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Deficient due diligence?

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1 INTRODUCTION

1.1 Purpose of the study

The purpose of this research report is to identify and establish the current standing of traditional due diligence practices and whether they contribute to Merger and Acquisition (M&A) success or failure. By conducting a review of due diligence processes and compiling a dataset on its strategic outcome in practice, the research will provide a base for studies involving the effectiveness of due diligence procedures going forward.

1.2 Context of the study

This study aims to determine whether traditional due diligence procedures affect the success or failure of M&A's. According to Moeller (2009), many companies defined the term "due diligence" as a study of the profit and loss and the financial position of the acquired company, and therefore the due diligence assessment was restricted to a review of the financial, legal and limited technical aspects. This is therefore defined as 'limited' or 'traditional' due diligence. Of these three categories, financial due diligence is understood to be straightforward to conduct (Moeller, 2009). This has resulted in many executives relying on only financial reports to make their decisions without taking into account other factors (Moeller, 2009).

Papadakis (2007) argues that in the zero-tolerance environment that was created in the post Sarbanes-Oxley world, the term "due diligence" gained new significance. It now includes not only data analysis but also analysis of every aspect of the value chain of the acquired company. Furthermore, "due diligence" should also mean examining such subtle issues as cultural fit, minimizing the reputational risk, as well as communication with employees. Executives should also ask for a thorough strategic, cultural, legal and reputation risk due diligence (Papadakis, 2007).

This study aims to determine whether traditional due diligence procedures have been successful in the investigation of any problems, concerns, strengths, and the value that the procedures have added historically. It intends to document the trends in the forms and manner of due diligence practices. The study is specifically focused on the application of due diligence assessments in practice, comparing and contrasting traditional due diligence procedures against a more effective due diligence assessment.

1.3 Problem statement

The research questions to determine whether traditional due diligence procedures are effective and adequate in M&A's in South Africa.

Given the prominence of traditional due diligences historically, more recent research conducted by Spedding (2008), establishes that from a 21st century perspective, the traditional due diligence method should ideally account for approximately 10 to 25% of a complete due diligence process. This research report aims to assess whether this is ideal in modern day practice. In addition, given the drastic changes due diligence efforts have undergone traditionally, the research aims to establish the reality of current practice, as well as the future of due diligence efforts, traditional and otherwise.

1.4 Research Objective and Strategy

The primary objective of this research report is to establish whether traditional due diligence procedures contribute to the success or failure of M&A's. The literature review will compile a dataset of traditional due diligence practices, which will form the basis for interviews which will be conducted with corporate finance firms identified based on volume and value of M&A's each is involved in. The interview agenda has been designed to assess general due diligence practices of each practitioner, rather than for a specific assignment in order to ensure that a statistically significant number of due diligence engagements is covered. The interview outcomes were analysed and themes created from the emerging data using the 'Data Management System' described by Miles and Huberman (1984). The transcripts from the recorded interviews were condensed into data summaries using a descriptive content analysis method (Neuendorf, 2002), and key themes presented across all interviews were identified and any specific differences and inconsistencies were noted.

1.5 Significance of the study

M&A's are often seen by market analysts as glamorous, as a sign of a dynamic management, and therefore mark up share prices accordingly, whereas for management, a M&A can be a means of bolstering short-term performance and/or masking underlying problems (Howson, 2009).

The results in a survey on M&A activity performed by KPMG (1999) showed that due diligence was the most crucial of the pre-deal activities. According to the KPMG (1999) study, companies which prioritised due diligence bettered their chance of a successful deal by 6% - this highlights the value of due diligence if used effectively.

In a recent project, a U.S. insurer determined the target company value — a European multi-business financial institution — to be around $5 billion. Taking into account related synergies both expected to derive from the deal, the U.S. Company was initially prepared to pay $5.5 billion. However, a closer look at the issues revealed:

- The once-off golden parachutes to senior management in the event of a change in control amounted to $100 million.
- Unbudgeted pension costs, governed in part by local laws, amounted to a total of $300 million.
- Rationalizing the compensation plans the two companies amounted to a one-time cost of $10 million
- And the complex regulations governing workforce streamlining would have created additional costs of $10 million.
- Taken together, these people related costs amounted to $340 million — the amount by which the acquirer would have overpaid in the deal had it not performed adequate due diligence (Nigh and Boschetti, 2006).

It is thus extremely important that due diligence procedures are performed with a more open, unrestricted focus.

Many companies use M&A's for faster growth and aggressive expansion as an alternative or as a complement to internal organic growth. Respondents in the Accenture/ Economist Intelligence Unit Global M&A Survey (2006), found that only 17% of firms were highly satisfied with the rigour and accuracy of their due diligence - one might reasonably hope for a more sweeping confidence in such a key element of M&A. As most companies produce audited accounts it might seem a little surprising that so much time, effort, angst and expense is devoted to traditional due diligence. According to Spedding (2008), very few deals are carried out without financial, legal and some commercial due diligence practices. Accordingly, from a 21st century perspective, the traditional due diligence methods account for 10 to 25% of a complete due diligence process. This must, however, be assessed whether it is ideal and if so, if practitioners maintain their due diligence practices in accordance with these guidelines. In this regard, this is what this research endeavours to determine.

Accenture (2006) suggests that traditional due diligence processes are essential for M&A success. However, McDonald (2005) holds that the scope and complexity of due diligence has increased as businesses continue their expansion. Therefore it is important that past M&A experience be explored to identify whether an organisation can learn from past mistakes and improve its M&A performance (McDonald, 2005). Thus by performing a review of the effectiveness of the traditional due diligence process, the study attempts to identify improvements or suggestions to current practice, to provide more efficient and effective due diligence.

1.6 Delimitations of the study

- The failure of a due diligence assessment can result in M&A failure. This study will be limited to reviewing the failure of M&A's that could have been prevented solely by means of carrying out an effective due diligence assessment.
- The aim of this research is not to discuss the various types of due diligence procedures that an investigating entity can/ should perform, but rather will be limited to observing the effectiveness of traditional due diligence procedures only.
- The intention of this research report is not to generate broadened 'checklists' of due diligence procedures to perform.

1.7 Definition of terms

The definitions below have all been adapted from *Spedding (2008)*:

Traditional Due Diligence: This comprises of Financial, Legal and Commercial due diligence.

Financial Due Diligence: Financial due diligence utilises historic financial data to determine the future performance of the entity. Developed around an array of building blocks — including auditing and verifying financial results, reviewing forecasts and budgets, pinpointing areas where warranties or indemnities may be needed, and providing confidence in the underlying performance (and therefore future profits) of a company — financial due diligence allows the bidder to make the proper offer for the target, or perhaps uncover reasons for not proceeding with the deal (Spedding, 2008).

Legal Due Diligence: An investigation of legal rights over assets to be purchased, and ensuring that target entity is legitimate and free of any legal obstacles which may affect the

M&A process subsequent to purchase. Governmental regulatory concerns (such as monopolies, employment law, taxes, etc.) may also be investigated as part of this due diligence (Spedding, 2008).

Commercial Due Diligence: Focuses on the likely strategic position of the combined entity by reviewing the drivers that underpin forecasts and business plans, it concentrates on the ability of the target's businesses to achieve the projected sales and profitability growth post acquisition. It also provides an objective view of a company's markets, prospects, and competitive position to re-enforce its projected future (Spedding, 2008).

1.8 Assumptions

- It is assumed that the respondents in the interview process will have enough knowledge of the due diligence process to be able to clearly articulate answers to the questions asked in the interview process, as well as answer all the questions posed truthfully and honestly. False or uncertain responses will be severely detrimental on the effect of the study's results.
- The total number of respondents will be sufficient to gain adequate data required to draw a conclusion for the purposes of the research, as the respondents will cover the majority of the M&A deal flow activity in the South African market in the 2010 year. This will be further discussed in Chapter 3.3.

1.9 Organization of the study

The study first observes the background and history of the traditional due diligence process, providing an in depth understanding of what it constitutes, the role it has played historically and the effect it has on due diligence efforts traditionally. Over and above its meticulous past, the study observes various empirical research by scholars throughout the decades on the adequacy of traditional due diligence assessments, detailing its key vantage points, as well as its flaws and deficiencies. Various instances of practical applications of traditional due diligence assessments are cross referenced to the literature throughout, comparing and contrasting the theory to practice, providing an insight into the reality of actual due diligence engagements completed.

The empirical research observed in the first chapter explores reasons which necessitate the expansion of the traditional due diligence framework, and provides and paves the way to a more comprehensive and effective due diligence, which is supposedly required in present day in order to meet the expectations of today's business makers. This framework, evidently, justifies the need to establish a more strategic due diligence to ensure a transaction's long-term success.

As this finding stems largely from empirical research, the next chapter attempts to understand the reality of traditional due diligence efforts, and the need for this apparent expansion, from a practice point of view. The study therefore outlines the practical aspects of the various constituents of traditional due diligences, and details the effectiveness and role of each constituent in ensuring a M&A's success. Over and above observing financial, legal and commercial due diligence characteristics, the study considers other facets too which have an impact in determining the adequacy of traditional due diligence assessments at present. Thereafter, the chapter assesses the need for this strategic, effective due diligence, as borne from the empirical research.

