

## Valitas Insights: Blockchain and M&A

### Part II – Due Diligence & Compliance, Cross-Border Payments, and Confidentiality

Last month, we introduced [Part I of the three-part Blockchain and M&A series](#). Our objective is to open readers' imaginations to the benefits of a world where mass adoption of blockchain technology has occurred. To do this, we outline five potential use-cases for blockchain technology in M&A, with an emphasis on how blockchain can *improve* rather than compete with the current infrastructure. In Part I, we covered the concept of a blockchain and discussed how smart contracts create greater certainty in contractual agreements between the parties to an M&A transaction.

In this article, we will cover possible improvements in due diligence & compliance, cross-border payment systems, and confidentiality. As a reminder, there is a concerted effort throughout the series to deviate from the typical 'cryptocurrency propaganda' surrounding superfluous price speculation and the prospect of amassing fabulous wealth.

#### **Due Diligence & Compliance**

**Current System:** The modern M&A due diligence process is cumbersome. Compiling the hundreds of documents and contracts required for M&A due diligence can, at times, be like pulling teeth. Once all the documents are finally extracted and neatly compiled into a 'data room', reviewing certain aspects of the due diligence information is time consuming and monotonous.

There is often duplication of effort, as illustrated by the example of multiple parties attempting to pin down a 'true' EBITDA figure. Duplicated efforts are particularly apparent when one considers that prior to an M&A transaction, lenders, auditors, and a company's internal finance department, have likely also spent time investigating the target's financials in a similar fashion.

**Blockchain Solution:** To understand the limitless applications of the blockchain solution, it helps to imagine a world where all transactions occur on a blockchain. For this to be possible on a mass scale, local currencies would likely need to be 'digital'. There is already speculation that some of the most powerful countries in the world are quietly investigating the feasibility of a nationwide digital currency. [Canada](#), [Germany](#), [South Korea](#), and [Russia](#) are rumored to be at the forefront of this paradigm shift. A nationwide digital currency would look something like the Canadian government recalling all Canadian Dollars and replacing it 1:1 with CAD Coin, a digital version of the Canadian Dollar.

With a digital currency on the blockchain, a key benefit is that all transactions would be tracked and permanently stored in a [distributed ledger](#), which could then be shared among all members of the blockchain. For a business, everything from payroll, to rent, to a few sandwiches ordered for a client meeting, would be stored in a permanent database, for everyone with access to review. No intermediary would be required to validate the transactions i.e. accountants, and it would be [impossible to manipulate/reverse the data](#).

With a distributed ledger of transactions, algorithms could be built to automatically index and model out every transaction for a specific company. To make things even easier, 'notes' could be stored on the distributed ledger, so everyone who reviews a transaction could input clarifications on confusing or complicated transactions. Imagine how much time this would save, replacing the tedious review of separate notes from accountants, lenders, CFOs, and whomever else has reviewed a company's statements. In addition, 'offline documents' such as employment records, supplier contracts, and

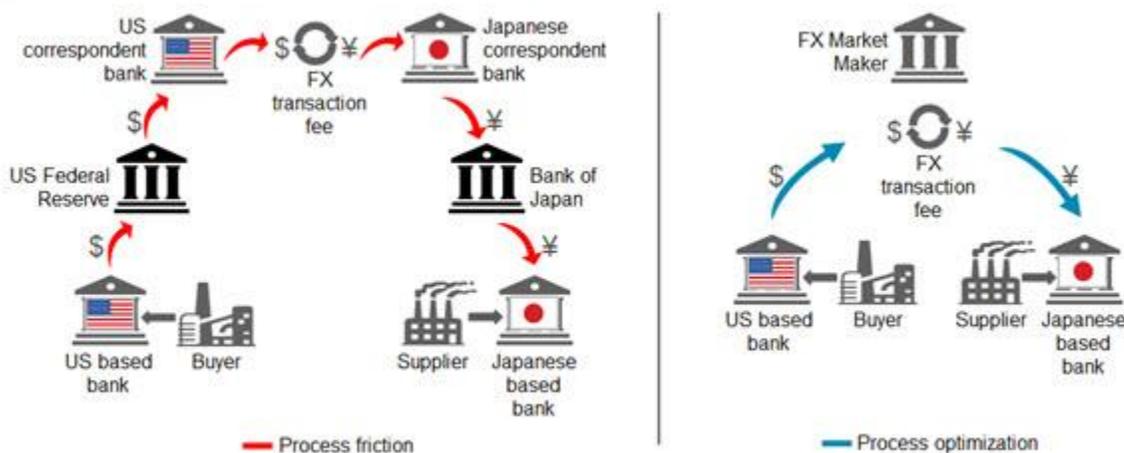
leasing agreements could be converted into digital records secured on the distributed ledger. How's that for simplicity?

