

MADD—What's the **Catch?**

The financial traps in Merger and Acquisition Due Diligence

By Johnny Yu

SOMETIME DURING late 2007, one of Watson Wyatt's Benefits and Actuarial Consultant in our Shanghai office received a phone call from a China client who happily told us that they had just finished the acquisition of a former competitor. As the actuary of this company listed overseas and domestically, we were happy to hear the news but felt concern over the matter at the same time...

Our concern was justified two months later when preparing their 2007 year-end financial disclosure. The company they had acquired used to be a state-owned enterprise (SOE) where employees are entitled to traditional supplemental retirement and long-term health benefits. Unfortunately, during the Merger and Acquisition Due Diligence (MADD), the implicit financial liabilities of these benefits were somehow overlooked. Although the buying price reflected the estimated cost of the employee benefits for the next five years, it amounted to far less than needed to cover the total liability. Indeed, the final calculated liability was actually about 50% of the deal price. Furthermore, the liability would show up on the balance sheet for a long time until all the covered employees passed away, and it would also significantly impact their Profit and Loss. In other words, they were 'losing an arm and a leg' in this deal.

Actuarial consultants are not fortune tellers. The reason we can 'tell the future' lies in the numerous Merger and Acquisition cases we have done in the past. For many reasons, a company could face various 'traps' in the process of a MADD.

The inevitable 'historical problem'

Thanks to thirty years of rapid economic development, there are many types of enterprises that play an active role in China's market today. They are based in different places; have different backgrounds and development paths; and continue to maintain distinct characteristics.

While these companies were being born and taking root, the three decades also saw the development of economic legislation in the country. Many laws were established which were meant to





MADD 有甚么隐藏 的问题？

小心并购尽职调查的财务陷阱

文/ 于晨

2007年底的一天，华信惠悦座落在上海的办公室，我们的福利精算咨询顾问收到了一个内地客户的电话，客户高兴地通知我们，他们刚刚并购了一家原来的竞争对手！作为这家海外和国内上市企业的精算师，我们一方面分享他们的兴奋，但同时也增加了一份隐忧……

我们的担心在两个月后成为现实。这家客户并购的是一家国有企业，当我们在按照国际和中国的会计准则，为他们准备2007年底的精算披露报告的时候发现，他们所并购那家企业的员工享有著传统形式的统筹外退休和医疗福利，而这些福利所产生的隐性负债在并购尽职调查时被忽略了。虽然成交的并购价格反映了未来五年这些福利的预计支付额，但是这五年的支付额是远远不够的：我们最后估算的负债达到了这个并购价格的50%，而这一负债将长时间留在客户的负债表上，对每年的损益也产生巨大的影响。用句通俗的话说：我们的客户这次‘亏大了’。

我们之所以能够在进行精算评估之前的两个月就‘先知先觉’，正是因为在一一次的并购前的尽职调查中，为客户发现了诸如此类的隐含问题。由于种种原因，企业在并购的尽职调查阶段面临著各种各样的‘陷阱’。

provide a more and more standardized and fair competition platform for enterprises which were expanding quickly in China, thereby ensuring the positive, systematic and rapid development of the society's economy.

Even as legislation and policy took shape and became more comprehensive, the enterprises couldn't meet, let alone match these changes. While many companies made the fundamental adjustments necessary to operate under these new laws they ran into problems. First, not all companies could adjust smoothly to the more regulated environment, and second, not all companies could understand the new laws clearly and comprehensively.

In cases where firms were unable to execute a smooth transition to meet the requirements laid out in new policies, managers opted to delay mandated changes, in a move known as 'grandfathering.' This solution led to complicated situations due to the separation between people entitled to grandfathering and those not entitled, because the move was temporary, a stopgap, rather than a solution to the problem. Firms that opted to use 'grandfathering' hoped that those issues would eventually disappear with time.

Changing legislation

But the second issue is more difficult to handle and resolve, since no enterprise can grasp a total understanding of all new legislation, particularly when laws are passed and adopted within a short period of time. Often the decision makers within the organization had no knowledge or understanding—especially of the long-term consequences—of their decisions. What would have been considered a 'good' decision at the time of making could easily go the other way as the laws and regulations keep changing.

Now some readers may say that there has always been issues resulting from constant variations and improvements in corporate legislation. Why are problems surfacing or becoming more significant today?