Having assessed due diligence efforts from a lens of theory and practice, the study then attempts to discover the veracity of due diligence efforts in South African markets, based on the findings of the literature review. Once having outlined the methodology adopted by this study, the research summarises the main findings concluded from the interviews conducted with the various corporate finance firms identified (based on volume and value of M&A's each is involved in), using the descriptive content analysis method suggested by Neuendorf (2002). Subsequently, the research identifies key themes presented across all interviews and elucidates any differences and inconsistencies noted. Using illustrations and cross referencing to several texts from the literature reviewed, the study concludes on the reality of traditional due diligence assessments, the role it plays at present in M&A success and the future of due diligence assessments going forward. The study also identifies the need for further research to further our understanding of due diligence practices in the modern day.

In the appendices attached to this study include excerpts from the interviews held, due checklists, a range of actual M&A cases which display noteworthy principals referred to in the literature, as well as illustrations on due diligence assessments conducted by other scholars, amongst other things. They have all been inserted in this Appendix for the reader's interest to complement the research report.

2 LITERATURE REVIEW

The first section of the literature review includes an introduction to traditional due diligence, which serves as a background of the issues of traditional due diligence assessments which are required to develop a more comprehensive understanding of the process in practice. The second section establishes the key empirical findings of traditional due diligence assessments, highlighting the importance of traditional due diligence, the issues relating to it as well as its key vantage points. This if followed by a review of instances of practical applications of traditional due diligence assessments, including an assessment of the effectiveness and adequacy of traditional due diligence procedures in practice through the review of studies on actual due diligence engagements completed. These can be found in the extracts attached in Appendix E**.** The final section concludes with an overview of the key learning's.

2.1 Introduction and background to traditional due diligence

Due diligence is an objective, independent investigation of a target company which concentrates on the annual financial statements, tax matters, asset valuations, operations, the valuation of a business and various other matters (Angwin, 2001). Its purpose is to present assurance to the lenders and advisors in the transaction. The process is intended to supply the acquirer with satisfactory information about the value and risks associated with the target company (Angwin, 2001).

Sinickas (2004) defines due diligence as a process whereby the acquiring party investigates the target entity to eliminate misapprehensions and to ensure that the anticipated price is appropriate. In many ways, due diligence affords comfort to an acquirer's senior management, the Board, and ultimately the shareholders, who should all contend on a rigorous due diligence, which provides them with relative (though not absolute) assurance that the deal is sensible and that any potential problems that may disrupt matters in the future have been adequately dealt with (Moeller, 2009).

Due diligence also includes numerous non-financial elements, including the evaluation of organizational fit, ability to merge cultures, technological and human resources capabilities and fit, and a variety of other factors (Epstein, 2005). The lack of assessment in both financial as well as soft personnel and organizational issues, that are both critical to organizational success, frequently result in M&A failure (Epstein, 2005). Furthermore, it is contended that effective due diligence should

uncover issues which might overturn negotiations or may lead to the failure of the M&A post acquisition (Epstein, 2005).

While due diligence does enable prospective acquirers to find potential issues, the aim of due diligence should ideally include realizing any future prospect opportunities for the enlarged corporation, identification of synergistic benefits, and post merger integration planning amongst many other things (Moeller, 2009). Due diligence is often seen as an 'audit', however, most audit assessments focus on addressing the state of affairs that a company has created for itself. Due diligence auditing is dissimilar in the sense that it focuses on the liabilities that have been generated by current and previous projects which the purchaser may 'inherit' on acquiring the target. Due diligence assessments also differ in that they are often characterised by extremely tight deadlines that restrict the amount of time available for data gathering and evaluation (Howson, 2003). Under certain circumstances, the availability of pertinent information may also be limited (Howson, 2003).

Moeller (2009) recognises that even though due diligence is only one element of an acquisition, in many ways it is the most significant aspect of the M&A process. If performed correctly, acquirers should be better able to manage the risks in any transaction, contribute to the ultimate effective management of the target and realize all the goals of the M&A. Despite the fact that due diligence is an expensive exercise, as a result of fees charged for often highly complex work by professional services firms, the alternative of litigation or the destruction of stockholder value as a consequence of having been 'penny wise and pound foolish' in the execution of the due diligence process may prove far more costly in the long run (Moeller, 2009).

Howson (2003) asserts that the underlying reasons for M&A failure all share one thing in common- they could have been avoided by conducting apposite due diligence. At present, there is a profound need for entities to conduct effective due diligence in M&A deals. A more proper due diligence, according to the KPMG (1999) study, uses a 'springboard approach to due diligence which often uses a range of investigative tools designed to systematically assess all the facts impacting on value' (Howson, 2003). Historically, due diligence focus was almost always limited to financial aspects, imminent law suits, and specialized IT systems (Moeller, 2009). Traditional or limited due diligence, as this study determines, corroborates merely the history of a target entity, whilst appropriately applied due diligence offers insight of the future value of the target across a variety of aspects. Today, these traditional areas of due diligence are still important, but they must be accompanied with other dynamics such as management and employees, commercial operations, and corporate culture (Moeller, 2009). In line with Moeller's (2009) findings, newer areas of due diligence are

developing rapidly such as risk management, innovation, and ethical (including corporate social responsibility) due diligence.

Although the number of M&A deals has declined in the last decade, these deals are far riskier than those of the 1990's (Perry and Herd, 2004). The consequences of incomplete due diligence are demonstrated by Perry et al (2004) by example: In the case of a 1997 Merger between Halliburton and Dresser, which resulted in asbestos claims against Dresser, although the extent of the due diligence process remains disputed, court documents allege that information on Dresser's situation, including a letter from a complainant, was available during the due diligence period and not uncovered by Halliburton. The expected cost to Halliburton as a result of this negligence is generally estimated at more than half a billion dollars. The cordial nature of the merger talks and friendship between the two company leaders is cited as a possible reason for this laxity (Epstein, 2005).

In an attempt to understand M&A failures, analysts have reached one deduction: making a merger work is a problematical task (Moeller, 2009). From the beginning, the acquirer needs to know 'what it's getting and what it's getting into,' (Moeller, 2009). In recent times, new statistical techniques and formal decision making tools have been developed considering the factors to be addressed, and practices have been subject to these empirical analysis. However, the number of factors to be addressed continues to increase steadily (Finkelstein and Haleblian, 2002).

While M&A's continue to become increasingly more complex, in line with the findings of Moeller (2009), the activities of due diligence become ever more important. The peril is not that groups neglect to do due diligence, rather that they neglect to do it well (Moeller, 2009). To their avail, there exist a number of methods and best practices that can help due diligence efforts and give the deal a confident opening (Moeller, 2009).

Types of traditional due diligence:

There are a number of different types of due diligence which can be carried out. Table 1.1 summarizes the three main areas. The list below is not intended to serve as a comprehensive list of due diligence types.

Table 1: The main due diligence topics as per Howson (2003):

Due diligence	Focus of enquiries	Results sought
Financial	Validation of historical information, review of management and system	Confirm underlying profit. Provide basis for valuation
Legal	Contractual agreements, problem-spotting	Warranties and indemnities, validation of all existing contracts, sale and purchase agreement
Commercial	Market dynamics, target's competitive position, target's commercial prospects	Sustainability of future profit, formulation of strategy for the combined business, input to valuation

Often these are combined, for example, Human Resources, IPR and property could be covered by legal due diligence; tax, insurance, IT, operational and pension matters by financial due diligence and management and technical by commercial due diligence (Howson, 2003). Each due diligence will be defined more comprehensively in the next section below:

Traditional Due Diligence:

Traditionally due diligence has customarily involved the inspection of extensive available documentation. According to Spedding (2008), traditional due diligence is generally defined as:

> '… mainly a legal and financial course of action, first designed to avoid litigation and risk, second to determine the value, price and risk of a transaction, and third to confirm various facts, data and representations.'

Appendix D contains a typical traditional due diligence checklist.

Financial Due Diligence

Financial due diligence uses a set of structured data which is audited and corroborated and is intended to identify potential deal breakers, evaluate forecasts and budgets, investigate danger areas where warranties/ indemnities may be needed, and provides a level of confidence for the underlying performance (and therefore future profits) of the target company (Spedding, 2008).

Financial due diligence intends to verify whether the targets' financial records are a true reflection of its current trading position and market worth, which is not evident from these historical or filed accounts (Spedding, 2008).Although there is much that can be gathered from released financial reports and the supplementary financial ratios there however is still much that may lurk behind the figures(Spedding, 2008).Amore critical evaluation is required to ensure that the accounting systems used to record data is accurate, accessible and manageable. Financial due diligence generally entails:

- recognition of a commercial rationale for the M&A;
- the segregation between all the facts, conjectures and predictions;
- The financial particulars and projections (Spedding, 2008).

Appendix D contains a typical financial due diligence checklist.

Legal Due Diligence

Legal due diligence is defined by Spedding (2008) as the process of ensuring that:

- The assets are correctly valued;
- The assets are not encumbered/pledged as security;
- There are no unknown liabilities or commitments attached to these assets that could reduce their value (Spedding, 2008).

Therefore, the primary purpose of legal due diligence is the corroboration of the legal affairs and good standing of the target company, which may have an effect on consideration payable. As companies expand to commercially less experienced parts of the world in search of new markets and products (such as China, Vietnam, or certain countries in the Middle East and Africa), the requirement to conduct effective and sufficient legal due diligence work becomes more difficult, and in certain cases near impossible (Spedding, 2008). Nevertheless, the need to check the title over assets that are being sold, and to ensure that the entity being acquired is legitimate and free of any

contractual or legal obstacles which might derail the M&A process, will undoubtedly remain pivotal to the due diligence process no matter where the target resides. Rigid governmental matters (such as tax, competition, employment regulation, etc.) will also be investigated as part of the legal due diligence (Spedding, 2008).

