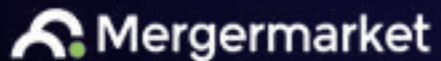


The

Dynamics of

Due Diligence

Produced with



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About this report

This report is the first in a four-part series. The second will explore how deal terms impact due diligence; the third will cover the fallout from deal leaks; and the final report will examine the extent to which dealmakers are making use of technology in the due diligence process.

Introduction

A decade ago, The M&A Research Centre at Bayes Business School and SS&C Intralinks published groundbreaking research into the impact of a variety of metrics on the mergers and acquisitions (M&A) due diligence process and how these affect the outcome of transactions.

This analysis, and the subsequent report *When No One Knows: Pre-announcement M&A Activity and Its Effect on M&A Outcomes*, were unlike anything that had previously been published in the market. They explored the overall length of time taken for pre-announcement due diligence and the way in which the timeframe affected the outcome; how the size, type and geography of a deal impacted the due diligence process; the relationship between leaks and deal outcomes; and the extent to which dealmakers were making use of technology and, in particular, virtual data rooms (VDRs).

In the intervening decade, there has been no equivalent research on this subject and therefore, 10 years on from the original analysis, we have decided to revisit *When No One Knows* and explore how these factors affect the dealmaking market in a much-changed world. And we have found significant differences.

In a four-part series, we examine how today’s due diligence process has changed, and the fundamentals on which dealmakers need to concentrate to achieve a successful outcome.

This first report, *The Dynamics of Due Diligence*, explores the reasons behind the ever-expanding due diligence period in the past decade and reveals why those deals that have a “medium” duration in terms of timing are the most likely to succeed.

Key Findings

1. Pre-announcement due diligence periods have increased

The average due-diligence period has risen from 124 days a decade ago to 203 days today.



2. Longer due diligence periods are more likely to result in deals completing

However, deals with what we define as a medium-length due diligence process are most likely to complete.



3. This “happy medium” effect has multiple dimensions

Medium-length due diligence processes are also associated with lower premiums and faster resolution times.



4. “Happy-medium” deals are more likely to deliver for investors

Our research reveals a clear link between medium-length due diligence processes and superior long-term share price performance.



Ever-expanding Due Diligence

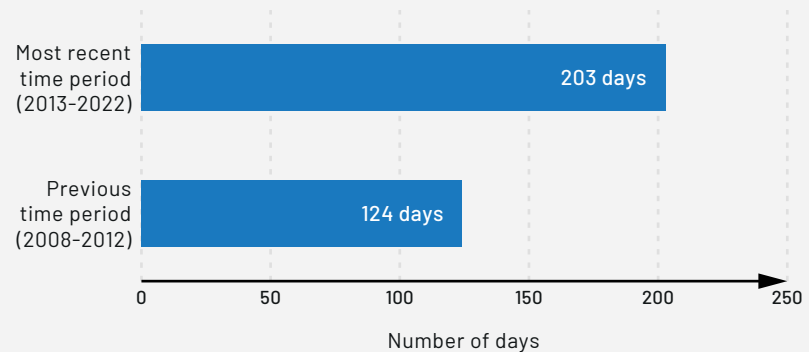
As we reported in *When No One Knows: Pre-announcement M&A Activity and Its Effect on M&A Outcomes* a decade ago, the average M&A transaction between 2008 and 2012 featured a pre-announcement due diligence period – defined as the time between the opening of a VDR to the public announcement of a deal – of 124 days, or roughly four months.

By contrast, our research today shows that deals done since then, between 2013 and 2022, spent an average of 203 days in the due diligence phase – well over six months.

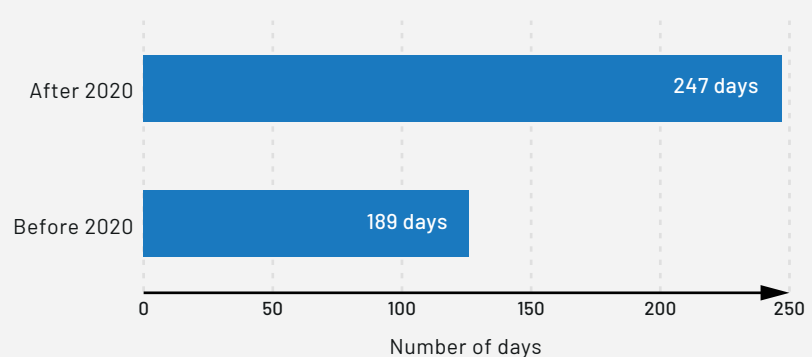
Moreover, this trend appears to have accelerated. On deals conducted prior to 2020, the average due diligence process lasted 189 days; on deals conducted between 2020 and 2022, this increased to 247 days.

