Future of due diligence

Capture a more complete view of a deal's risks and value opportunities

KPMG International

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Contents

A demand for a new approach to due diligence

Key takeaways

- A new, more complete approach to due diligence considers a wider aperture of risks and identifies the performance improvements to deliver against a deal's longer term value potentials.
- A new set of capabilities are required, which include advanced data analytics and technologies, and deep sector specialization.
- To identify value, dealmakers need clear insights through the financial and operational levers of a business.

Before committing to a transaction, dealmakers want to ensure they know exactly what they are buying and what obligations they will assume. Sellers, too, need to know what they are selling and what they can expect from the market. Getting to these answers typically involves a substantial amount of due diligence. Traditionally, much of due diligence has focused on capturing a clearer picture of a business' financial matters — looking back to historical sales and costs through to its future performance projections.

This isn't enough in today's environment. Technology is more sophisticated than ever and continues to readily advance with artificial intelligence, machine learning, the metaverse and Web 3.0. Such innovation is spurring company digital transformations. Further, business models are changing as are M&A finance options and regulations. Together these factors are creating systemic changes in M&A. In the short-term, the deals market is facing higher competition as deal volumes remain muted compared to years past, and companies and investors are holding record amounts of capital ready to be deployed in acquisitions.

As these factors culminate and collide, dealmakers face greater pressures to deliver long-term value with each deal's close. In this paper, we consider this new context and offer a new proposition that will help inform dealmakers as they navigate upcoming deals.

Risk mitigation + Value creation

As companies and investors contend with challenging macroeconomic environments, they continue to seek opportunities that will help them refine and optimize their corporate portfolios, or gain access to new technologies, service capabilities, markets and more. This often leads dealmakers to step outside their core business or sector, opening the door to a broader, and at times lesser-known, spectrum of risks.

Without assessing these risks, investors limit the potential of the deal's financial returns. Further, dealmakers and their businesses can assume unforeseen risks that could jeopardize their strategic and operational goals, and in more extreme cases, subject them to public scrutiny.

Incomplete due diligence often lies behind the headlines detailing the tales of bad investments. In some cases, investors were shown to have never received the target's audited financial statements. In others, dealmakers admitted to not having a concrete grasp of the company's technologies or processes, or missed effectively investigating the legitimacy of partnerships or user databases.

To compete in this increasingly complex market and ensure a deal will return its intended advantages, dealmakers need a new approach to due diligence — one that is more holistic and sector-focused. The approach also needs to be steeped in a globally consistent methodology to enable efficient outcomes with each deal, while allowing for returns on investments to be compared consistently across markets. To get here, it is essential that due diligence considers a wider aperture of risks, effectively leverages data insights and captures an understanding of the value opportunities the deal offers.

Beyond simple financials

Financial due diligence, along with tax and legal due diligence, remain the cornerstones of evaluating the merits of a transaction. However, increasingly complex deals and businesses demand a more robust list of risks be considered. Such a list has and will continue to evolve as our businesses, technologies and markets continue to advance and change.

Cybersecurity, for example, is an obvious area of risk that requires thorough investigating today. Yet, it was hardly a consideration just a few years ago. Other areas are quickly following a similar path. Case in point: digital due diligence. Our next article in this series will look at how our advancing digital economy demands a detailed assessment of the target company's financial and non-financial digital assets, among other areas. In the same vein, dealmakers may benefit from assessing a target company's ESG strategies and progress, IT assets and processes, HR operations and talent management, geopolitical risks, and more.

As the list of risks to assess grows longer, dealmakers will need to focus their efforts on the areas that are most relevant to the deal, the target's company, sector and market in relation to the investor's business and goals. By creating a more complete picture of the deal's risks, dealmakers can more effectively evaluate the deal, and proactively set in motion plans to mitigate potential risks, improve synergies and realize long-term value across the business.

Adding areas of diligence to help capture a more complete view of deal risk

- Tax due diligence/ Tax structuring
- SKU analysis (data & analytics)
- HR due diligence
- Digital due diligence
- ESG due diligence
- IT/Cyber due diligence

Investigating value opportunities

Value is the other side of the due diligence coin. Already, astute investors are considering potential operational opportunities as part of their hypothesis to invest in a deal. This needs to go further. In addition to understanding what dealmakers get from their investments, true value will come when they consider where they can further enhance the acquired business. This dual view on value will enable investors to see strong returns on their investment well after the deal's close.