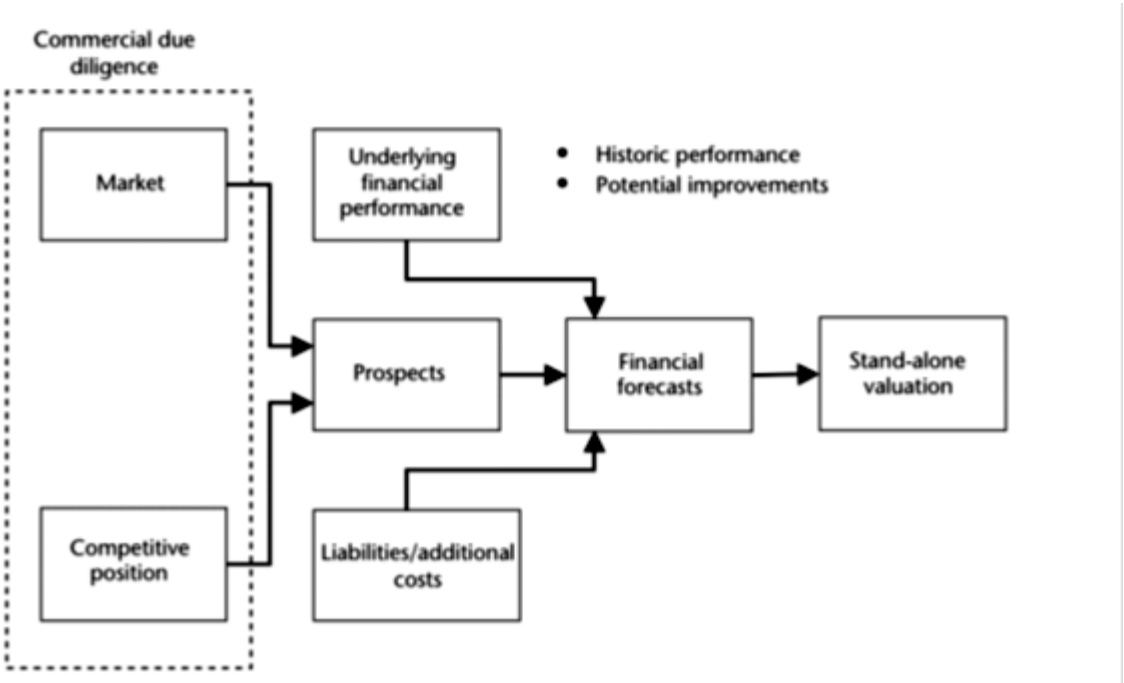
Harvey and Lusch (1995) list the following functions typically included in a legal due diligence audit: (1) basic organizational matters; (2) ownership of securities; (3) banks and borrowing; (4) financial history; (5) litigation; (6) general regulatory data; (7) real property; (8) personal property; (9) intellectual property rights; (10) contractual management issues; (11) labor contracts and history; and (12) insurance. A vast majority of the audit is verification of the existence of material elements of the business and, in addition, the lawyers are often asked to provide a legal opinion to the acquiring company and its leaders on liabilities or contingent liabilities (Harvey and Lusch, 1995).

Appendix E provides a typical Legal Due Diligence checklist.

Commercial Due Diligence

Commercial due diligence focuses on the true business potential and generally concerns itself with the market environment, competitors, the brand value of products, the amalgamation and interface of the employees at sundry levels, as well as the power and costs of negotiation with any accessible lenders or financier (Spedding, 2008).

Figure 1: The Deal Evaluation Process as illustrated in Howson (2003):



"Given that companies are bought not for their past performance but for their ability to generate profits in the future, acquirers must use commercial due diligence to obtain an objective view of a company's markets, prospects, and competitive position," (Spedding, 2008, p. 89). Focused on the likely strategic position of the combined entity, commercial due diligence, enables acquirers to examine a target's markets and performance — identifying strengths, weaknesses, opportunities, and threats and by reviewing the drivers that underpin forecasts and business plans, concentrates on the ability of the target's businesses to achieve the projected sales and profitability growth post acquisition(Spedding, 2008). Figure 2 further outlines the requirements of an ideal commercial due diligence assessment. Appendix E contains a typical Commercial Due Diligence checklist for further understanding.

Figure 2: The commercial due diligence outline Howson (2003):

	Market	*Competitive position of the combined entity*
Price	Degree of industry rivalry: • Number of firms • Relative shares • Degree of differentiation • Stage of industry life cycle • Demand/supply balance • Fixed cost intensity • Height of exit barriers Buyer power: • Relative size of customers • Degree of customer concentration • Profitability of customers • Cost of product relative to buyer's total costs • Importance to performance of customer's product • Ease of backward integration • Ease of switching/cost of switching/ availability of substitutes Threat of new entrants: • Cost of know-how • New technology • Cost of plant and equipment • Importance of experience • Economies of scale Degree of commoditization	Relative share Rationality of competitors Performance relative to the competition against customers' purchasing criteria Product strengths relative to competitors': • Performance • Differentiation • Innovation Relative distribution strengths: • On-time deliveries • Distributor network • Salesforce • Back office • Location/access to markets • Strength of customer relationships Brand strengths Costs relative to those of the competition: • Cost base • Proprietary technology or know-how
Volume	Existing market share Market growth Stage of product life cycle Threat of new products Shifts in technology Cyclicality/stage of cycle Change of regulations	Segments served Segments not served New territories New applications New products

2.2 A reality of due diligence adequacy: A point of view from empirical research

2.2.1 Introduction

With additional pressures on financing of transactions and the general instability in the business climate, it does not come as a surprise that due diligence practices have fallen under greater scrutiny in present day (Milton and Solomon, 2009). Today's buyers are more careful and willing to search longer to identify the best targets for strategic acquisition – a trend that is causing all parties to rethink their approach to due diligence. According to the studies of Milton and Solomon (2009), when the US economy plummeted in financial crisis (the 'credit crunch'), the M&A landscape changed quite dramatically, and transactions were being retraded at an alarming rate, and due diligence data requests skyrocketed. Further, they add that the average days to close a deal [from letter of intent signing to deal close] increased from 95 days in 2008 to 125 days in April 2009, (Milton and Solomon, 2009).

In light of this claim, Fitzgerald (2009) contends that although deals of a high standard are still being completed, particularly in the mid-market, industry players are aware that there are more opportunities for them to fail than there were previously. Similarly, Spizman (2008) asserts that in a tough market where investors can afford to be selective, advisors today are cautioning their clients to be more vigilant and thorough in their assessment of potential targets. Buyers must realize that due diligence is a different game in today's difficult economy as troubled targets may take a variety of steps to try to disguise negative trends and poor results and make operating decisions that may have long-term negative effects on the value of the business. Accordingly, a more disciplined, extended due diligence process is now more important than ever before (Spizman, 2008).

2.2.2 The need for an expanded due diligence framework

In understanding what this disciplined, extended approach entails, an extended literature base must be observed. Price, Harvey and Lusch (1998) argued that the extent of the due diligence process needed to be extended, although more than a decade later, the argument evidently still stands true. As per their contention, the due diligence process conducted during M&A's should provide decision-makers with information on opportunities as well as potential problems (Price, Harvey and Lusch, 1998). All too frequently however, due diligence has been viewed as a mechanical verification of legal, accounting, and tax matters (Harvey and Lusch, 1995). As a secondary consideration, more

intangible functions have received cursory examination historically by members of the due diligence team (Harvey and Lusch, 1995). The need to ascertain a more fully developed picture of the potential benefits and liabilities of M&A's necessitates' modifying the nature of the due diligence process.

In line with this argument, Fitzgerald (2009) argues that when it comes to due diligence assessments in the modern day, one must bear in mind that attitudes are changing and that dealmakers are being more calculating and thorough. He further maintains that there is a greater emphasis on the management team 'to get to know the target' throughout the M&A process and the knowledge they gain has never before been given greater emphasis to assist the post acquisition integration phase of a merger (Fitzgerald, 2009).Due diligence should commence from the initiation of a deal in an attempt to search for matters such as finance, the Board, employees, IT, legal, risk management systems, culture, innovation, and ethics (Harvey and Lusch, 1995). As per Shimizua, Hitt, Vaidyanath, and Pisano (2004), the due diligence process largely conforms to organizational learning theory and exploratory learning, specifically. While an original structure to the approach is needed to ensure that all major areas are evaluated, effective due diligence also has an exploratory nature (Shimizua et al, 2004). If some information is identified that poses further questions, answers to them must be pursued even if they require movement outside of the original structure. Thus, good due diligence can be described as semi-structured, containing both primary and exploratory inquiries (Shimizua et al, 2004).

Correspondingly, the study conducted by Zweig (1995) as cited in DiGeorgio (2001) claims that the major reasons M&A's do not work is because of: (1) Inadequate due diligence by the acquirer; (2) lack of compelling strategic rationale; (3) unrealistic expectations of possible synergies; (4) overpaying (5) conflicting corporate cultures; (6) failure to integrate the two companies. In an effort to understand what "inadequate due diligence" entails, this study must understand the reasons to justify the need for an expanded due diligence framework, to ensure that due diligence can then be 'adequate' in its aims. By expanding the framework, a more effective, strategic due diligence can be achieved, as discussed above.