Problems are becoming apparent because of the change in the people's mindsets. A growing number of entrepreneurs consider adherence to an economic legislation as the key to maintaining a business's healthy, long-term development. The increase in the number of professional organizations have also further educated the market, making the concept of good corporate governance more and more widely acceptable.

But only when the existence of potential problems is widely accepted and talked about, will companies and managers recognize their importance and start to systematically deal with them.

From 60 thousand to 10 million

Borrowing for a famous film script: 'What resource is most lacking in the 21st Century?'

'Talent,' is the reply.

A quick look at the average age of leaders in China and the amount of time they stay loyal to an employer gives an idea of the desperate need for talent in. Many enterprises are employing different means not just to attract, but to retain good staff. But some of these employee

“During the Merger and Acquisition Due Diligence (MADD), the implicit financial liabilities of these benefits were somehow overlooked”



不能回避的‘历史遗留问题’

经过三十年的高速发展，活跃在中国市场上的企业多种多样，他们来自五湖四海，有著不同的背景和发展轨迹，并且在今天继续保持鲜明的特点。而这三十年，也正是中国的立法大发展的三十年，很多与经济发展相关的法律法规从无到有，从初级到完善，给所有在中国大力发展的企业提供了一个越来越规范和公平的竞争平台，确保这个社会经济的良性的有序的快速的发展。



法规政策是一步步到位的，但是企业却不是法规到位后才出现的。企业在新的政策法规出台后，必须对其现有的运作做出必要的调整，以符合企业的最大利益。于是复杂的地方就出现了：第一，并不是所有的现有运作都可以顺利调整；第二，也不是所有的企业对所有的法律法规都能够理解通透。

对于第一种情况，那些不是那么容易调整的企业的制度，很多会延续进行，英文俗称为‘Grandfathering’。享受Grandfathering的人或事和不享受Grandfathering的人或事，自然而然就产生了复杂。Grandfathering一般并不能真正解决问题，而只能是对问题的一种临时性措施，并且寄希望那些Grandfathering的问题能够随着时间的推移而自然消亡。

对于第二种情况，对企业来说难度就更大。任何企业都不可能确保对所有的法律法规了如指掌，特别是在我国的法律法规快速大量出台的情况下。很多企业的决策者在做出决定的时候，往往并不清楚这一决定对企业的整体影响会怎样，尤其是长期的影响如何；更有很多今天看来正确的决定，可能在明天政策法规改变时就不再是最好的决定了。

或者读者会问，企业的多种多样和法规的不断完善而带来的复杂性并不是一天两天的事情了，那为什么今天才显得如此突出呢？

笔者认为，原因在于人们的思维方式在改变。按照经济规律办事，按照政策法规办事，被越来越多的企业家确认为能够保持长期健康发展的不二法门。更多的专业机构的涌入，更教育了这个市场，并推动这种理念，使其更广泛地被诸多企业所接受。

当所有人都开始谈论这些问题，当所有人都意识到这些问题的重要程度时，复杂性的客观存在才在人们的主观上获得认可。

从六万到一千万

借用电影里的俏皮话：‘二十一世纪最缺乏的什么？是人才。’不过，你只要看看你周围那些企业精英骨干的平均年龄和他们在一家企业停留的时间，你就知道今天的中国是多么需要人才，而各个企业也在绞尽脑汁，用不同的办法保留和激励员工。可是，要当心，有些没有书面化的‘奖励’已经是造就了一个并购的‘陷阱’。

笔者去年在桂林进行一项并购尽职调查的时候曾发现，一位老总给他下面的五名骨干口头承诺，如果这些骨干在公司工作满五年，公司就奖励每人一套价值一百万元的住宅。这种口头承诺是不会出现在任何报表中的。这次并购后来没有成功，但是假设它成功了，而这个口头承诺在尽职调查的时候没有被发现（毕竟，尽职调查往往是秘密进行的，这五位骨干怎么会记住他们要‘提醒’调查员这项潜在债务），那么在双方举杯庆祝交易成功的几年后，就很有可能出现某位骨干在总裁办公室里大吵大闹，要求得到‘应得’房产的场面。

这仅仅是一个很小的例子，但为什么会这样状况呢？那是因为我们企业的老总在推出类似的‘保留人才’的计划时，很少考虑它们对企业的财务的长期影响，即便是在决策一些书面化的政策。

再举一个例子。北京的生活费用是很高的。一天，人事部的王部长找到企业老总，申请给在职的二百名员工每人每月增加一百元住房补贴。这个企业效益很好，员工的月平均工资是五

“福利所产生的隐性负债在
并购尽职调查时被忽略了”

rewards and incentives aren't on the record, and they constitute another possible trap in the world of Mergers and Acquisitions.