In the short-term, identifying value opportunities during the due diligence process can help dealmakers make a more balanced evaluation of the target business within the context of its risks. This positions investors to make competitive, more effective bids. Deeper analysis through a sector lens can uncover longer-term potentials, such as revenue opportunities, cost optimization, and cash and working capital improvements. From here, dealmakers can plot a plan to advance these potentials by clarifying performance and operational improvements.

Advanced data capabilities

Due diligence has always been a data-driven practice. Now, as dealmakers go deeper and broader in their risk assessments, the volume of data continues to grow exponentially. Different types of data will come from new and previously untapped sources. Some of these details can be mined publicly; however, unexplored areas will likely require access to proprietary data sources and advanced technologies.

Data analytics technologies can now mine data within minutes and hours, not days and weeks as in years past. These tools can also identify trends, patterns and anomalies, that together, derive the powerful insights dealmakers need to make decisions quickly and with confidence.

Leveraging data analytics demands new capabilities to ensure accurate and unbiased information is being collected from reliable sources. This requires staying on top of emerging trends and building relationships with the right vendors. A second set of capabilities is also necessary: the ability to assess the risks identified holistically through multiple lenses, including deal objectives, involved sectors and markets, and more.

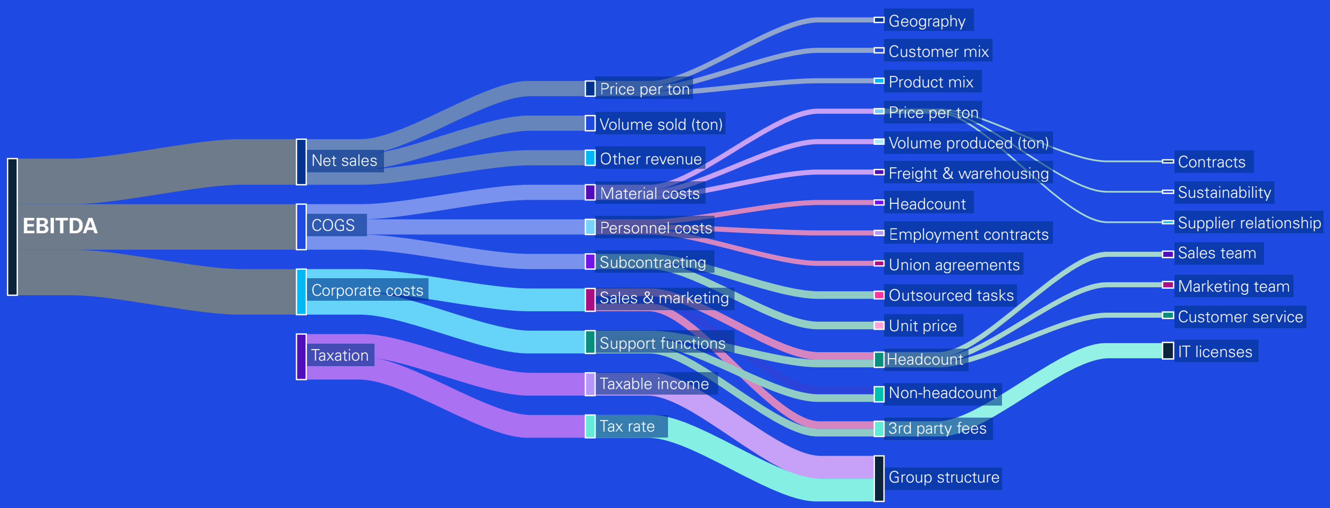
Deep sector knowledge

Assessing and analyzing value requires an investigation of the financial and operational levers of a business. These differ between and across sectors as each one is impacted by a different set of internal and external factors. As such, dealmakers will want to leverage sector-specific value driver diagrams that break down the key drivers of a business' performance into their component parts. This way they can clearly identify opportunities that create value, and understand the operational and financial KPIs of a business.