The literature reviewed reveals the following reasons to justify the need for an expanded due diligence framework:

2.2.2.1 Narrow and uninformative studies

"While some studies have even indicated that seven out of ten mergers do not live up to their promises, the analysis of the causes of failure has often been shallow and the measures of success weak. For decades, success and failure in M&A has been studied in terms of narrow and uninformative measures leading to the aforementioned claims that most mergers fail. Many have taken this finding at face value, moving on to the search for causes of failure, which include culture clash, lack of synergies, and flawed strategy" (Epstein, 2005, p. 37). Hence, in line with the findings of Epstein (2005), the studies on the causes on M&A failure have been deliberated rather poorly. Using other scholars' research, such as Zweig (1995) wherein due diligence is understood to be one of the reasons for M&A failure, the due diligence conductions historically were never modified or expanded to have been more strategic in their aims, thereby resulting in such alarming failure rates in M&A's.

2.2.2.2 The needs of acquirers

In a more recent study by Calenbuhr (2007), it was found that the timing of transactions was largely driven by buyers rather than sellers, and, given the more cautious nature of buyers and their financing groups, the whole due diligence process was slowing down (Calenbuhr, 2007). The growing concern about what was being purchased and defending the price of the M&A assisted those in charge of due diligence, and allowed broadened scope for the information collection process, as was the case in Extract 10, attached in Appendix E. Likewise, Price et al (1998) stated that the role of the due diligence process needed to be expanded to include a pre and post deal investigation. They therefore contended that the due diligence process should persist to aid the amalgamation of the two operating entities into one, and that there was a lack of attention given to this critical aspect of the deal, as due diligence was commonly viewed as a mere box-ticking exercise (Price et al, 1998).

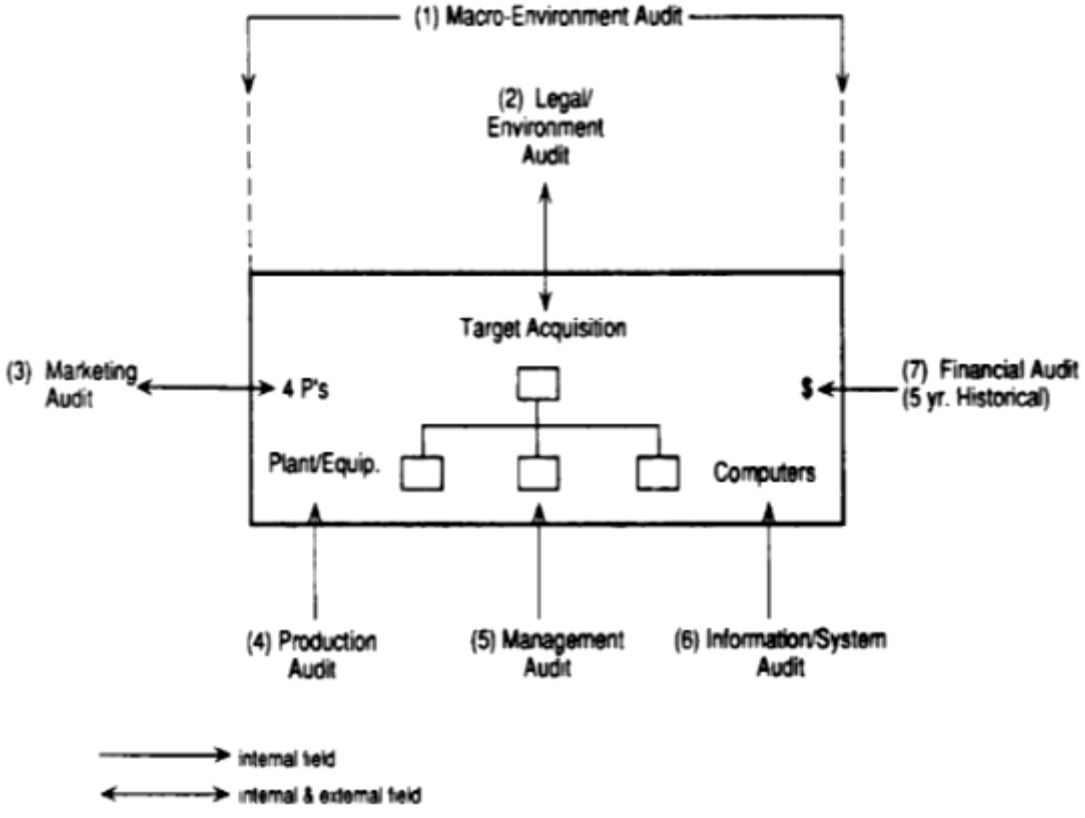
As can be seen in the case of Caparo Industries vs. Fidelity, the probing of a wide variety of due diligence areas should provide a counterbalance to the short-termism of traditionally limited financial and legal due diligence, assisting acquirers in understand how markets and competitive environments will affect their purchase, and confirming that the opportunity is a prudent one to assume from a commercial and strategic point of view, particularly in cross-border deals (Moeller, 2009).

2.2.2.3 Comprehensive due diligence requirements

Figure3below as developed by Harvey and Lusch (1995) depicts seven fields that need to be investigated in a comprehensive due diligence process. Beyond the traditional legal and financial examinations, they recommend that the macro environment, production, management, marketing, and information system assessments should be included during due diligence (Harvey and Lusch, 1995). This expanded scope to the due diligence process should provide critical information for making more informed M&A decisions. In addition, the managerial data provided by these audits should provide guidelines for integrating the two entities after the transaction (Harvey and Lusch, 1995).

What is being recommended is that each of the seven fields identified in Figure 3 be audited, examining both *tangible and intangible* dimensions of the function. What is included in each audit and how these audits are conducted becomes a focal point of expanding the due diligence process. Practitioners would argue that it would take too long and would be too costly to conduct all seven audits recommended (Harvey and Lusch, 1995). Other M&A mavens would contend that the traditional due diligence process covers the topics described (Harvey and Lusch, 1995).

Figure 3: The Due Diligence Audit Requirements (Harvey and Lusch, 1995).



Those involved in more traditional due diligence would argue that the fields identified in Figure 3 have been encompassed within their due diligence in the past. However, the traditional due diligence process primarily focuses on tangible assets or documents relative to the operation of the company. The effectiveness of the integration of operating units may be essential to forecasting financial targets for the combined entity; these additional components of due diligence should be undertaken sequentially, to conserve time and money (Harvey and Lusch, 1995).

2.2.2.4. Time and Cost Constraints

Although due diligence practitioners seek to produce a perfect sketch of the target company, the truth is one of time and cost constraints (Weiner, 2010). According to the studies conducted by Nigh and Boschetti (2006), over the last decade, senior managers rated their M&A transactions as unequivocally successful less than half the time, leaving them contemplating whether their next M&A deal will be any more successful than their previous experience. It is hardly startling that the failure rate is so high when the *je ne sais quoi* of M&A pushes acquirers to rush into acquisitions (Nigh and Boschetti, 2006).

Time restrictions have been of paramount importance in many deals. A good due diligence investigation takes time, and depending on the size and complexity of the target, and the structure of the deal, the time necessary to perform a complete due diligence investigation can be quite substantial (Weiner, 2010).In a competitive auction situation, for example, adequate time may simply be unavailable, as displayed in Extract 6, Appendix E. In addition, it is quite often that due diligence is viewed as too expensive to bring in experts in every functional area to render an opinion (Hearne and Dean, 1989) as cited in Harvey and Lusch (1995)). Cost constraints are also usually a function of the size of the deal. If the deal is relatively small then it will be viewed as un-economic to invest in due diligence. Both time and cost constraints also need to be viewed in terms of using warranties and representations to remedy problems that are not uncovered during the due diligence process (Harmon, 1992).

When time and cost constraints are present, it is often the case that the effective examination of the target acquisition, beyond the major financial, legal, tax, and future sales projections, does not occur (Crisafio and Schliebs (1989) as cited in Harvey and Lusch (1995)). However this would mean that choices and judgments need to be made about which issues are critical and need to be pursued. As traditional due diligence practitioners attempt to give value for money by tailoring their enquires to their clients concerns as far as possible, the due diligence report can begin to lose objective balance

which an advisor may bring, in preference for the particular interests of the acquirer (Angwin, 2001). Given the emblematic time, cost, and data limitations discussed above —it is important for a due diligence team to focus on areas that are likely to have the most impact on value (Angwin, 2001). In this regard, in an attempt to expand the nature of the due diligence process to a more effective conduction, Moeller (2009) maintains that due diligence should be customized to the type of transaction, the motivation for doing the deal, plans for the target (once acquired) and the impact on the existing operations of the acquirer.

2.2.2.5. Scope limitations

Along these lines it can be stated that due diligence, despite an absent legal requirement to conduct one, is an indispensable part of the M&A process (Howson, 2003). Nonetheless, in keeping with the arguments of Weiner (2010), over and above the time and cost constraints discussed above, there are a few other negative aspects of due diligence assessments, especially extensive due diligence investigations. As per McDonald (2005), the more extensive the due diligence, the greater the extent to which a target begins to become either weary or suspicious of the buyer's true intentions, the greater the extent of adversely affecting the buyer's negotiations or relationship with the target, as can be seen in Extract 8, Appendix F. In some cases, as revealed in VeriSign's acquisition of Jamba (Extract 1, Appendix F), it is seen that the cause of failure was not due to a malfunction of the traditional due diligence process, but instead resulted as the process did not start early enough and an ineffective due diligence was performed to gather the necessary data regarding the types of acquisition candidates to consider (McDonald, 2005).