That effect may partly reflect the impact of the pandemic, which forced dealmakers to adapt to different ways of working. However, it is undoubtedly a significant shift.

**Average due diligence period
(from VDR opening to public announcement of deal)**



Average due diligence period (by year of deal announcement)



EVER-EXPANDING DUE DILIGENCE

While the pandemic may explain the acceleration between 2020 and 2022, the trend to longer due diligence periods had already started seven years earlier. Dealmakers taking part in this research point to a range of factors that have made transactions increasingly complex. These include the growing importance of technology and digitalization in the deal process, as well as increasing regulation, including the General Data Protection Regulation (GDPR). Economic and political volatility have also added to the complexity, including, for example, the 2015 Brexit referendum in the U.K., rising tensions between the U.S. and China, and the ongoing conflict in Ukraine.

The growing importance of environmental, social and corporate governance (ESG) issues has also driven extended due diligence periods, effectively adding dimension to the process.

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We have seen a raft of changes: We’re dealing with different market dynamics, new regulatory requirements, supply chain and logistics challenges, technological advances and the rise of ESG compliance requirements.

Managing director, U.S. private equity firm

logistics challenges, technological advances and the rise of ESG compliance requirements,” says the managing director of a U.S. private equity (PE) firm. “All these aspects have changed the way we perform our due diligence activities. More in-depth research and the need to validate our findings are crucial.”

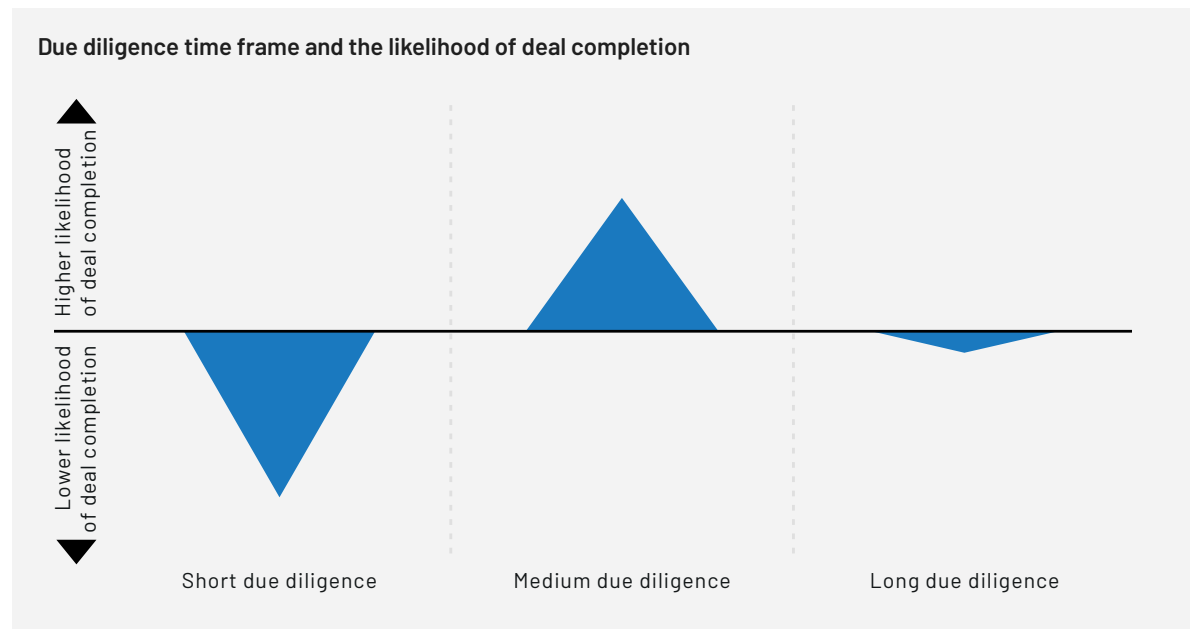
Naturally, this has increased the number of people involved in the due diligence process and extended the time needed to complete such work. “Initially, the process involved only

a few people, but rising complexity and the need to manage risk has forced us to bring in new processes and involve more functions,” says the partner of a Malaysian law firm. “The need for more monitoring, communications and strategic work has inevitably led to delays.”

