



United States Market Entry for Foreign Enterprises

Due Diligence

This blog post continues our Foreign Direct Investment series for Italian enterprises seeking to enter the US marketplace via an acquisition of or merger with an existing US business. In this post, we discuss the strategy and critical importance of “Due Diligence”.

When viewed from a long-term perspective long after a Target has been assimilated into a Client’s operations, the M&A project phase commonly referred to as “Due Diligence” may have the greatest impact upon the Client’s return on investment. Yet, many M&A advisors would submit the ultimate purchase price paid for the Target is the real determinative factor with respect to the Client’s return on investment (“ROI”). However, the due diligence phase is the only project phase which provides an in-depth view of the benefits which may accrue to the Client from its investment as well as all the “warts” and potential “landmines” strewn in its path by the Target.

It is an age-old axiom of criminal jurisprudence that **“a defendant must take their victims as they find them”**, i.e., it is no excuse for the defendant if the victim has a pre-existing condition which contributed to the victim’s demise. Within the context of an acquisition transaction, this holds true as well and only thru a comprehensive due diligence examination of the Target can the Client adequately prepare to defend its investment thesis.

From a strategy viewpoint, due diligence should be undertaken with the view to either confirm or reject the Client’s seminal investment thesis. For example, if the foreign direct investment is predicated upon the Target’s top line sales generation, then the emphasis in due diligence should focus upon everything which contributes to Target sales, such as its direct and indirect sales channel assets, quality of Target’s product line, bookings and backlog, production supply chain, etc. Similarly, if the acquisition is driven by the Target’s intellectual property portfolio (“IP”), then the Client should take a deep dive into all aspects of the Target’s IP assets and personnel, replete with a “Freedom to Operate” opinion issued by competence patent counsel where Target has patents on file or has pending patent applications.

Of course, the due diligence exercise is not complete unless all other operations of the Target are examined as well. To this end, the Client should assemble a competent and experienced due diligence team comprised of key personnel as well as third party advisors and consultants, such as accountants, finance professionals, lawyers, engineering and technical personnel, and each should be assigned specific tasks consistent with their relevant areas of competence. Upon completion of their respective investigations, their findings should be compiled in a written report and submitted by the CEO to the Board of Directors with the CEO's final recommendations as to a final "go" or "no-go" as to the foreign direct investment. Many a CEO's fate and tenure have rested upon this recommendation. ***Thus, for the CEO, there is simply no substitute for a thorough and professional due diligence examination.***

Lastly, it would be remiss not to mention the "roadmap effect" which a comprehensive due diligence exercise provides the Client. Most notably, it guides the drafting of the definitive acquisition or merger agreement as the "warts" and landmines" discovered in the due diligence of the Target will surface as curated representations and warranties in order to allocate the assumption of risk between the Parties. Equally important, due diligence must also be undertaken with a view toward shaping and drafting the post-transaction integration plan and assimilation of the Target into the Client's operations.

In sum, only thru an in-depth due diligence examination can the Client adequately understand and address the many issues and operational challenges confronting the Client on the very first day following the closing of the transaction at hand. To a large extent, many of these issues require adroit human recourse planning and melding together two disparate workforces and cultures; not an easy task by any stretch. Again, a competent and thorough due diligence examination is the best way to get it right....

Next up in our Foreign Direct Investment Series will focus upon “Deal Structure”.