Due Diligence in M&A Transactions: Why First-Time Buyers Should Avoid Analysis Paralysis

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By Michael N. Mercurio

For many first-time buyers, the initial instinct in M&A transactions is to scrutinize every financial detail, prolonging the diligence process until they have an answer to every single question. This is certainly understandable, particularly for first-time buyers; however, this approach can often do more harm than good.

The reason many deals fall apart is because they lose momentum, conditions shift over time, or sellers simply lose patience and walk away. All of these are considerable risks when the diligence process extends too long.

Over-Diligence

While thorough diligence is essential in any M&A transaction, when there is too much focus on financial minutiae, it can result in decision making paralysis. For first-time buyers, this can be difficult as they struggle to quantify risk and get caught in over-diligence, or a cycle of analysis and re-analysis. What can end up happening is analysis paralysis, meaning the fear of the unknown stops a deal from progressing.

When buyers engage in over-diligence, it can lead to deal fatigue, where one or more parties lose interest or confidence as the process drags on for too long. When the diligence process stretches out, market conditions can also shift during the delay, or there could be internal changes such as an executive departing or a new business challenge arising.

Timing is Essential

In any transaction, momentum is key, and timing is everything. During the diligence process in M&A transactions, there are three ways in which timing can make a critical difference.

First, timing is essential to the overall process. By keeping diligence tight, you can better ensure that the entire process will be compact and efficient. Then, there is timing of the market. When external factors such as regulatory shifts or new competitors pop up, they can start to impact deal value when a deal lingers. And finally, there is the internal timing of the target company itself. Over time, internal challenges could arise with leadership or operations that can lead to unnecessary hurdles. So, when diligence drags on too long, buyers run a significant risk of paying the same price for a business that could be fundamentally different, or even losing the deal all together.

Buyers should also consider the period of exclusivity to complete diligence outlined in the LOI. That period of exclusivity can run out, and buyers could be forced to request extensions if they spend too much time focusing on incremental details. At a minimum, this can erode confidence, and at the worst, the seller could walk.

Built In Protections

It important for first-time buyers to understand one constant in M&A transactions: there is risk in every deal. But equally as important to understand is that you do not need to chase every risk. That is why there are built-in protections in transactions to help buyers move forward even when every minute detail is not fully uncovered during the diligence process.

Buyers should work closely with legal counsel and advisors to structure agreements that include contractual provisions such as representations, warranties, indemnifications, and insurance solutions to protect parties from anything that was not uncovered. These kinds of tools are designed to balance the interests of buyers and sellers, and they allow buyers to focus their diligence efforts on those issues that affect valuation or viability of the deal, rather than wasting valuable time attempting to eliminate all risks.

At the end of the day, diligence is designed to manage risk, not to eliminate it entirely. When you resist the tendency to over analyze financials, and stay focused instead, you can better maintain the necessary momentum and avoid paralysis. This leads to deals that close with confidence and are set up for long-term success.