M&A Experts Agree . . . Due Diligence May Miss Significant Risk

No CEO in is his right mind would attempt to acquire another company without a thorough evaluation of the risk inherent with the deal. Assessing that risk requires a team of experienced professionals – attorneys, CPA's, tax specialists, valuation analysts, and finance experts. Their services are costly but essential.

The problem is that 80 percent of US businesses that attempt these deals fail to achieve their financial objectives within a year following deal close and 50 percent actually lose value. It's a trend that affects businesses of all sizes, across industries, markets and market cycles. And it has persisted for longer than a decade.

What's going wrong? I asked 100 M&A experts – practitioners in varying deal-making roles – to share their insights. They agree that "culture clashes" are a significant contributing factor to poor performance. Each company is wedded to its way of operating which sets up a natural conflict when integration is attempted.

Why isn't this risk identified during due diligence? According to the experts, the deal makers aren't looking for it. Due diligence is focused on exposing the risk associated with target selection with a singular focus on the value of the target company and any accounting discrepancies, legal issues, or anticipated market conditions that would significantly alter the future financial performance of the company. However, *people are the value drivers that make the difference between deal success and deal failure.* Traditional assessments of M&A risk overlook the considerable risk exposure created by human resistance to change.

This risk exposure is evidenced when integration of business operations is required. These deals are highly confidential. When they are announced, there is a dramatic shift for employees from working conditions that are known and accepted to working conditions that are changing and highly uncertain. Frequently, deals are accompanied by layoffs, changes in compensation and healthcare benefits, supervisors, work locations, and numerous other changes that affect the perceived value of the employee's job. This creates a high-stress work environment.

Adding to the stress is the information vacuum that usually follows the announcement of the deal. Typically, so much leadership time and focus is consumed with closing the deal, that integration is assigned a post-deal priority. Prolonged uncertainty about future working conditions redirects the attention of the workforce from getting the job done to determining how the deal will impact their jobs and their careers. Depending on the size of the deal, it may be months before "employee critical information" is available. Employees with marketable skills – the company's top talent – usually don't stick around that long.

M&A experts also agree that integration risks are highly interrelated. When the first risk is triggered, it sets into motion a chain of events. Each successive event triggers one or more related events – like falling dominoes. Several top sales consultants unexpectedly leave. Relationships with the company's best clients are now at risk. Key clients are lost. Supply chain pricing based on volume (which has declined) increases. Revenue projections are missed. The stock price drops. Shareholders react. The investment bank brings in a turnaround specialist.

For most, there is no happy ending. The CEO moves on to lead another company. Another CEO is hired to trim operations and regain market share. Top talent is gone. The competitive advantage envisioned by the deal never materializes.

The dismal track record of companies that attempt these deals makes a compelling argument for a pre-deal assessment of post-deal integration risk and the development of a people strategy to support business integration. Business marriages will always be risky, but the costliest risks are always the ones you don't know you're taking.

The interviewees consisted of CEO's of global and middle market companies, attorney negotiators, brokers that represent buyers and sellers, CPA's, investment bankers, private equity investors and global consultants. They noted that their roles are to protect their client's interests in finalizing the deal. Most are not involved with events following deal close.