In an ideal world, due diligence should be initiated at the conception stage of a deal, using any publicly available information (McDonald, 2005). However, the due diligence should then continue to evolve as the M&A progresses, utilizing proprietary information as it becomes available. Full use of the due diligence information collected would mean that it is not just used to make an investment decision, and to determine the terms of the deal, but should also be incorporated into the planning for the post-merger integration, in line with the practice reflected in Extract 9 in Appendix E (McDonald, 2005).

In the same way, Price et al (1998) notes that the due diligence team has the required erudition and acquaintance that are extremely valuable in accurately uniting the two merging firms. The authors further contend that acquiring firms' managers are generally hindered to their specific industry due to a general lack of awareness about other operating markets and industries. Thus, to accomplish

the due diligence process, the due diligence team must inspect the acquiree's compatibility with the acquiring firm from a strategic, as well as an integration, perspective (Price et al, 1998).

2.2.2.6 The accessibility of information

As alluded to by Weiner (2010), Reichardt (2006) similarly maintains that the type of information available for the traditional due diligence assessment is dependent on whether the bid is hostile or friendly. The amount of time available for data gathering and assessment is generally limited, given that the majority of due diligence exercises are conducted against an aggressive time frame (particularly in the case of a competitive bid) and remote accessibility of the site like the case of Geita Gold Mine and Ashanti Goldfields in Extract 6, Appendix F. Hostile bids, aggressive time frames and remote site location may restrict the due diligence team to a desk top review of available data. Reliance on exclusively desk top due diligence is particularly perilous where the project is located in an unfamiliar jurisdiction or involves technologies which the potential purchaser has no prior experience. This limited due diligence can prove to be quite disastrous as shown in the cases of Barrick Gold Corporation, Extract 2 or the case of Harmony and Goldfields Limited, Extract 6 found in Appendix F.

Obtaining internal information of high-quality is simplified if a M&A is friendly unlike the due diligence conducted in unfriendly deals which sometimes never develops further than publicly accessible data (Reichardt, 2006). Thus, to the avail of traditional due diligence assessments, it cannot be said to be the sole reason for M&A failure - information is key to any effective due diligence assessment and the inability to access such data cannot be said to be a failure of the underlying due diligence (Howson, 2003). In light of this, Moeller (2009) argues that firms must start the due diligence process with external sources. Although he argues that these rarely provide a sufficient overview of an organization at the level required to obtain a proper understanding, secondary sources do equip management with valuable information, allowing them to strategize and develop honed and more focused questions for their further internal due diligence on the prospective acquisition (Moeller, 2009).

2.2.2.7 Soft due diligence

In further understanding what 'inadequate due diligence' entails to understand the need for an expanded due diligence framework, Reichardt (2006) maintains that the role of due diligence historically has always been to document the financial background and legal information on the

target entity, as observed in the situation of Barrick Gold Corporation, Appendix F: Extract 2. Another reason he upholds, which is becoming more apparent, is commonly referred to as 'soft issues' and is often more of a token gesture than a genuine attempt to understand the full risk profile of the company under consideration, which was the predicament reflected in the circumstances of Halliburton and Dresser, discussed earlier. According to Schuler and Jackson (2001), managing the soft due diligence activity can mean:

- Gaining facts of the make-up and motivation of the two workforces
- Assessing the management team of the other company
- Conducting an analysis of its organizational structure
- Comparing benefits, compensation policies, and labour contracts of both firms
- Assessing the cultural match between the two firms (Schuler and Jackson, 2001).

As management tend to put their resources and energy into the more traditional financial and operational measures, key factors and many other issues are often overlooked or minimized, especially measures aimed at determining the cultural fit of the merging organizations. These are often ignored or given superficial attention because they are perceived to be more difficult, or even impossible to objectively identify and evaluate by comparison to the traditional measures. Frequently these factors are viewed as less important than the more traditional measures - however, these elements are often the root cause of the failure of M&A's (Dodgen, 2011). Even though they appear on the surface to be qualitative and difficult to accurately measure, with the appropriate approach and the application of proven empirical disciplines, a much more comprehensive and accurately-predictive analysis may be used to improve the chances of a successful M&A (Dodgen, 2011). It is critical that an appropriate balance between traditional operational measures and these ignored cultural measures be reached in order to have the highest probability of success in any M&A (Dodgen, 2011).

Research data conducted by Spedding (2008) shows that 55-77% of M&A's fail in meeting their intended results. The reasons behind this alarming failure rate are not absolutely clear, but what is apparent is that this is the case of M&A's in spite of the traditional due diligence processes. Spedding (2008) alludes that these failures are overwhelmingly attributable to 'culture clash' that occurs as attempts to bring the two organisations together are made. The reality is that merging two organisational cultures is extremely difficult, if not impossible; the inevitable result is an expensive demerger. It is therefore important to understand how to avoid the culture clash and what to do post-merger when expected results have not occurred (Spedding, 2008). By assessing the

characteristics of both organisations' cultures as soon as possible in the merger process, potential culture clash problems can be predicted, prioritised and focused on in a comprehensive cultural integration plan(Spedding, 2008).

Bearing in mind the failure rate and costs, cultural due diligence as vital and necessary as traditional legal and financial due diligence in providing an informed basis for executive de cision-making and planning, and perhaps more so in increasing the odds of success of the M&A (Spedding, 2008). The degree to which traditional due diligence is performed capably plays a significant role in determining the successful integration of the two organisations. However, exclusively focusing on these concerns utterly understates the reality that a merger is similar to a marriage of two people who may have different personalities- the human side must not be ignored. In spite of the centrality of financial, legal, cultural, and other areas of due diligence, examples abound of transactions that were completed without effective due diligence being done through lack of time or because management was overconfident in its ability to understand the target, resulting in devastating losses of stockholder value (Schuler and Jackson, 2001). Such can be seen in Appendix E: Extract 5, T&N and Federal Mogul.

2.2.2.8 Non-financial considerations

A further reason for expanding the scope of due diligence as posited by Reichardt (2006), is the importance of considering aspects of non-financial performance as a part of the due diligence assessment process. Reichardt (2006) explores the inherent risks of not factoring such risks into the overall project/company risk profile and provides practical advice on the structuring of due diligence assessments and teams to ensure that the full risk profile of an asset can be identified. The nature of the non-financial risks to be considered will vary, but will include at least some of the issues listed in Table 2 below. Likewise, the sophisticated, forward-looking acquirers who use a springboard approach to due diligence as mentioned earlier, also encompass a range of investigative tools designed to systematically assess all the facts, financial and non-financial, impacting on value- including market reviews, risk assessments, and the assessment of management competencies, as well as areas to concentrate on for synergies or operational impact. This approach to due diligence is evidenced by Cadbury's sweet success, in Extract 7, Appendix E, and should be adopted in an expanded framework of due diligence conductions.

Table 2: The spectrum of non-financial issues that need to be considered during due diligence assessments adapted from (Reichardt, 2006):

Environmental	**Social**	**Workplace**	**Other**
Non-compliance with environmental legislation or permits	Pending land or compensation claims	Fatality and injury rate in the workplace	Country risk
Non-compliance with environmental or socio-economic conditions of project finance	Non-delivery on commitments made to stakeholders	Occupational disease (e.g. silicosis, asbestosis)	Political instability and/or xenophobia
Non-compliance with industry codes of practice to which the company or site is a signatory	Antagonistic relations with external stakeholders	HIV/AIDS	Security of tenure
Disposal of waste	Requirement for involuntary resettlement	Other endemic diseases (e.g. malaria)	Relationship with potential Joint Venture partners
Use of processes, technologies or chemicals that have potentially unacceptable environmental impacts	Relationship with artisanal/small scale workers	Workplace and employee security	Risk to the company's reputation
Inadequate financial provision for closure and rehabilitation/ reclamation	Dependence on infrastructure that will not be retained post-closure	Industrial relations	The company's reputation for management of non-financial risk for other projects

Traditionally, due diligence assessments may have been restricted to a review of the technical and financial aspects of a project, however, companies are increasingly realising that failure to explicitly consider risks associated with non-financial issues (such as environmental, socio-economic and sustainability performance) may affect the economic viability or operability of a project. Holistic risk management considers financial as well as non-financial risk and if considered at a due diligence

stage, a better chance exists that such areas of risk will be proactively managed throughout project life (Reichardt, 2006).

2.2.3. Conclusion on the due diligence stance from empirical research

The literature observed from an academic stance, examined the historical significance of due diligence efforts, as well as the role of due diligence in present day and attempts to identify the due diligence of tomorrow. Whilst due diligence conductions were traditionally once seen as an audit, a costly burden, an exercise with a much unknown definition –the purpose of which was not defined, let alone understood- this is evidently not the case at present. The literature observed reflects the aim of due diligence efforts as they ought to be seen by practitioners, and identified various issues that have always played a role in the limited application of due diligence over the years.

The literature moreover identifies that it is imperative for practitioners to bring originality and creativity to due diligence efforts in the modern day, and even explores eight meticulous reasons to expand the due diligence framework to meet the expectations of today's business makers. This framework justifies the need to establish a more strategic, effective due diligence to ensure a transaction's long-term success. It is quite apparent that as the business climate worsens, dealmakers are finding it increasingly challenging to meet expectations. Although acquirers are still active in the M&A market, they appear to be proceeding with caution, as their needs have drastically been redefined over the years, they continue to change as time progresses. In addition to focusing on innovative deal structures, ensuring that this process is as efficient as possible, is fundamental to the long term profitability of the deal.

