Why due diligence is of utmost importance in a M&A transaction

Prior to taking over another company potential buyers should complete a thorough examination of every aspect of the target's operations, for the long-term benefit of both parties

In contrast to the rest of the world's sluggish growth and uncertainty in the wake of recent economic turbulence, African economies lead the way with their forecast high rates of growth and the immense opportunities they can bring to the world. Mergers and acquisitions (M&A) activity on the continent has remained resilient and is expected to increase. In order to make a good investment decision, carrying out due diligence is critical for any potential investor.

KPMG's sixth global survey on M&A revealed 'What would you do differently?' In each of our studies, when we ask acquiring managers what they would do differently next time, the three themes that recur are:
- Better due diligence and planning;
- Faster implementation/ integration; and,
- More attention to HR and cultural matters.

WHAT IS A DUE DILIGENCE?

Due diligence is a thorough examination of all critical aspects of the business subject to the transaction ('Target'), typically undertaken prior to agreeing the final value and signing of the sale and purchase agreement terms. Every aspect of the Target's operations should be subject to due diligence – financial, commercial, operational, tax, human resource, IT, anti-bribery/corruption, integrity, environmental, social, health and safety, governance, regulatory, and so on.

WHAT CAN A DUE DILIGENCE REVEAL?

Issues identified through a due diligence should be addressed at the pre- or post-deal stage. A recent due diligence revealed a number of challenges: revenue recognition not in line with international accounting standards requiring a re-statement for the prior periods, provisioning for long outstanding receivables in conjunction with compensation for not meeting the contractual terms was yet to be recognised on the profit and loss, employee turnover levels were on the rise, employee taxes remained a long-term payable and a lack of an end-to-end financial accounting system rendered the control environment weak. In light of these findings it was very difficult to provide a view on the forecasts and its achievability.

DEALING WITH DUE DILIGENCE FINDINGS

In such an instance the potential investor very carefully needs to assess how to address the issues. From experience due diligence issues can be classified into three main buckets:
- Impacting on value;
- To be addressed in the sales and purchase agreement; and/or,
- Post-transactional improvements.

If there remains a willing buyer and a willing seller then due diligence issues as such should not deter a successful closure of a deal. Once the value is agreed upon, then a way forward can be mapped together, enhancing value for all parties in the longer term. Think positively on value creation.

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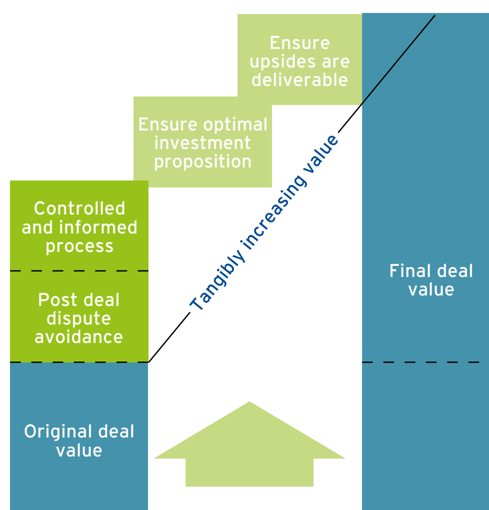

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