acquisition also include specialized practices, outpatient services, urgent care services, and physician groups. The Affordable Care Act has had an effect as well. Many organizations are looking to improve care experience, population health, while reducing costs, and resorting to M&A in a growing economy and at a time when interest rates are low. Technology deals represent a trillion-dollar business. One trend is to purchase IT companies with the IT personnel needed. Finding technology experts is generally a challenge, and unemployment in this sector is low. Buyers are making the decision to acquire organizations with the appropriate manpower, instead of seeking to hire workers with skill sets that are relatively scarce. Such organizations are also favored due to their recurring revenue and predictable earnings, at least prior to interest, tax, depreciation, and amortization.




## Private Equity Firms and M&A Transactions

These organizations have specific needs when it comes to M&A transactions. After all, they exist just to buy and sell companies, raising money from limited partners along the way. The funds are managed by general partners, who oversee a firms daily operations, make investment decisions, and manage the companies that are acquired.

Nowadays, private equity (PE) firms are providing more assistance and management after the deal. High valuations are increasing the competition, and these firms are often outbid during the buying process. It's common for a PE firm to attain greater ownership of a company, and have board seats. Although the client company's existing management team usually runs day-to-day operations, in a different arrangement, they could lose complete control. The PE firm's ownership and the ability of the management team brings a strategic advantage in terms of access to capital and operational expertise.

## The Consulting Firm and the Client's Management and Executive Team

One way to determine if the relationship with a consulting firm is positive is if the consultancy requires access to the client's management team and executives. They need to be involved in the process; otherwise, key individuals may leave and that means a loss of talent. Companies also may fail to address cultural matters that can determine how people feel about the new environment. This can cause talented people to leave.

### Transaction Structure and Tax Due Diligence

The transaction structure is important to consider during an acquisition, as it can have significant tax consequences. A business acquisition can involve most assets and liabilities of an organization, or a transfer of corporate stock or partnership interests. Transactions can involve the purchase of corporate stock or assets. The tax consequences for the seller are fewer for a transfer of assets and partnership interests than corporate asset or stock sales. In any case, tax due diligence is an important part of the M&A process. It helps to focus tax indemnity negotiations, especially when the buyer is acquiring an entity. An entity's entire tax history will be under review, and any liens on assets or taxes not paid prior to closing will be scrutinized. In addition, each party must decide who controls key tax matters. They must decide how to apportion the cost of taxes applicable before the closing date, due after closing, and taxation related to the transaction. The cost of property taxes, excise taxes, and similar ones are often split between the two parties. Return filing, audits, and the handling of non-income taxes need to be addressed as well.

The board typically reviews and approves proposed transactions. It also advises on financing, structuring, and integration and has a say in due diligence and whether the acquisition is a strategic fit for the organization. Strategy setting and risk management are typically overseen by the board as well.

## Key aspects of tax due diligence

**Revenue recognition**: One needs to consider the U.S. Generally Accepted Accounting Principles (GAAP). In the case of a multi-element contract, it requires that revenue recognition be deferred if failing to deliver any remaining elements results in a tax refund. Revenue is recognized in the form of a delivered element, even with a later refund, per the International Financial Reporting Standards (IFRS). It is more principles-based, while GAAP offers more rules and guidance in regards to revenue recognition during the merger and acquisition process. Given certain criteria are met, it allows for a "percentage of completion" approach. If this value cannot be estimated in a reliable way, IFRS requires a cost-recovery method or revenue-cost approach to be applied.

**Tax treatment of stock-based compensation**: Corporate stock purchases are non-taxable, but the taxation is deferred rather than avoided. The tax requirements of the different types of tax-free reorganizations differ. The stock target shareholders receive a carryover basis that is equal to the fair market value of the stock. Each owner retains a continuing interest, so recognition of the gain or loss can be deferred to when the stock is sold.

An LLC is often taxed as a pass-through entity, so tax-free reorganizations are rare.

**Compliance with foreign operations**: Acquiring a foreign entity requires being compliant with the Foreign Corrupt Practices Act of 1977. The activity of the target organization can be a liability, even if their conduct didn't violate any principles before the acquisition. Prohibited activities include officers, directors, or employees offering or authorizing corrupt payments or gifts to influence a foreign official's decision.

**Inter-company transactions**: Tax regulations, sharing arrangements (including operating or lease agreements), and cash-flow statements of carve-out entities are just a few aspects that need to be considered among stakeholders.