From an empirical research point of view, it is apparent that the role of traditional due diligence procedures is no longer as prominent or reliable as they were a decade ago. Scholarly research has identified the many various flaws with traditional due diligence procedures, and have identified a gap for an expanded, more strategic effective due diligence process as identified in this chapter. This appears to be the future for due diligence efforts going forward.

2.3. The reality of due diligence: A practical perspective

As the research attempts mainly to investigate the reality of due diligence assessments in practice, this chapter attempts to comprehend the realism of traditional due diligence efforts, and the need for a more strategic due diligence, from a practical point of view. The chapter therefore outlines the practical aspects of the various constituents of traditional due diligences, and details the effectiveness and role of each constituent in ensuring a M&A's success. Over and above observing financial, legal and commercial due diligence characteristics, the chapter considers other facets too which play a role in determining the adequacy of traditional due diligence assessments in the modern day. Thereafter, the chapter assesses the need for this strategic, effective due diligence (as borne from the empirical research observed in Chapter 2.2) in present day practice.

2.3.1. Introduction

The practice of due diligence has advanced significantly over time, practitioners comment that not only is it customary to never question whether the foundations of traditional due diligence are sound, but it is a widespread practice to look no further into a prospective M&A's beyond the mere basics (Spedding, 2008). In business markets today, when a transaction is under consideration, and the target becomes more impatient as the due diligence process extends the reluctance to push for important information additionally rises (Spedding, 2008). Subsequently, the due diligence process is curtailed. As the time lengthens and the costs rise, it becomes easier to justify minimising or even ignoring anything that is difficult to process; the truth is that many, if not most, firms suffer from mild to extreme reluctance to consult with more qualified outside expertise, and all too often, the deal is completed before any real due diligence, traditional or otherwise, takes place (Spedding, 2008).

In M&A's, the more knowledge the buyer can gather about the target, the greater the likelihood that it will be able to minimize deal risk and maximize deal value (Weiner, 2010). Effective due diligence according to Weiner (2010) is how well the due diligence team can gather the relevant information to pursue these objectives. Accordingly, it is the due diligence uncovering the complete story of what is happening behind the numbers that can provide the buyer with valuable information for negotiation and consideration. Due diligence is too often mistaken as an audit - whilst the aim of an audit is to verify results, due diligence on the other hand seeks to explain results (Howson, 2003). Due diligence begins with information supplied by the company and supports this by interviewing key members of the management team and by reviewing the auditors' working

papers; it takes reported results and arrives at underlying profitability after isolating exceptional income and costs and it does not normally involve the independent verification of financial information by checking it to source documents. Inevitably traditional due diligence uses a lot more 'soft' issues than an audit (Howson, 2003).

In most countries, the typical traditional due diligence process in general looks at the target company, its financial performance, products, market and employees – usually in that order of priority (Spedding, 2008). The typical traditional process starts with a legal questionnaire and disclosure documents attested by the candidate, and is coupled with a review, compilation or audit of financial records. Often, research is added in areas such as the industry niche(s) of the candidate, and sometimes the media (Spedding, 2008). Spedding (2008) asserts that the majority of traditional due diligence projects are directed and performed by legal professionals and secondarily by audit professionals. It is widely recognised that the legal professional's primary obligation in a traditional due diligence concerns the prospective liabilities, and the financial professional's primary obligation concerns the financial data integrity (Spedding, 2008).

Spedding (2008) further asserts that due diligence is applicable in varying extents or degrees depending on circumstances. It is self-evident that the detail, scope and intensity of the process will have to be adapted according to the size, value and significance of the transaction, as well as having regard to the human resources available to each of the parties to the transaction (Spedding, 2008). As per the authors' research, traditional due diligence methods account for approximately 10 to 25% of a complete due diligence assessment from a 21st century perspective. It must be investigated whether this is ideal; especially in light of the fact that approximately two-thirds of all M&A's fail completely, or fail to deliver the value expected (Howson, 2003). It is thus essential to reflect on the role of traditional due diligence and its current standing in modern day practice.

Traditional due diligence is made up of three main components, as discussed in the academic literature review in Chapter 2.1. To better understand the meaning and value of this form of due diligence, these three components of which it constitutes (financial, legal and commercial due diligence) must be considered and analysed from the perception of practice in greater detail:

2.3.2. Financial due diligence

Howson (2003) contends that very few deals are carried out without the above mentioned traditional financial due diligence; failures such as Enron make it unlikely that its importance will

diminish. However, according to Howson (2003) there is a lot more to financial due diligence than examining accounting policies or information systems: effective financial due diligence aims to provide a view of underlying profit which can be used, if not to predict the future, then to provide a canvas on which the picture of the future can be painted. Correspondingly, acquirers generally do not feel comfortable if they do not commission financial due diligence; they need to be assured that the routine accounting issues, underlying profit and the balance sheet is clean and not manipulated (Howson, 2003). They want to understand the quality of the target and the extent to which it meets their strategic objectives- this means that they want firm opinions from the accountants on non-financial as well as financial issues (Howson, 2003).

In practice, reporting accountants are known to be well-trained business professionals who spend a lot of time in the target company and can be an extremely good source of both financial and non-financial, business information about the target. As per Moeller (2009), until a firm offer is made, the target will have controlled information, therefore anything provided prior to a firm offer will inevitably have presented the target company in its best light. The acquiring firm would probably have based its offer on a multiple of last year's profit and will have made a number of assumptions, for example:

- The future performance of the business will be similar to the past.
- The relationships with customers are strong and this will continue.
- Margins are not under pressure.
- Accounting policies have been consistent and reasonably applied.
- There are no looming liabilities.

In addition, Moeller (2009) identifies that it is the acquirer's responsibility to satisfy itself on the assumptions made, not just about the target but also about how well the target fits the buyer's acquisition strategy and the deliverability of its synergy assumptions. Furthermore, it is the only opportunity a buyer will get to make sure these are no skeletons in the cupboard big enough to break the deal and therefore provides the acquirer with an ideal opportunity to negotiate a possible price reduction. Financial due diligence is important in determining the net debt position at completion of the transaction, it can help in structuring the transaction and with any ramifications for price clauses in the contract, it can assist in identifying uncertain liabilities and tax efficiencies achievable (Howson, 2003). But financial due diligence goes one step further than purely transaction-related enquiries- its real aim is to look behind the information provided by the target company and assist the acquirer in forming a view on underlying profitability (Howson, 2003). This

will provide the basis for forecasting future performance and provides the fundamental building blocks of financial due diligence (Howson, 2003).

2.3.3. Legal due diligence

Legal due diligence covers a multitude of speciality areas as well as the more obvious legal areas such as title, consents and releases, and regulatory issues (Spedding, 2008). In practice, generally one firm of lawyers could well cover all of these; however even when other specialists are involved, the lawyers liaise very closely with them as all findings are essential input to the final agreement (Spedding, 2008). For the same reason, even where the lawyers cover all the legal disciplines, they still work closely with other advisers and with overseas lawyers where local advice is needed on cross border issues (Howson, 2003). While most lawyers cover more than purely legal items in their due diligence efforts, there are many other aspects of a target's business that must be reviewed by the appropriate buyer personnel or other outside advisers (Howson, 2003).

Traditionally, legal due diligence is undertaken to achieve three objectives. These are to:

- Uncover potential liabilities
- Find any legal or contractual obstacles
- Form the basis of the final agreement (Howson, 2003).

Further, Howson (2003) maintains that a complete due diligence examination must look not only at what is inside the company, but also what is outside i.e. the environment in which the company operates. In nearly every case, this will include the company's customers and vendors, and the industry in which it operates (Howson, 2003). Moreover, as the government's policies affect more businesses, the legal due diligence exam may need to look at the effects of current and prospective government regulation; there may also be provincial and national government issues to be examined as well (Weiner, 2010).

2.3.4. Commercial due diligence

- Howson (2003) identifies that problems often result from transactional myopia and strategies that are based on optimism, rather than reality. The focus becomes the nuts and bolts of the transaction -forgotten are the sources of its profitability and cash flow, an understanding of its market and the need to maintain a close relationship with the customer (Howson, 2003). Since seeing that a company is acquired not for its past performance but for its ability to generate

profits in the future, commercial due diligence is all about estimating future performance. In contrast to most other forms of traditional due diligence, it looks outside the target for its information (Howson, 2003).

- Commercial due diligence is the process of investigation a company and its markets; traditionally, however, it has been poorly performed when compared to legal and financial due diligence (Howson, 2003). As a discipline it can provide the best available forward-looking information on a business, and therefore is an indispensable process-it relies heavily on primary sources to get the most up to date facts on markets and market participants (Howson, 2003). Ideally, it should look beyond the immediate deal to the competitive future of the combined entity, as reflected in Appendix E: Extract 3, Hewlett-Packard's acquisition of Compaq. In its traditional form, commercial due diligence is the investigation of a company's market(s), competitive position(s) and, putting the two together, its future prospects (Howson, 2003). Thus, traditional commercial due diligence has three aims:
- Reducing risk. The purchase price is often a ratio of current profit but if future profit is under threat, the buyer needs to know this and negotiate the price down accordingly.
- To assist with valuation. Projecting a business ten years out is not easy, yet this is exactly what a discounted cash flow demands. It certainly cannot be done using just historic financials - cash flows which are more representative of the future performance of the entity are required.
- To help plan integration. Bad integration is a major reason why M&A's fail. Commercial due diligence examines the target's markets and commercial performance. In so doing, it identifies strengths and weaknesses which should be addressed as part of the integration process.