In Search of a 'Happy Medium'

The research splits deals into three equally-sized groups: transactions requiring short, medium-length and long periods of due diligence – averaging 49 days, 139 days and 429 days, respectively. It finds a positive correlation between deals with longer due diligence periods and the likelihood of deal completion, a finding replicated from our previous research a decade ago. Today, however, it is transactions with medium-length due diligence periods that are most likely of all to complete.

This might be described as the “Goldilocks effect” – or the search for a happy medium. When a due diligence period is neither too short nor too long, there is a greater likelihood of the deal reaching successful completion. Buyers are anxious to secure a more granular understanding of the target business, including potential risks, but do not want to



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IN SEARCH OF A 'HAPPY MEDIUM'

get bogged down and may walk away from overly complex transactions or those where the target is not responsive.

To run due diligence effectively and efficiently, many dealmakers are now devoting significant additional resources to this work – both to cope with the increasing volume of data and information, and to test the merits of the deal.

“We’re using more specialized talent to manage due diligence,” says the global head of strategy at a Luxembourg-based corporate. “We’ve understood that enhanced due diligence performance depends on preparation, so there is more time spent on planning. We decide on the data sources and processes to validate these sources effectively.”

Dealmakers say it is important to focus on deal objectives at this diligence phase. “We prioritize value creation opportunities during due diligence,” says the director of strategy at a U.S. corporate. “We use multiple data sources to identify opportunities for

operational growth and development, and we look at whether the target company has missed out on opportunities to scale; we also analyze the integration of technology in operational systems more critically.”

The growing sophistication of VDRs can also help dealmakers work through due diligence more quickly, even when many additional issues need to be resolved. That said, buyers still have to contend with delays on the sellers’ side: Several respondents to this research say one reason for extended due diligence periods is that sellers take too long to assemble documentation and respond to queries.



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**Global head of strategy,
Luxembourg-based corporate**

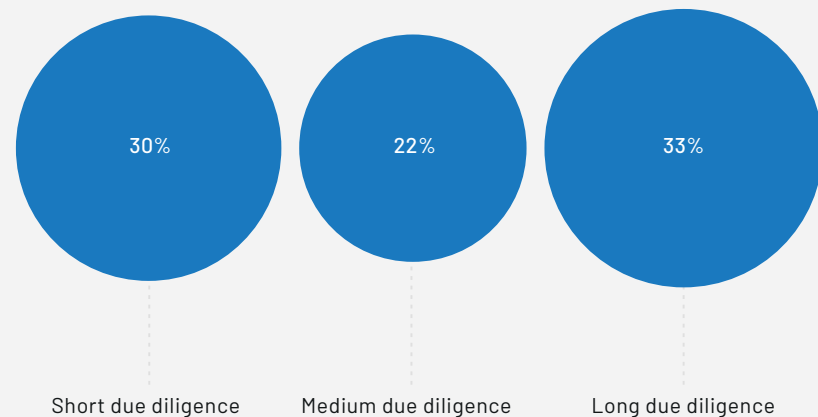
More Dividends From the 'Goldilocks Effect'

In addition to being more likely to reach completion, deals with medium-length due diligence periods are also associated with other positive outcomes.

First, buyers are less likely to have to pay a significant premium when moving to completion within this period. The average deal with a medium-length due diligence period saw the buyer pay a 22 percent premium to the target's share price on the day prior to the announcement of the transaction. The average premium following short and long due diligence periods, by contrast, was 30 percent and 33 percent respectively.

In addition, medium-length due diligence periods are associated with shorter deal resolution times. Where due diligence was medium length, the average period between the public announcement of a deal and its completion was 104 days. This figure rose to 135 days in deals with long due diligence periods and to 141 days in short processes.

Average price premium relative to undisturbed target share price (as of one day before deal announcement)