Examples of MADD gone MAD

When conducting a MADD in Guilin last year, it was discovered that a general manager provided five key employees with an oral promise that each of them would be rewarded a property worth 1M RMB in value, upon completion of five years of services. This oral promise would not be shown on any reports. The merger and acquisition failed later, however, if it had been successful, the verbal promise would be unlikely to be discovered in the due diligence process (generally, due diligence are conducted in a confidential manner, it is hard to imagine that the five employees would have 'reminded' the investigator of the hidden promise). But should the deal have gone ahead, there would likely have been subsequent problems created by the five employees claiming their 'due'.

This is just an example, but why do such situations happen? This is because when senior executives implement 'Talent Retention' plans, they need to think more carefully of the possible impact those measures may have on the enterprise longer term financial health.

Let me cite another example. The cost of living in Beijing is high. One day, the head of Human Resources, a Mr. Wang, met with the general manager of one company, to ask for a 100 RMB increase in housing allowance for 200 staff members. The average monthly pay of each staff member was 5,000 RMB. To spend an extra 20,000 a month would mean an additional expense of 240,000 a year—which is not a large sum. After some consideration, he decided 300,000 was not a considerable expense; so he also allocated 60,000 among staff members who had retired earlier at a rate of 500 a month. After all, he reasoned, he could afford to help because profits were good.

The manager was not a 'philanthropist'. The real purpose was that: a couple of ten thousand was not a big amount, but it would demonstrate to the staff feel that the company cared about its employees' welfare. That would help the staff focus on work with a higher morale, their faith in the company restored and the company would be better off.

But in signing off on the benefit, the general manager ignored the financial implications of his actions, and this is a common problem among senior management in China today. China's accounting regulations and practices did not conform to international standards until 2007; the new standards require the disclosure of any long term liability for employee benefits, i.e. the actuarial liability, in the balance sheet and income statement.

If the general manager was aware that the amount of 60,000 RMB, which he just signed off for retirees, would translate into a debt of RMB10 million in the corporate balance sheet, would he still sign off on the amount? This is not an exaggeration here but a real case that was just handled before writing this piece.

Eventually this merger was carried out smoothly, with some necessary changes made to the terms of the housing allowance before both parties signed the contract so the 10 million RMB would not be reflected on the balance sheet, and the story ended happily. But what if our actuarial consultant had not discovered this

“When problems are widely recognized, managers will start dealing with them”



“当所有人都意识到这些问题时，经理才开始着手处理”

千元，每个月增加个两万元，一年也就是二十四万元，确实不多。老总想了想，觉得三十万也不是什么问题，多出的那六万元正好可以给公司十名已经退休的员工：每个人每个月五百元，毕竟人老退休了，企业效益好就多帮帮他们。

老总不是‘慈善家’，他这么做的实际目的是：几万块钱不多，但是可以让现在的在职员工觉得我们企业关怀员工，以人为本。员工安心工作了，凝聚力增加了，企业就更好了。

然而，他却忽视了这一举动的长期财务影响。而这一影响往往是目前企业老总们的‘通病’，因为中国的会计准则直到2007年才开始接受国际通行的准则，要求在资产负债表和损益表中披露员工长期福利的负债，也就是它的精算负债额。

如果这个老总知道刚才他批给退休员工的六万块反映在公司资产负债表上的数字可能是一千万债务的话，他还会那么简单地大笔一挥，签字同意吗？从六万到一千万，这是笔者在单人听闻吗？不是，这实际上正是笔者写这篇文章时刚刚完成的一个项目中的真实故事。

这个并购案子最终顺利实施，而这项员工住房补贴的某些条款在双方签字之前进行了必要的修改，避免了那一千万债务在报表上的出现。这是个皆大欢喜的结果，但是如果我们的精算顾问没有发现这项福利，或者如果尽职调查的实施中没有专业的精算顾问参与呢？那么，本文开头时的那个例子有可能就有了小型的翻版。

benefit? Or what if the MADD was not carried out by a professional actuarial consultant? Then the case could have turned into yet another example of the scenario that I drew up in the beginning.

The Zhong Guan Cun depression

Even now, some new circumstances have emerged, which are confusing to the MADD investigators...