These are perfectly valid roles for commercial due diligence, and probably exactly what is needed on some smaller deals, although ideally commercial due diligence should go much further. If approached from a strategic angle, commercial due diligence will go beyond simply evaluating the future performance of the company against its forecasts; the point of strategy is to improve returns or at least to stop them deteriorating any more than they otherwise would (Howson, 2003). Some would argue that financial due diligence will provide much of the information and analysis needed to form a view on commercial prospects and so one should not have to go to the trouble and expense of conducting a detailed commercial due diligence. In this regard, it must be noted that financial due diligence tends to be internally focused - it collects its market and competitive information from management which is only one way of reaching an assessment of future prospects, however, by itself it cannot be said to be enough (Howson, 2003).

2.3.5 Other Considerations

As indicated by the studies of Spencer (2008), the reality is that due diligence assessments are generally conducted under a tight environment with reduced liquidity, low consumer demand and the threat of insolvency. Due diligence, under the prospects of a recession and tighter credit markets, should focus more effort to better understand the risks involved in the transaction and there is an increased awareness of the analysis of the target's solvency and liquidity (Spencer, 2008).It is crucial to understand that while due diligence is considered to be part of the process in more developed economies, in others it is considered a cost that should be mitigated, or worse, eliminated (Spencer, 2008).The trend is to make a better initial assessment, identifying risk areas and focusing the scope of due diligence in those areas- as was the case displayed in Extract 7, in Appendix F. This method encourages practitioners to perform due diligence with fresh research and analysis, instead of using existing sources or management assumptions; it allows a more accurate and efficient evaluation of the value and risk involved in a transaction (Spencer, 2008).

As per the studies of Spencer (2008), companies must assemble multinational teams of professionals representing expertise in each of the areas of interest help to preserve value while emphasising the importance of the due diligence process to the target. Accordingly, it is essential to have team members who understand not only the traditional environment in each jurisdiction, but as importantly, the cultural and business traditions as well, as what is deemed to be a thorough due diligence exercise has evolved in line with market trends and developments. While traditional due diligence remains essential, other aspects are becoming increasingly important; these include the analysis of market fundamentals, environmental issues, insurance and risk management together with cultural and organisational due diligence (Spencer, 2008).

Moeller (2009) alike contends that the due diligence process, if only theoretically, allows acquirers to understand the target company in sufficient adequate detail, and ensures the legitimacy of what is actually being purchased. Accordingly, due diligence should not be a mere confirmation of the facts, but rather bridging the strategic review and completion phases of any M&A exercise. In bridging this strategic aspect of due diligence maintained by Moeller (2009) and its former traditional ways, Very and Schweiger (2001) identify that the due diligence team will typically experience several issues in conducting a more effective due diligence assessment. These issues have been encapsulated in Table 3 below and should be borne in mind by practitioners. They have been presented in this research as they highlight the key reality that the conduction of due diligence in theory is not as straightforward in practice.

Table 3: Typical problems faced by a firm (Very and Schweiger, 2001):

Problems Faced When Acquiring

STAGE OF THE PROCESS	NATURE OF PROBLEMS	
Identifying and selecting acquisition candidates	• Finding candidates with a strong strategic fit • Limited number of potential candidates	• Difficulties in identifying candidates in new countries • No clear picture about potential M&A advisors
Before the closing: target analysis, first contacts, valuation, pricing, deal structuring and negotiations	• Evaluating strategic fit • Reliability of financials • Poor quality of order backlog • Over-estimation of synergies • Finding ethical problems • Suspecting environmental problems • Trustworthiness regarding target accounting principles • Difficulties in pricing • Difficulties in valuation • Valuing some assets • Legal and tax effective structuring of the deal • Time pressure • Competitive bidding for the target • Keep the acquisition confidential	• Market transparency in relation to M&A relevant facts (shareholders, . . .) • Accounting differences • Finding information about the reliability of the country economic and political system • Establishing first contacts • Financial projections difficult to make • Country restrictions • Currency control regulations • Tax laws • Other legal hurdles (environmental, . . .)
Negotiation with target and other stakeholders	• Price negotiation • Obtaining warranties and representations • Getting the customer list included in the contract • Negotiating environmental issues	• Ethical problems • Negotiation about employment • Respect of anti-trust law • Knowing how to negotiate in a particular country
After the closing: integration	• Dealing with poor quality of target management • Integration of multinational targets • Managing firms' cultural differences • Combining different organizational structures • Maintaining market share • Controlling expenditures • Dealing with unions • Difficulties in implementing sophisticated procedures and techniques	• Compensation of management (stock-options) • Keeping management in place after the closing • East-Asia economic difficulties • Integrating management from local view to group international objectives • Integration planning and execution
General problems throughout the entire process	• Language • Communication • Time differences • Differences in country cultures, management mentalities and practices, business approaches and work methodologies	• Structuring teams to conduct the process • Keeping the process going in spite of adverse conditions • Limited knowledge of the country

2.3.6. A more effective, strategic due diligence

By prioritizing and arranging of a number of primary but often neglected standards, successful acquirers follow a rather disciplined approach, known as *strategic due diligence,* counteracting the traditional limitations discussed earlier. As per the research of Cullinan and Holland (2002), acquirers routinely perform due diligence, but for a variety of reasons they tend to do their checking too narrowly - mainly on understanding historical financial reports, uncovering possible legal liabilities and hunting for other unpleasant surprises. In other words, acquirers usually concentrate on the past, not on the future of the combined companies. They contend that traditional due diligence is evidently necessary, but is hardly sufficient to ensure a transaction's long-term success (Cullinan and Holland, 2002). According to research conducted by Dodgen (2011), the most successful acquirers go far beyond traditional due diligence as it does not give the full consideration to all of the critical factors necessary to make for a successful merger. The "Critical Fit Criteria" methodology adapted from this author's research follows the strategic due diligence used to extend the due diligence process discussed above:

Table 4: The traditional due diligence process vs. the elements of the Critical Fit Criteria (Dodgen, 2011):

Traditional Due Diligence:	**Critical Fit Criteria:**
Strategic intent	*Knowledge management*
Market profile	*Stakeholders*
Customers	*Physical systems*
Shareholders	*Political systems*
Competitors	*Operating plans*
Asset analysis	*Human capital skills & abilities*
Employee agreements	*Trust*
Environmental regulations	*Ethics*
Distribution	*Programs & initiatives*
Organizational structure	*Adaptability/flexibility*
Potential tax & legal issues	*Autonomy*
Goals & objectives	*Managing paradox*
	Inward vs. outward focus

This criteria was developed with the objective of improving due diligence by providing a structured, systematic due diligence program. By planning, identifying, prioritizing, collecting and analyzing the appropriate and relevant data, an efficient and methodical approach is followed to support fundamental purchase decisions (Dodgen, 2011). "The adoption of a formal due diligence program should be a strategic initiative by the decision-makers of every organization with an aim of adding structure to the decision management process. Once established, the due diligence should become an integral, ever-present facet of the organization's strategy, assisting management through every decision; and will create significant improvement in the organization's capabilities, risk reduction, agility, morale and profitability" (Dodgen, 2011, pg 4).Similarly, research conducted by Accenture (2006), reveals the following summary reflecting alike data:

Table 5: Traditional due diligence vs. Strategic due diligence as per Accenture (2006)

Different approaches

Traditional due diligence differs from strategic due diligence in a number of areas.

	Traditional due diligence	Strategic due diligence
Focus	Target company's past	Combined companies' future
Key question	Can the deal be done?	Will the acquisition succeed?
Areas of inquiry	Financial, legal, unpleasant surprises	Traditional concerns, as well as validation of key operational and strategic assumptions
Participants	Finance department, accountants, lawyers	Traditional participants, plus operations, IT, HR and other key players, as needed
Information sources	Two to three, mostly for checking management background	A dozen or more, including customers, competitors, joint venture partners, key suppliers and former employees

Using the above data table adopted from the works of Accenture (2006), the purpose of traditional due diligence is simply to confirm that the deal makes near-term financial sense. The purpose of strategic due diligence, by contrast, is to assess whether the acquisition will *succeed,* and beyond that, to identify specifically what will need to be done in the post-merger integration to make the transaction a success, and makes use of a wider array of information sources (Accenture, 2006). In order to ensure that the target acquired will function well as an integrated business, this more detailed, tactical, value assessment needs to be followed (Perry and Herd, 2004). Strategic due diligence is known to be more work than traditional due diligence, however, when deadlines are tight, strategic due diligence helps successful acquirers to focus on the key ideas and assumptions (Perry and Herd, 2004).

An obvious question then arises: If there is a logical, disciplined process that companies go through to gauge whether a transaction is being properly valued—looking at issues such as industry impact, customer reaction, and competitor response— why aren't more of them doing it? In keeping with these key questions, further research on these matters must be sought after. Please continue on to Chapter 4 and 5 in this regard.