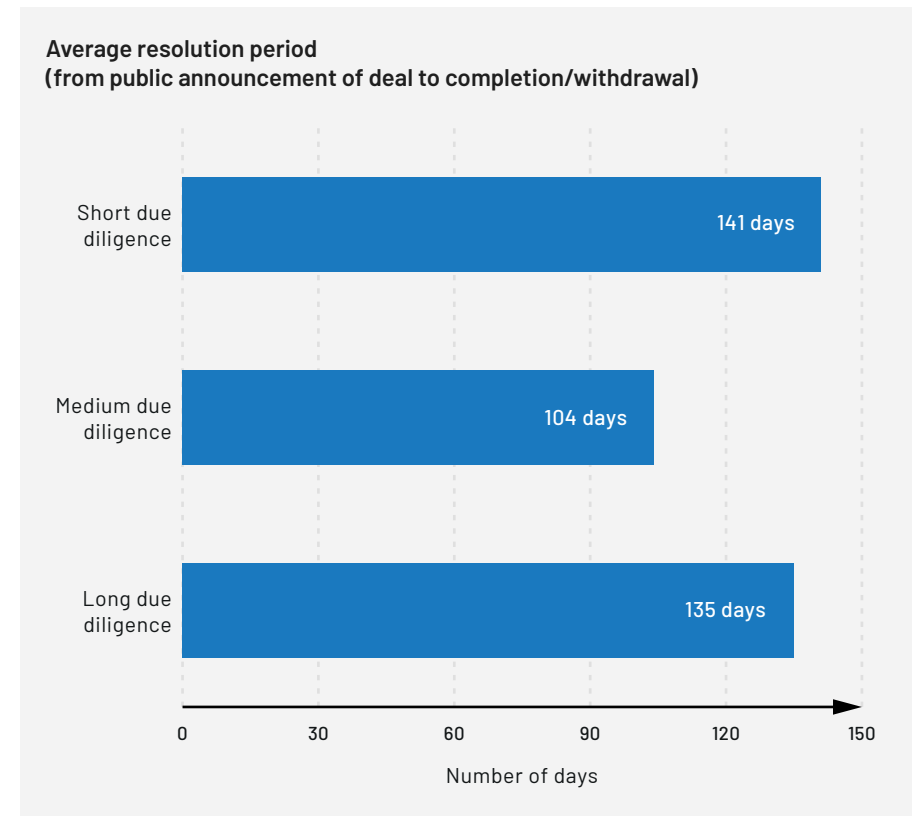
MORE DIVIDENDS FROM THE 'GOLDILOCKS EFFECT'

In other words, these medium-length due diligence processes appear to be hitting a sweet spot that ensures the deal proceeds smoothly, with buyers securing the data and insight they need, while avoiding unnecessary complexity and delay.

Achieving this balance is not always easy. The head of M&A at a U.K.-based corporate observes: "Identifying the data points to be mapped for due diligence is not time-consuming, but collecting the data, validating it and analyzing it takes a huge amount of time and resources."

Nevertheless, the ubiquity of VDRs and the evolution of technologies that can be deployed during the deal process give dealmakers new tools with which to conduct more robust due diligence exercises without creating unnecessary delays — particularly where both buyer and seller are prepared to be open and collaborative.

"Technology has been very effective in helping us manage our due diligence processes more efficiently," agrees a partner at a Japanese law firm.