This approach can also be used to rapidly assess a potential target in the pre-deal stage. Investors can better review deal opportunities, identify any potential red flags or recognize those with stronger returns on investment to allow for a go or no-go deal decision to be made early on in a process.

Adding a broader value lens to due diligence offers dealmakers an exponentially more powerful view of the full risks in a deal as well as the opportunities that lie ahead. With such clarity, investors can make effective deal decisions with conviction — from setting a competitive bid to putting in place post-deal plans to deliver measurable improvements that can create quantifiable value across the business.

Keeping a long-term vision on value in mind during the due diligence phase will also call upon a new set of capabilities. Sector specialization will be paramount. Advanced technologies, including those noted above, will also help process value-focused data efficiently to deliver insights at deal speed.



Source: 2023 KPMG value driver tree

Transformation never stops. Neither do we.

At KPMG we believe that business transformation is too good an opportunity to miss. Combining the right tech and the best processes with people whose insight is as broad as it is deep, KPMG helps dealmakers take a deliberate, forward-thinking approach to deal planning, execution and integration in light of their business, sector and the global economy. KPMG has worked at the heart of global businesses for many decades, helping clients manage complexity and realize the full potential of their strategy, people and technology. We work together to achieve real-world outcomes. Because when strategy, people and technology are in harmony great things happen.

Making a world of difference

KPMG people can make all the difference on your transaction and transformation journeys. Together we can help you to uplevel your performance, grow your business, orient your organization around the customer and new business models, optimize functions for a new era, manage enterprise risk and regulation for a safer future, pursue opportunities to better realize or preserve value, and create an environment for managing ongoing change.

The power of plus: An enhanced, value-focused approach to due diligence

KPMG Diligence+ brings together our global methodology and sector-specific value drivers to deliver holistic insights to enable dealmakers to make rapid, confident decisions to grow their business.

Our approach transcends traditional financial due diligence to assess an expanded universe of risks and rewards. At the same time, we leverage our proprietary data analytics and insights, along with our deep sector and functional experiences to identify the levers that can create value across a business.

We extend our support beyond a deal's close by orchestrating a dedicated team of world-class execution professionals across the globe to deliver the measurable performance improvements that can create quantifiable value across a business.

Learn how KPMG can power your next deal at kpmg.com/diligence.

Authors

Craig Mennie
Global Head of Transaction Services
KPMG Australia
T: +61 2 9335 8671
E: cmennie@kpmg.com.au

With more than 30 years at KPMG, Craig Mennie specializes in financial services, real estate and infrastructure transactions, serving the largest Australian and international clients in these sectors.

Christoph Kaiser
Head of Transaction Services
KPMG in Germany
T: +49 173 5764860
E: ckaiser@kpmg.com

Christoph Kaiser leads corporate transactions for KPMG, providing systemic analysis of business models and corporate structures to support lasting impact.

Timothy Johnson
Americas Lead, Deal Advisory
KPMG in the US
T: +1 312 665 1048
E: tejohnson@kpmg.com

Tim Johnson advises financial sponsors and strategic investors in their transactions. His work crosses multiple sectors, including banking, capital marketing, specialty finance and others.

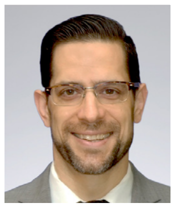
Contributors

Tim Bryan
Head of Transaction Services
KPMG Australia
T: +61 2 9335 8954
E: timbryan@kpmg.com.au

John Cho
National Leader, Deal Advisory
KPMG in Canada
T: +1 416 777 3994
E: johncho@kpmg.ca

Elaine Yu
Head of Transaction Services
KPMG China
T: +86 21 2212 3543
E: elaine.yu@kpmg.com

Vincent Delmas
Head of Transaction Services
KPMG in France
T: +33 1 5568 7502
E: vdelmas@kpmg.fr



Paul Ford
Head of Transaction Services
KPMG in Japan
T: +81 3 3548 5394
E: paul.ford@jp.kpmg.com

Nicola Longfield
Transaction Services Lead
KPMG in the UK
T: +44 207 311 4383
E: nicola.longfield@kpmg.co.uk

Contact

Jaime Muñoz
Head of Transaction Services
KPMG in Spain
T: +34 660 38 02 36
E: jmunozestrada@kpmg.es

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