Now, you may be thinking that the scenario of a digital currency and transactions being stored on a distributed ledger is unrealistic. If so, perhaps think twice. There are already companies emerging that can perform this function. For instance, [Factom Harmony](#) is working to “convert your document management solution into a blockchain based document platform that eliminates lost documents, reduces audit time and prevents costly disputes.” Still not convinced? Check out [Deloitte's publication](#) on how blockchain will change the accounting industry. Each of the Big 4 accounting firms are [experimenting with blockchain](#) and the potential implications could transform traditional audit processes. With blockchain, we would all be looking at the same database and working on one set of books, so reconciliation policy becomes a thing of the past.

### Cross-Border Payments

**Current System vs Blockchain Solution:** Sometimes, a picture is worth a thousand words. In this case, the image below provides a visual representation of how blockchain solution could both speed up transactions and reduce fees incurred by both parties in a transaction:

#### Cross-Border Payment Flows



Source: Ripple, Celent

There is no need for financial intermediaries, which reduces costs and counterparty risk. Companies like [Ripple](#) are working with banks to make this system a reality.

In an M&A transaction, the dollar figures are often enormous, and trigger correspondingly significant fees. A fraction of a percentage point in savings on transaction costs could mean millions of dollars saved for shareholders.

### Confidentiality

**Current System:** Confidentiality is top of mind during any M&A process, and is discussed at length in a Valitas [white paper](#) authored by founding partner, Paris Aden. By adopting appropriate protocols and utilizing simple technology aids such as a secure data room, watermarking documents, and



password protecting documents, the likelihood of a confidentiality breach is substantially mitigated. At Valitas, we use [Firmex](#) for our M&A data rooms. Firmex has features that allow the admin to monitor user activity, set permissions on who has access to specific files, and permit/reject entry. When a leak occurs, it is usually due to human error or deliberate malicious behavior. The system is not broken.

**Blockchain Solution:** The adage “if it ain’t broke, don’t fix it” applies here. There are some blockchain solutions available to maintain confidentiality in private market M&A, though they are likely to add complications, rather than improve current infrastructure. To understand why this is, the notion of a private blockchain is one that is worth delving into.

A [private blockchain](#), is exactly like the name suggests. It is a closed loop, impenetrable, fence where information is only shared among known participants. Private blockchains essentially create private networks of participants. To replace a data room with a private blockchain seems like overkill. Data room invites are sent directly to a recipient’s email. An email is essentially a verified, unique, identifier that gives permission only to the desired person. I doubt any data room administrator is going to give permission to enter their data room to a random “@Yahoo.com” or “@gmail.com”. Again, the confidentiality system is not presently broken, so why overcomplicate things?

One potential use case where a private blockchain could improve current confidentiality infrastructure is in a scenario where a confidential shareholder vote is necessary. This would be the case in public market M&A or widely held private companies. This [technical paper](#) written by MIT and Intel describes how anonymity is possible through private blockchains and [technical paper](#) from Dartmouth describes how voting is possible through blockchain. Combine the two, and the result is a guaranteed anonymous and secure voting system.

Anonymity, however, is typically counterproductive to M&A. Complete transparency among a managed and tightly held group is far more productive. In Part III of the series, we will dig deeper into this concept by introducing the Delaware Initiative. The implications of this initiative are so far-reaching that they could fundamentally change the M&A landscape forever. Stay tuned.