Compliance-Related Diligence Protects M&A ROI

OCTOBER 2021

By Brad Wilson and Christopher McIndoe

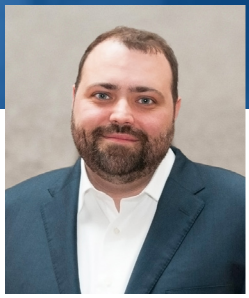
Recent antitrust charges against Argos Group and bribery charges involving Amec Foster Wheeler demonstrate how compliance problems can lurk within acquisition targets.

Even though compliance issues can destroy acquisition ROI, pre- and post-deal diligence focuses too often on specific risks—e.g., bribery, tax compliance, data privacy—rather than the overall ethics and compliance program.

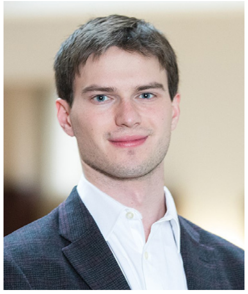
This narrow approach considers the cost of compliance-related diligence as just another factor increasing the cost basis of the transaction. Buyers should instead regard compliance-related diligence as an investment to protect and increase returns.

The costs of investigating, remediating and settling compliance issues are staggering. Reputation damage and loss of brand value decrease the target's exit value, further dragging down return. And these costs may just be the tip of the iceberg.

Compliance failures can negatively affect a business's ability to generate cash flow and recruit talent, which can also materially affect business



Brad Wilson
Partner, StoneTurn
bwilson@stoneturn.com
+1 617 570 3790



Christopher McIndoe
Manager, StoneTurn
cmcindoe@stoneturn.com
+1 617 570 3795

valuation and return on M&A. Earlier identification and remediation of a compliance issue, however, can blunt the impact on returns.

Antitrust compliance failures, for example, can severely affect return on investment. If bid-rigging concerns are raised post-acquisition, a buyer will likely incur the potentially significant costs of investigating the issue and reaching a resolution with antiitrust prosecutors. The buyer will also have to incur costs to strengthen antitrust policies and controls to protect against recurrence. Future revenues and profits can also be materially affected if the company wins fewer bids at lower prices without the advantages provided by the illegal bid-rigging.

Breaches of environmental regulations also can reduce the return on M&A. In addition to the costs of investigation, legal settlement and remediation, reputational damage can impact future sales, and the increased cost of an environmentally safe manufacturing process can drive down profit margins.

Antirust and environmental compliance are just examples of areas where problems can and do occur. Besides due diligence focusing on key compliance risks, potential buyers should determine whether the target's risk profile warrants an evaluation of the overall ethics and compliance program. Factors that increase the risk profile include operations in high-corruption risk jurisdictions, new and evolving business models, contracts with governmental agencies, and highly or newly regulated industries.

Based on our experience evaluating M&A transactions, investigating compliance failures, and evaluating compliance programs as independent compliance monitors, we suggest holistic compliance-related diligence should address four fundamental areas:

1. **Control Environment.** Is there a consistent tone from the top on the importance of ethics and compliance? Does the company have a strong speak-up culture? Does the compliance function have the appropriate level of autonomy and resources?

2. **Risk Identification.** Does the company have a process to identify its risks? Are both business and compliance personnel involved in the risk assessment? Is there a process to identify emerging risks? Is the assessment done at a granular level?

3. **Risk Response.** Does the company have a controls inventory? Are controls in place to remediate key risks? Are the personnel performing controls activities competent?

4. **Controls Assessment.** Are key controls regularly tested? Are testing results reported to senior management? Are identified control weaknesses timely remediated?

Assessing these four areas can greatly enhance a buyer's understanding of potential compliance problems before closing and can help focus resources on the highest risk areas first. Savvy investors will include an evaluation of the overall ethics and compliance as part of due diligence. A well-designed compliance program says a lot about a company's leadership team, its commitment to long-term returns, and its ability to overcome the unforeseen obstacles that undoubtedly lie ahead post-deal.

This article originally appeared in **Crunchbase News, October 2021.**

About the Authors

Brad Wilson, a Partner at StoneTurn, leverages 17 years of experience in forensic accounting and forensic auditing to advise companies and their counsel on complex financial, accounting, valuation and compliance matters.

Eva Weiss, a Partner with StoneTurn, has more than 25 years of experience in forensic investigations and compliance controls and monitoring for both the public and private sectors.