Bribery and Corruption

M&A Corruption Due Diligence
Introduction

- M&A transactions deal with the buying, selling, dividing, and combining of different companies and similar entities.
- M&A transactions are no longer restricted by borders or geography.
- Many corruption-related problems arise during mergers and acquisitions.
Introduction

- A number of trends have increased the importance of M&A due diligence, including:
  - International M&A activity is on the rise.
  - Executing M&A deals is more complicated.
  - Regulatory scrutiny of M&A transactions has increased.
Types of M&A Activities

- A *merger* occurs when two firms agree to pool their interests and operate as a single new entity.

- Types of mergers:
  - Horizontal merger
  - Vertical merger
  - Congeneric merger
  - Conglomerate merger
  - Reverse merger
Types of M&A Activities

- An *acquisition* occurs when one company purchases another company.

- Types of acquisitions:
  - Friendly takeover
  - Hostile takeover
  - Leveraged buyout
  - Bailout takeover
Why Companies Engage in M&A Transactions

- Reasons to improve financial performance:
  - Tax reasons
  - Synergy
  - Market power
  - Strategic realignment
  - Diversification
  - Purchase undervalued assets
Why Companies Engage in M&A Transactions

- Reasons that might not improve financial performance:
  - Managerial hubris
  - Mismanagement
  - Managerialism
The M&A Process

1. Prepare list of target companies
2. Contact approved list’s potential targets
3. Sign confidentiality agreement
4. Distribute memorandum of interest
5. Management meetings and negotiations
6. Buyer submits letter of intent
7. M&A due diligence
8. Draft purchase agreement
9. Pre-closing
10. Closing
Key Participants in the M&A Process

- Investment banks
- Lawyers
- Accountants
- Proxy solicitors
- Public relations firms
Why Mergers and Acquisitions Are Vulnerable to Bribery and Corruption

- Corruption issues might arise concerning specific payments, intermediaries, or the adequacy of internal controls.
- The target company’s malpractice could become the responsibility of the acquiring company or the emerging entity.
- Both the acquiring company and the targeted company are at risk.
M&A Corruption
Due Diligence and Integration

- An acquiring company can limit its liability by conducting M&A due diligence, rectifying any identified issues, and implementing compliance programs.
M&A Corruption
Due Diligence and Integration

For example, an acquiring company generally will not be held liable for the target’s FCPA violations that occurred before the acquisition if it:

• Implements a compliance program promptly after closing
• Discloses any corrupt conduct that it discovers
• Cooperates in the government’s investigation
Pre-Acquisition M&A Corruption Due Diligence

- Conduct a risk assessment.
- Review target company’s anti-corruption program.
- Review any past corruption and current risks.
- Conduct background checks on key executives.
Pre-Acquisition M&A Corruption Due Diligence

- Conduct background checks on key employees.
- Interview key executives.
- Identify target’s jurisdictions.
- Interview target’s employees.
- Review the target company’s business practices.
Pre-Acquisition M&A Corruption Due Diligence

- Use data analytics to uncover red flags.
- Review target’s third-party files.
- Include representations in the agreement.
- Delay agreement if an issue arises.
- Monitor target’s business activities until the merger or acquisition takes place.
Post-Acquisition Integration

- Due diligence obligations do not end with the closing.
- After closing, the company must strive to fix any shortcomings identified:
  - A weak tone at the top
  - Inadequate code of conduct
  - Inadequate anti-corruption policies or procedures
  - Poor or no procedures for third-party due diligence
  - Local risks
  - Insufficient training
Post-Acquisition Integration

- After closing, combined companies’ policies and programs must be harmonized by:
  - Providing an ethical tone at the top
  - Establishing an ethical culture
  - Implementing entity-wide policies and programs
  - Furnishing uniform training
  - Reevaluating third parties
  - Establishing a uniform accounting system
  - Considering uniform technology
  - Informing management and others of identified issues
  - Conducting audits on new business units
Red Flags in M&A Transactions

- The target is in a region with a history of corruption.
- The target’s industry has a history of corruption.
- The target has no anti-bribery programs.
- The target’s employees have government ties.
- The target uses shell companies.
- The target uses cash excessively.
Red Flags in M&A Transactions

- The target has invoicing discrepancies.
- The target recorded an excessive amount of gifts or expenses.
- The target made payments to government officials.
- The target’s third-party controls are inadequate.
- The target employs dubious agents.
M&A Transactions and Insider Trading

- High-stakes financial activities, such as M&A, lend themselves to insider trading.
- Insider trading occurs when an insider trades securities while in possession of material, nonpublic information about the security.
- Insider trading on confidential information about impending M&A is prevalent.