Let us take a look at the example of Zhong Guan Cun (ZGC). Its name can not be any more rustic. Zhong Guan Cun is China's Silicon Valley; a large number of high-tech companies are found here, they expect their technological advances and innovations will make them famous one day, making them the next success story, like Microsoft or Google. When success didn't come, they used just one method to retain key staff members: employee shareholder programs.

Watson Wyatt actuarial consultants have dealt with too many cases of this kind, so that when we learn that an M&A project is involving a high-tech company, we will immediately think of the impact of employee shareholder program. In addition, this effect is not limited to high-tech companies in Zhong Guan Cun: as long as there is an employee share-holding program, companies are likely to suffer from this 'Zhong Guan Cun Depression'.

On 1 February 2008, the www.p5w.net – Securities Times reported on the corporate earnings of the largest dairy product company in North China. The dairy company's projected revenue report said 'as we implemented a share-holding incentive program, according to the accounting standards, the expenses should be recognized on the company's book. This leads to a deficit in the net profit for 2007, compared to the company's net profit of 345 million RMB in 2006'.


Similarly, on 7 March 2008, Shanghai Morning Post reported the earnings of a large pharmaceutical company in South China, 'as the cost of the company's shareholding incentives is calculated based on new accounting standards, the company will be suffering a deficit for 2007... the implementation of shareholding incentives will lead to a deficit of 50 million RMB in the 2007 net profit.'

From a profit of 345 million to a negative earning, and even a deficit of 50 million, if you were the company owner, wouldn't you be depressed?

In the cases mentioned above, there was no historical problem, nor a huge liability arising from senior management's rash approval of retiree benefits. These were brand new enterprises providing their active staff with new benefits. However, due to the changes on financial accounting policies and regulations, MADDs become more complex creating the need for deeper investigation and new levels of enforcement.

Conclusion

Every M&A project needs due diligence work, and every MADD involves human resource. But if the available HR survey report only contains information of staff headcount, corporate structure, total salary amounts, and annual costs, then it's highly likely that your MADD investigator missed something in the Chinese market.

This is a diversified market full of opportunities. On the other hand, you could easily fall into the trap of being 'penny wise, pound foolish'. Beware of the traps and good luck! 

中关村忧郁症

而一些新情况的出现,也不断迷惑著尽职调查人员.....

来看看中关村吧,它的名字实在不能再土了,公司实在不能再多了,但是潜力也实在是太高了。因为那里号称中国的'硅谷':众多的高科技公司汇集这里,期待他们的技术和创新有一天能让他们一步冲天,成为下一个微软或者谷歌。而在他们没有成为微软或者谷歌的时候,他们所依赖的、留住骨干员工的手段就是各式各样的员工控股计划。

我们做过太多这样的案例了,以至于当我们听说下一个并购项目涉及高科技企业的时候,就会不由自主地想到控股计划的影响。而这一影响却并不仅限于中关村的高科技企业:只要你有股权计划,你就有可能出现这种'中关村忧郁症'。

2008年2月1日,'全景网络-证券时报'报道一家中国北方最大的乳制品公司时披露:这家乳制品公司的业绩预报称,'因实施股权激励计划,依据会计准则相关规定,计算权益工具当期应当确认成本费用,导致该公司2007年度净利润出现亏损,而该公司2006年时的净利润还有3.45亿元人民币'。


类似的,2008年3月7日,《新闻晨报》有关中国南部一家大型制药公司的报道称:'由于按照新会计准则处理公司股权激励费用,2007年公司将亏损.....股权激励的实施导致公司2007年净利润将出现约5000万元亏损'。

从3.45亿到负数,再来个五千万亏损,如果换了你,你能不'忧郁'吗?

在这些例子里,没有长期历史遗留问题,也没有企业老总大笔一挥的员工退休后长期福利,完全是新企业,完全是给在职员工的新福利,但是由于财务会计政策和法规的更新,使尽职调查的复杂性和深入性要求有到达了一个新视角和新层次。

结语

每个并购项目都会做尽职调查,而每个尽职调查都包括人力资源。但是如果你手里的人力资源调查报告只告诉你员工人数、层级机构、工资总额和年度成本,那么,在中国这个市场上,十有八九你的调查员可能遗漏了什么。

这是个丰富多彩的市场,这是个充满机会的市场,这也是个一不小心就会'亏大了'的市场。小心那些陷阱。祝你好运! 

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