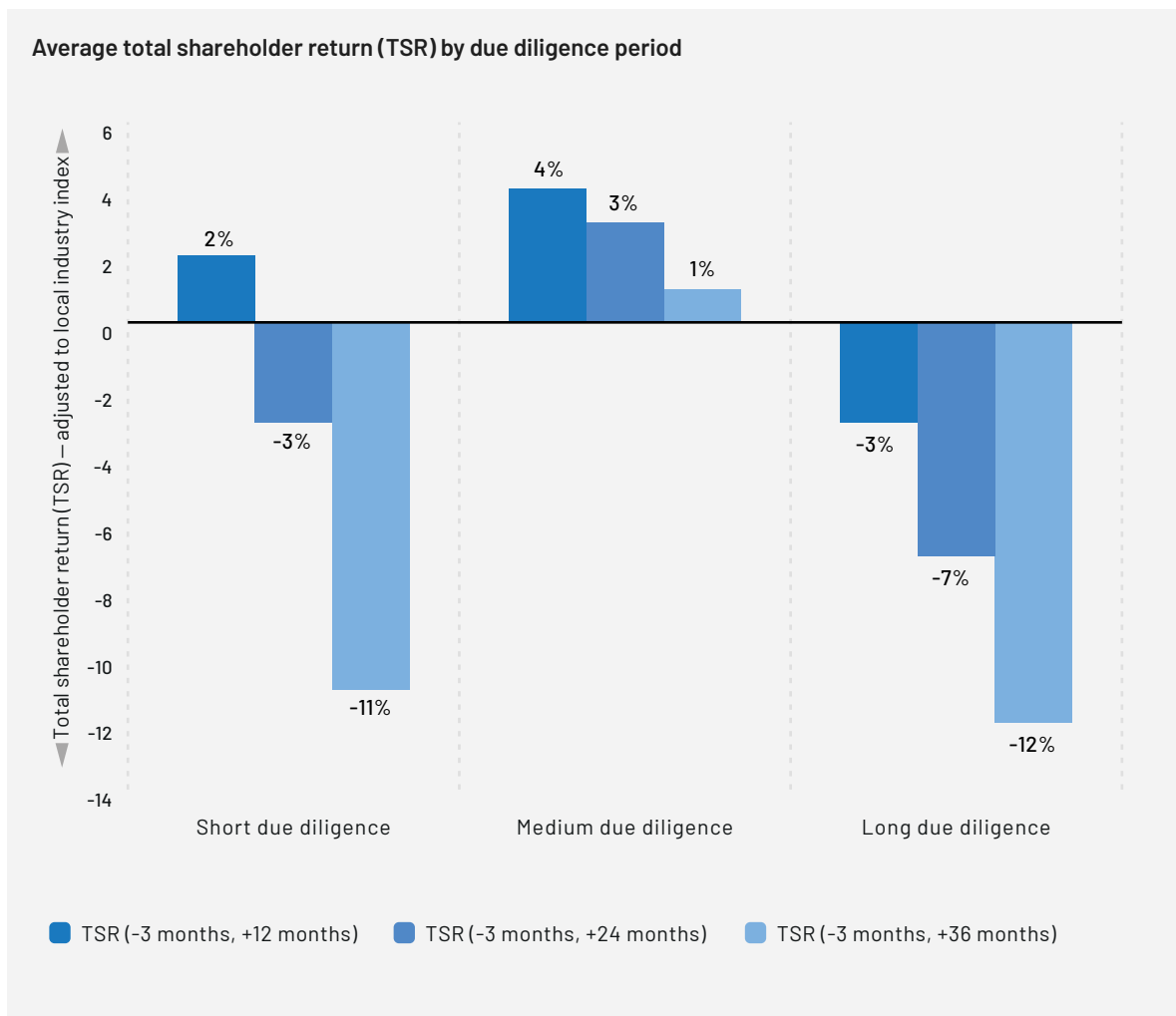


Delivering for Investors

Perhaps the most important reason of all to focus on optimizing the due diligence process – certainly for buyers – is that deals where this happens tend to deliver outsized returns for shareholders.

Based on a period starting three months prior to the deal announcement and ending 12 months after completion, deals with medium-length due diligence processes generated average abnormal returns of four percent for investors.

By contrast, deals with long due diligence periods delivered a negative average return of three percent. Deals with short due diligence periods produced a slightly better average performance, at two percent.



Nor was this effect limited to the short term. Deals with medium-length due diligence periods also outperformed over 24-month and 36-month time frames, delivering higher returns for shareholders in both cases.

This makes sense, argues a partner in a Belgian accountancy firm. “For the deal to be value-generative for shareholders, we must secure a 360-degree view of the target business, and this takes time,” the partner says. While the effect diminishes over time – with overlong due diligence periods becoming counterproductive – “analyzing the level of risk, discovering hidden synergies, performing effective compliance management and developing risk management strategies are essential parts of the process.”

Some respondents are more cautious, urging dealmakers to focus on the quality of the due diligence process, rather than its length. “It is quality that matters,” says a partner in a U.S. law firm. “The time taken will be longer on more complex deals, but due diligence should

be performed intensively and having all the data is important.”

Nevertheless, our research suggests dealmakers should strive for a happy medium. The “Goldilocks effect” is created when buyers conduct thorough due diligence processes that help them build the value case for the transaction. However, a process that stretches on may suggest there are underlying problems that could give all parties pause for thought.



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**Partner, Belgium-based
accountancy firm**

Methodology

The M&A Research Centre at Bayes Business School analyzed 900+ global M&A transactions announced between 2013 and 2023 from the Intralinks' proprietary database.

This unique data set allowed metrics from the pre-announcement due diligence process to be compared with public data on variables including deal type, size, price and performance. A multivariate analysis on these parameters established where a statistically significant relationship existed, allowing inferences to be drawn on how the due diligence process is affected by the properties of the deal as well as the impact of due diligence on deal negotiations and deal success.

In conjunction with this research, interviews were conducted with 30 M&A professionals (10 lawyers, 10 accountants and 10 corporate executives) to get a clearer picture on how due diligence impacts the dealmaking process, the tactics used by participants to push the process in their favor and the relationship with leaking.

About SS&C Intralinks

SS&C Intralinks is the pioneer of the virtual data room, enabling and securing the flow of information by facilitating M&A, capital raising and investor reporting. SS&C Intralinks has earned the trust and business of many of the Fortune 1000 and has executed over USD 35 trillion worth of financial transactions on its platform.

For more information, visit intralinks.com

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