### M&A and the Consequences on IT

There can be significant consequences on IT during the process. Unfortunately, they are often overlooked at the beginning stages. Areas to consider include governance, structure, security, privacy, and operational processes. During reorganization, help desk support, change management, performance monitoring, and disaster recovery need to be addressed to be sure they are in place and adequate once the merger is complete.

**Old Hardware/Software**: If a company is using older hardware and software infrastructures, there can be hidden costs that are quite high. Many consulting firms overlook this matter. Applications and processes can often be consolidated, while redundant platforms should be eliminated. **VERVE** has seen the financial impacts that older technology can have and ensures the matter is addressed early in the process.

**Origin of IT Information**: It is unusual that the seller and buyer use the same information systems. Compatibility is an issue as well; once the transaction is finalized, effective communication between the buyer's and seller's systems is important. Working with an outside vendor often allows for a more effective outcome.

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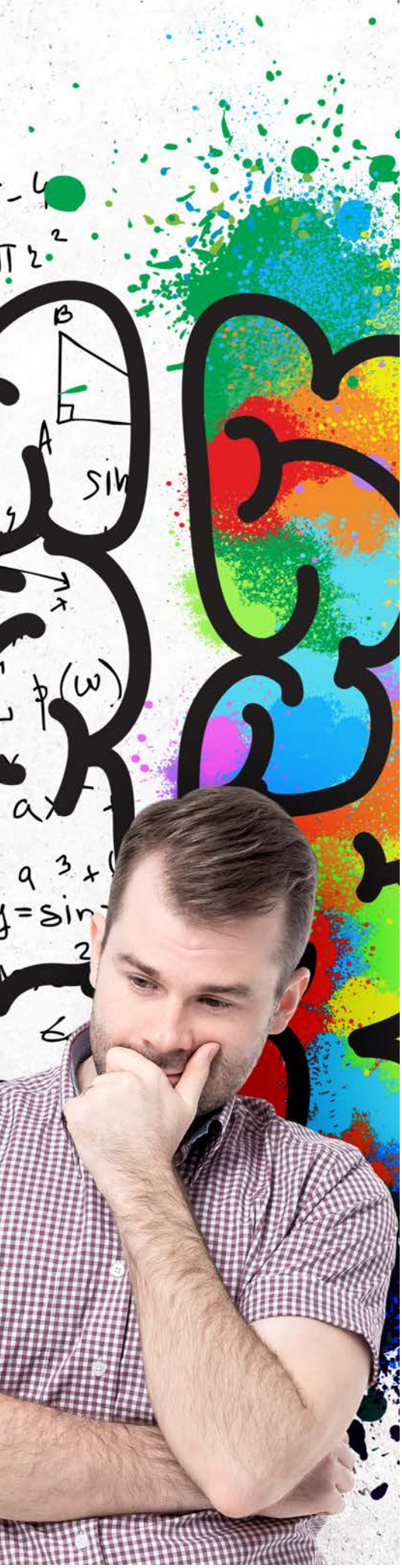

**Industry Regulations**: These vary depending on the company's industry. If it is highly regulated, IT infrastructure is subjected to stricter compliance standards, which can complicate matters if multiple infrastructures are in place. Highly regulated industries include health care, banking, education, and defense.

During an acquisition, IT requirements should be assessed, and the team should assess any gaps in capabilities. Initiatives should then be prioritized based on business impact, ease of implementation, and anticipated benefits. Key risks need to be considered by IT leadership, especially those related to growth and cost savings. The leaders of IT implementation must be identified early, so there will be less uncertainty later in the M&A process. Potential initiatives can also be defined as the merger is occurring. Inherently stressful on any IT organization, mergers can be made more productive with effective communication and articulation of the overall vision.

## How to Work with an Advisor

An advisor that has experience with M&A can help with rough patches every step of the process. Someone with no experience selling a company should never try to navigate it alone. The tasks are complex, and it's challenging to run a business and try to sell it simultaneously.

**Bring advisors into the process early**: Getting started on the right track saves time and minimizes the chances for errors. Multi-million dollar exit transactions are common. Professionals help to design strategies and focus on valuation expectations, post-transaction goals, timing, and finding the best process. Business owners who pursue a sale may be thinking of only cost, or have other ideas in mind, but an advisor will help focus their efforts in a logical way.

