

Due Diligence In Mergers and Acquisitions

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What is Due Diligence In Mergers and Acquisitions and its Importance?

The process of due diligence is a prerequisite for merger and acquisition (M&A) deals. It is a type of legal audit and research activity that offers the investor a precedent guarantee and contentment with the entity they are acquiring or merging. Before beginning to structure the deal, M&A lawyers organize this material by researching and developing a thorough M&A due diligence checklist. An orderly strategy to evaluate an entity you are acquiring through a sale, merger, transfer or any other means, is performed by way of verifying the information and documents provided under such an M&A checklist.

You can find out about a company's assets, liabilities, contracts, benefits, and potential issues by using this M&A checklist. Due Diligence In Mergers and Acquisitions checklists often follow a simple structure.

Due diligence in M&A can be followed by determining the objectives of the merger, acquisition or sale and investigating the potential business model. The investor can then lay out the compliance with their legal due diligence requirements after evaluating the risk and potential rewards of the transaction. The target company is then in charge of creating an online data room where all the material is provided for the investor's evaluation in accordance with the investor's due diligence checklist, which is provided to the target company.

An M&A deal might succeed or fail based on due diligence, particularly legal due diligence. It can help both the investor and the target company to discover potential liabilities and comprehend any legal risks by doing a crucial legal analysis of the documents and information.

Before signing a contract for an M&A deal, due diligence in M&A is crucial.

We will examine the importance of M&A due diligence in detail:

- Understanding the opportunity
You must collect information such as – to ensure that the offer or investment opportunity meets the investor's investment requirements.
- Fact-Checking
You can confirm and validate the information that was exchanged during the discussions of the deal by going through the documents and information provided by the target company. Analyzing the transaction's legal and financial details is crucial to make the decision of investment in the target company.
- Identification of risks
You may find potential flaws during the procedure of due diligence which will prevent an unfortunate business deal. The same can be rectified by the target company at the instructions of the investor and subsequently, the investor may go ahead with the decision of investment.
- Review the contracts and liabilities.
Although time-consuming, reviewing the material contracts is an essential step. It's critical to identify liabilities that can prevent you from making a decision towards going forward with the investment.

Steps Involved in Due Diligence

The lengthy and stressful process of mergers and acquisitions (M&A) due diligence comprises multiple stages. The following are steps in the general due diligence process:[1]

- Assess the project's goals: Setting business goals is always the initial stage in every endeavour. This makes it easier to identify the resources that are needed, what information you need to gather, and ultimately, how to ensure alignment with the overall business strategy.
- Evaluate business financial data: An extensive audit of financial documents is performed in this step. It guarantees that the papers shown in the Confidentiality Information Memorandum (CIM) are accurate.
- Inspection of Documents in Depth: The investor and the target company engage in a two-way discussion as the first part of the M&A due diligence process. The investor visits the target company's location, performs an inspection of the assets, and requests the relevant documents for audit.
- Analysis of the Business Plan and Model: Here, the investor pays close attention to the business strategies and model of the target company. This is done to determine its viability and how well the company's model would work with theirs or how the investment would be utilized to generate more revenue and subsequent profits.
- Forming the Final Offering: After gathering and analyzing data and documents, individuals and groups work together to discuss and assess their results and finalize the consideration for the investment, including the lock-in period, investor rights, etc.
- Risk Control: Risk management entails taking a comprehensive view of the target company and predicting any risks related to the day-to-day business of the target company and actions to be undertaken to mitigate the same.

Due Diligence Activities in an M&A Transaction

The following due diligence queries are typically answered in an M&A transaction:[2]

- Overview of Target Company: The target company will be better equipped to complete a sale of the company by properly preparing the merger activity and

examining every potential difficulty.

- **Financials:** Validating the target company's financial estimates and locating synergies are necessary for assessing the commercial attractiveness of an M&A purchase. The investor must first assess each and every set of historical financial statements and associated financial metrics for the target company.
- **Technology/Patents:** It must assess if the target's predictions of its future performance are reasonable. The scope and caliber of the target company's technology and intellectual property must be considered by the investor.
- **Strategic Fit:** The investor must comprehend the extent to which the target firm will fit strategically, in addition to the target company's expected future success as a stand-alone corporation.
- **Target Base:** The purchasing company must consider its clients and sales. The investor must have a thorough understanding of the customer base of the target company across all geographies, including the degree of concentration of the biggest clients as well as the sales pipeline.
- **Management Workforce:** The business must consider the management and employee difficulties at the target company. The investor must be aware of the caliber of the target company's management and workforce, as well as any past, present, or impending labor disputes.
- **Legal Issues:** Pending, threatened, or settled litigation which may pose a threat to the company's reputation and/or financials if any.
- **Information Technology:** Capacity, systems in place, outsourcing agreements, and recovery plan of the company's IT.
- **Corporate Matters:** It is crucial to enlist the help of an outside specialist who can evaluate each corporate component (such as corporate compliance, labour law compliance, real estate assets charges, etc.) critically and provide a road map for a sale to succeed. A thorough M&A due diligence process will ensure huge success.
- **Environmental Issues:** Whether the target company is under compliance of the environmental laws and rules.
- **Production Capabilities:** The target company shall make available to the investor any information necessary for the investor's due diligence. In M&A transactions, due diligence is a crucial step that might take many months of intensive examination if the target company is a sizable corporation with a global presence.
- **Marketing Strategies:** The market and competitive assessment must be driven by a strong analytical team, and the human resources team must concentrate on organizational and cultural concerns. To secure management support for any areas of consolidation, functional representation is essential.

Conclusion

Due diligence is a crucial step in mergers and acquisitions because an M&A deal can be a complex and expensive process. The investor, their consultants and accountants, must perform extensive due diligence to protect them from unexpected risks. Additionally, the target company must be ready for these due diligence tasks and make sure that everything goes smoothly and provide all relevant documents, efficiently, and in the best interests of all parties involved in the transaction.

FAQs

What is the purpose of due diligence?

The main goal of diligence is to lessen risk exposure. The procedure makes

sure that each party understands the specifics of a transaction before agreeing to it. By providing an investor with the findings of a due diligence report, for instance, it is ensured that the investor is fully informed.

What are the three 3 types of Due diligence?

Three types of Due Diligence are:

1. Business Due Diligence
2. Legal Due Diligence
3. Financial Due Diligence

[1] The Ultimate Guide to the Due Diligence Process in M&A,
<https://dealroom.net/faq/due-diligence-process#faq-9>

[2] Due Diligence,
<https://corporatefinanceinstitute.com/resources/knowledge/deals/due-diligence-overview/>