

Deal or no deal: The crucial role of anti-bribery and anti-corruption due diligence in M&A





Mergers and acquisitions (M&A) are popular methods for corporate expansion, enabling companies to achieve synergies and increase market share. In the Middle East, the technology sector accounts for the majority of the transaction volume, followed by the chemical and medical care sectors. In 2023, the United Arab Emirates (UAE) topped both the list of target and bidder nations in terms of value, followed by the Kingdom of Saudi Arabia (KSA) and Kuwait.

However, M&A carry inherent risks, particularly when comprehensive anti-bribery and anti-corruption (ABAC) due diligence is not diligently conducted. An unfavorable outcome in M&A could result in significant financial losses for firms, tarnishing a company's reputation and exposing directors to the risk of personal liability. Fraud concerns in acquisitions and investments have caused billion-dollar write-offs for multinational firms in the last decade. As a result, many have questioned the due diligence and supervision of high-profile and skilled investors after company collapses. Even experienced boards have acknowledged occasional lapses in giving sufficient attention to ABAC due diligence.

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Risks associated with lack of ABAC due diligence in M&A

M&A transactions present a variety of challenges and risks. By nature, major M&A transactions require interaction with government entities, which tends to increase the likelihood of bribery and corruption. Provision or receipt of unwarranted benefits to the target firm may result in financial losses due to legal penalties in addition to reputational harm. Moreover, M&A risks extend beyond the country where the involved parties operate, encompassing potential exposure beyond national boundaries. For example, if the target deals with consumers or suppliers in different countries, other non-domestic restrictions may apply. The following are key risks that could damage a deal's value if adequate ABAC due diligence is not conducted.

- **Successor liability:** Successor liability is the liability that is inherited by the acquirer after an acquisition. Under domestic and foreign bribery laws, the acquirer could be liable for ABAC violations carried out by the target prior to deal completion. Hence, if the target was found to be in breach of ABAC laws, this could lead to negative publicity and significant costs such as financial penalties that the acquirer would be liable for. Recently, the US Department of Justice implemented a new policy which entitles the acquiring company to a presumption of declination if they (1) voluntarily self-disclose misconduct discovered during the acquisition (2) cooperate fully and (3) implement a timely and appropriate remediation.¹

- **Ethics and compliance risk:** One of the key criteria for successful M&A is ensuring whether a company is the right cultural fit, which can have an impact on the efficacy and compatibility of the ethics and compliance program. An organization's culture can be defined as the way stakeholders and employees behave and the attitude and beliefs that inform those

behaviours. Culture does not change easily and it significantly impacts the effectiveness of a company's operations and its governance. Lack of culture cohesion can lead to the failure of a deal or damage its value. Failure to detect compliance and cultural red flags through proper ABAC due diligence can result in harm to the business's profitability and reputation, and risk civil and criminal liability.

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• **Third-party and jurisdiction risk:**

Although some companies might look very financially attractive on paper, in some instances, there might be hidden supply chain and third-party risks that are not reflected in the acquisition valuation. The acquiring company must have insight on the following issues when assessing the risk profile of the target:

- Are the main customers of the target governmental/state-owned entities? If so, how are these businesses awarded and are there any gifts, hospitality, entertainment, or charitable donations provided in connection with these transactions?
- Does the target engage with third-party agents who interact with customers or governmental officials? If so, does the compliance program include continuous monitoring of third-party contracts and activities?
- Does the target have significant business relationships with customers or suppliers that could potentially damage the reputation of the acquirer?
- Is the target selling products/services to sanctioned countries?

An instructive example of a failed acquisition is eLandia International acquiring Latin Node in 2007 for approximately US\$20 million with the aim of gaining access to customers in emerging markets. During a post-closing financial integration review, eLandia identified suspicious payments to government officials. After a thorough investigation, Latin Node admitted to having paid approximately US\$2.2 million in bribes to officials of state-owned telecommunications companies in Yemen and Honduras. Within a year of purchasing Latin Node, eLandia wiped out its investment and incurred additional costs due to (1) Latin Node becoming insolvent (2) the termination of Latin Node's senior management (3) incurring financial penalties and (4) the loss of customers. Had a proper due diligence been conducted pre-acquisition, such disastrous deals could have potentially been avoided. >

The value of integrating ABAC due diligence into the M&A process

Based on Deloitte's 2023 M&A Trends Survey, nearly all survey respondents (90% of businesses and 93% of private equity firms) believe that an effective transformation strategy and execution are critical to M&A results. Two-thirds of those surveyed at the Third Annual Due Diligence Symposium responded that poor due diligence was the major reason many mergers failed within a few years. Given the number of failed mergers, there is plenty of room to strengthen the type of operational due diligence that can detect deal-breaking issues before they destroy shareholder value.

Conducting ABAC checks and integrity assessments before a corporate transaction helps gain critical insights into the target company's compliance risks - findings that can be used in drafting the contract. Additionally, it may propose post-acquisition measures for the buyer, such as advising against retaining specific contracts or business relationships. Throughout the entire transaction process, it is essential to incorporate pertinent guidelines and internal controls to minimize ABAC risks within the target company.

Furthermore, ABAC checks can provide decision-makers with comprehensive information about the target company's integrity, allowing for informed decisions during negotiations and post-acquisition planning. In return, this allows for the preservation of the value of the transaction by addressing and mitigating corruption related risks early in the due diligence process.

Mitigating risks in M&A through ABAC due diligence services

Due to the broad reach of legislations like the US Foreign Corrupt Practices Act (FCPA) or the UK Bribery Act, it is critical that ABAC due diligence is conducted pre and post M&A to evaluate and test the target's ABAC and compliance programs. ABAC due diligence enhances understanding about the target, enabling valuation,

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risk assessment, and incorporation into the buyer's anti-corruption program. Additionally, it could identify factors impacting transaction pricing. Organizations can navigate and mitigate ABAC risks in an M&A setting through different types of services/approaches such as the following:

- **Pre-M&A transaction analysis:** One of the main steps to assess potential bribery and corruption risks associated with the M&A is transaction analysis, which includes the examination of specific business transactions to uncover any potential red flags associated with the target entity.
- **Pre-M&A ABAC compliance program assessment:** Such an assessment can help to evaluate the efficiency of the target's ABAC program. One of the main concerns to look out for is the tone at the top at the target company in order to assess whether the target is the right cultural fit. Such an assessment helps in identifying whether the target has an adequate compliance program and internal controls to mitigate fraud and ABAC risks.
- **Pre-M&A corporate intelligence:** Corporate intelligence services in the context of ABAC due diligence involves the collection, analysis, and interpretation of information about a company, its business partners, and the broader business environment to assess and mitigate corruption-related risks. These services aim to provide organizations with valuable insights and intelligence that can help them make informed decisions and effectively manage ABAC risks.
- **Post-M&A compliance program monitoring:** There are also post-acquisition anti-fraud ABAC compliance program assessments and implementation, which includes evaluating and establishing measures to prevent fraud and corruption in the target entity.

Companies that conduct robust ABAC due diligence on their targets, such as the approaches just mentioned, mitigate legal and reputational risks associated with M&As and drive alignment with their values and strategic goals. This process equips decision-makers with the information needed to ultimately make a conscious decision if the transaction is a "deal" or "no deal." Hence, rigorous due diligence plays a pivotal role in the success of an M&A process. ●

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Endnotes

1. <https://www.justice.gov/opa/speech/deputy-attorney-general-lisa-o-monaco-announces-new-safe-harbor-policy-voluntary-self>.