**Let your advisors know your "deal breakers"**: These may involve financial, funding, legal, tax, or personnel factors. Negotiation issues and risk-related matters can affect the deal as well. Pricing and valuations are among the most common deal breakers. Cultural gaps, lack of communication, or lack of chemistry between the buyer and seller may cause further issues. Discuss each factor and with an advisor so they can guide the process more efficiently.

**Choose a flexible consulting firm:** Acquirers often want new operations to be flawlessly integrated into their philosophies and operating strategies.

More thought needs to be put into the process for a more successful integration. A flexible consultant will offer new ideas and strategies. They can also help streamline finding IT outsourcing providers, and more to avoid the rigidity that can cause many deals to go stale. Since there are several parties involved in an M&A deal, being creative can be extremely useful.

**Communicate with the advisor and a legal team:** Don't only rely on the words of an advisor, but also legal experts involved. Legal advice will focus on regulatory frameworks, for example, while advisors such as investment bankers concentrate on non-legal matters. Legal factors include timeline, limitations of confidentiality, nondisclosure agreements, and due diligence. Help with documentation and other legal matters is important, but litigation is generally not helpful during the acquisition process.

**Use advisors familiar with the industry:** The advisor should know all the regulatory, legal, and economic aspects of the industry; an industry review is often conducted in the beginning stage of the process. The more familiar with the industry the advisors are, the better they can be at negotiating, sharing the right documents, and communicating.

### Miscellaneous Issues

A number of other issues can affect the mergers and acquisitions process. If they come up unexpectedly, they can slow things down. An issue that can sideline the deal can become a "deal breaker", especially if one entity did not come forward with the issue the beginning stages of the process.

**A seller with multiple legal entities**: The entity a buyer intends on acquiring may have multiple entities with different tax attributes. Obviously, the same taxation principles can't be applied to every entity. Purchase of assets and stocks have different requirements, as mentioned earlier. Each entity may have a different structure, so the M&A transaction must be negotiated accordingly. State and local taxes can affect the

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management, and executives can work on a strategy and be on the same page in terms of goals and performance expectations. The board typically reviews and approves proposed transactions. It also advises on financing, structuring, and integration and has a say in due diligence and whether the acquisition is a strategic fit for the organization. Strategy setting and risk management are typically overseen by the board as well.

**Joint venture agreements:** A joint venture can be beneficial to both parties, as skills, people, experience, and equipment can be shared. It also opens new customer bases. A legal partnership, a joint venture means the founding participants own the new organization created, but these organizations operate separately rather than forming a new company in their place.

**Overseas work:** Overseas deals involve special financial and legal challenges. Planning, communication, contracting, and the economic environments of each country are factors. The influences can range from cultural to market differences. All factors need to be considered so the M&A process and outcome can be favorable.

**Foreign currency and exchange issues:** Cross-border mergers and acquisitions are greatly impacted by foreign currency exchange rates. Typically, an acquiring company is in a country with a stronger currency than where the to-be-acquired organization is located. It also often has a greater relative value. The target company's debt may be paid for with the acquiring organization's higher valued currency. Transactions with higher relative currency values often include cash as well, to capitalize on the country's strong currency.

**Lack of audited states by reputable firms:** The advisory firm should be aware of all the tax and other financial issues in the states or countries of organizations involved in the transaction. If not, then there can

be significant gaps in knowledge that can affect the outcome of the transaction.

**Lack of transparency or availability of management:** Transparency should be in place from the very beginning. It can accelerate timelines, influence decisions regarding an acquisition at an early stage, and reveal the information and business processes of the selling and buying organizations. Visibility into compliance issues is important, as a significant percentage of acquisition targets lack sufficient levels of compliance and data security. Transparency also affects communications with internal employees and with customers and partners, hiring, operations, and defining the metrics for success. Management should be open to discussing everything from integration to new product messaging, to governance risk.

## Conclusion

**VERVE** is experienced with these aspects of the M&A process and can guide your organization through the acquisition process to ensure you are compliant with all applicable regulations. Our team can make the M&A process as smooth as possible and ensure all parties achieve their goals. Addressing due diligence, taxation, technology, and miscellaneous issues early on can boost transparency and ensure a sound strategy can be implemented. The impact of a merger on IT, employees, managers, board members, and other stakeholders can be less stressful. Partnering with **VERVE** means that an acquisition will lead to future success.

***VERVE** partners with some of the world's leading businesses and provides innovative solutions offering the same expertise of a Big Four firm or larger management consultancy. With **VERVE**, you keep control of the entire process as we help you reach your company goals. To learn more visit www.vervepros.com or call 1-888-283-7803.*

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