2.3.7. Conclusion of due diligence from a practice perspective

Through a lens of realistic practice, this chapter provides valuable insight on the veracity of the traditional due diligence process, and better elucidates on the predicament of due diligence assessments in markets at present. In line with the arguments observed, it is apparent that traditional due diligence reflects mostly on the historical data of the target, and not the imminent activities of the firm. As this chapter examined, this approach is often conducted cursorily, with a narrowed concentration and evidently is far from being an appropriate judge of the entities' future performance. Yet, as the literature above observed, these constitute approximately 10-25% of due diligence efforts from a 21st century perspective (Spedding, 2008). Undoubtedly, in the present day, more effective and far reaching tools are accessible by practitioners to achieve a more thorough, strategic due diligence, as viewed in the Table 4 and 5 exhibited. The purpose of such a due diligence is to ensure an acquisition will indeed succeed. As this chapter has shown, due diligence is a different game in today's challenging economy, as distressed targets may take a variety of steps to try to disguise negative trends and poor results and make operating decisions that may have long-term negative effects on the value of the business (Spedding, 2008). It is thus imperative that one reflects on the status and value of traditional due diligence assessments in practice today and the value of a more effective, strategic due diligence.

2.4 Conclusion of Literature Review

It can be seen that in the augmented analysis and apprehension over the faithful representation and trustworthiness behind financial statements and the executives behind them, it is sensible to perform an effective and thorough due diligence assessment before proceeding with an acquisition (Moeller, 2009). A due diligence assessment to know the target entities' industry, clients, customers, habits and practices, policies to procedures – its past, present and its expected future. This literature review shows that the due diligence process is indispensable, its scope and importance has never been more underestimated, now more than ever before. Many establishments have been exposed within the literature observed, which have proven the consequences of incomplete and inadequate due diligence, and the disastrous effects it has had on acquirers, as well as target companies. Whilst the literature identifies that many companies often find themselves making decisions based on imperfect or incomplete information, they can and should increase their comfort and confidence and should insist on more thorough, rigorous due diligence. In line with this, this study makes clear that although due diligence may only be one element of a potential acquisition, in many ways it is by far the most significant aspect of the M&A process, and the literature review reveals statistical data emphasizing this statement.

Catwright (2008) suggests that almost 58 percent of all M&A's fail to produce results rather than create value. In light of this, it is essential that an effective, strategic due diligence is conducted to find out as much as possible about the target and that a comprehensive investigation is performed on the strategic rationale behind the M&A. It is commonly understood that the devoting of the necessary time and resources to searching every nook and cranny is a laborious and costly task; however, it should be regarded as a necessary evil in present day. Pressures to expand often prompts many companies into hastily entering M&A's that ultimately prove to be costly misjudgments- a disciplined and objective approach is the only way to safeguard against making a blunder that could have serious financial repercussions later on. The literature draws together an understanding of the financial, legal and commercial due diligence issues and concepts relating to M&A corporate transactions, through both, the stance from academia and practice. By analyzing and appreciating these concepts through both lenses has proven to be rather insightful, as these views jointly flagged the route to a strategic due diligence, which is seen to be necessary given current trends, as well as enlightens the readers to better understand these concepts, their finer details and the reality of their application.

Many companies will want to take a hard look at how they invest in companies and how their due diligence efforts are managed- if history is any guide, the practices and business models that constitute advantages for today's most successful companies must be observed. The research presented here brings together many respected authors views and input to the efficiency of the traditional due diligence process. Although all the authors conducted independent studies of the process, they all shared one viewpoint: The traditional due diligence process as it stands, lacks in execution extensively. Each author argues in a different way as to *how* the process lacks, but nevertheless agrees that there exists a significant deficiency of traditional due diligence efforts in practice. If anything may be concluded from observing their empirical work, it is that traditional due diligence is not to be relied on exclusively to attain any sort due diligence comfort. This concurs mainly to the findings of Spedding (2008), who established that the traditional due diligence method should ideally only account for approximately 10 to 25% of a complete due diligence process.

The literature also identifies that the scope and extent of the due diligence process has drastically been redefined over time – as it will continue to change going forward. As opposed to an abysmal effort to project the future of a target company based on its history, an effective due diligence imparts an insight of the target company, across a fruitful variety of financial and non-financial factors. Evidently, management should aim to have a clear policy that not only prioritises the positive aspects of running a successful business but also has considered the more traditional concerns that embrace such matters as contracts; customer care; marketing; employment; health and safety etc. Over and above the rich depth of academic theory observed, from a practical point of view, this study has shown that due diligence is a two-way street- buyers must understand what they are buying and that in order to be successfully conducted, due diligence must have senior management involvement and control, assisted by outside experts such as management consulting firms, accountants, investment banks, etc. That said one must bear in mind the time restrictions, the resources available and the quantity of data to be analysed. On the whole, it is not the quantity of data that matters so much as it is the quality and how it that data is used (Moeller, 2009). Ultimately, the traditional due diligence process results in key information that is required to make a fundamental business decision. To quote from a PricewaterhouseCoopers report: "We always have to make decisions based on imperfect information. But the more information you have and the more you transform that into what we call knowledge, the more likely you are to be successful."

The question then remains, is the transformation process from transmuting 'imperfect information' to 'knowledge' leaving M&A's a success, or a recipe for failure?

3 RESEARCH METHODOLOGY

The primary objective of this research report is to establish the reality of traditional due diligence procedures and their effect on the success or failure of M&A's. The literature review compiles a dataset of traditional due diligence practices, which forms the basis for an interview agenda conducted with corporate finance firms identified based on volume and value of M&A's each is involved in. The interview agenda is designed to assess general due diligence practices of each practitioner, rather than for a specific assignment in order to ensure that a statistically significant number of due diligence engagements is covered. The interview outcomes are analysed in this study with the intent of creating themes from the emerging data using the 'Data Management System' prescribed by Miles and Huberman (1984). The transcripts from the recorded interviews have been condensed into data summaries using a descriptive content analysis method as recommended by Neuendorf (2002), and key themes presented across all interviews were identified and any specific differences and inconsistencies have been noted.

3.1 Research methodology / paradigm

The research contended here takes a qualitative approach, as the study examines the reality of traditional due diligence practices based primarily on a constructivist perspective. The research observes the collective stories of due diligence practices using a narrative approach, with the intent of creating themes from the emerging data (Kalof and Dan and Dietz, 2008). The research is rather informative and uses a small sample of individuals for a survey which is not representative of *all* due diligence practices. However, as the sample covers majority of the market's deal flow activity, it is assumed to be representative of the market. These individuals have each been interviewed for approximately thirty minutes to determine their experiences. The research establishes the reality of due diligence assessments in South Africa based on these participants' views. An Ethics Clearance Certificate was issued by the Ethics Committee of the University of the Witwatersrand validating and approving the empirical study. Please see Appendix C in this regard.

3.2 Research Design

A literature review on due diligence assessments was conducted, summarising and observing the data gathered to generate an overview of the traditional due diligence process. Reports which reflect due diligence executions were attained to reflect the theory observed in the literature in a different context, to obtain a more practical reality-based view. Using the above information, both

open and close ended questions were generated for an interview agenda for interviews to be held. A copy of this can be found in Appendix E.

An interview with the leading due diligence practitioners in 2010 and 2009 was conducted, in order to provide some clarity and insight into the traditional due diligence assessments in practice and to obtain an understanding of their practices of due diligence generally. Please see Chapter 3.3 for more information regarding this sample selected. The data gathered was then analysed and similarities and principles were then drawn using defined methodologies mentioned below. Thereafter, a combined understanding was formed of the relevant theory, previous research conducted and the results of the empirical research.

3.3 Population and sample

3.3.1 *Population*

An interview was held with each of the reporting accountant firms who have carried out the various due diligence practices behind the top 15 M&A deals (by ranking or by activity) in South Africa in 2010 and 2009 according to the DealMakers report.

DealMakers' is one of South Africa's Corporate Finance Journals and was first published in August 2000. The publication serves to record all deals assumed by every JSE-listed company quarterly. Although formal announcement of M&A deals involving unlisted companies is not a regulatory requirement (other than to the Competition Commission), DealMakers is notified by the Commission of all deals submitted to it as this is public information.

For the purposes of this study, the DealMaker report (Quarter 4 of 2010) has been used. Since the report covers both listed and unlisted M&A deals in South Africa, it reveals a more credible reporting of *all* of the latest M&A's in the market. The report furthermore lists the latest M&A deals by the highest value and deal flow activity in the market. It is assumed that the coverage gathered by interviewing these firms which reflect greatest deal flow activity and therefore represents the greatest due diligence exposure in the M&A market.

3.3.2 *Sample and sampling method*

The Dealmakers report on the top 15 M&A deals in 2009 (either by deal value or by deal flow activity) reveals that 5 reporting firms were the leading practitioners of the due diligence behind the M&A deals. The 5 reporting firms for the top 15 M&A deals reported in 2009 are:

1. PricewaterhouseCoopers
2. Deloitte
3. KPMG
4. PKF
5. Ernst & Young

The same 5 reporting firms were reported as the top 5 in the 2010 report (either by deal value or by deal flow activity).This reflects that five reported accountant firms remained as the top M&A advisors between 2009 and 2010. These five firms together with BDO, SizweNtsaluba VSP and Mazars have been used to represent the sample, as the cover the majority of the market's deal flow activity. Thus, a total of eight firms were selected, encompassing the leading practitioners of due diligence behind the top deals in South Africa for the last 2 years.

Therefore, in terms of ranking by transaction value, the selected 8 participants represent 97.97% of the market share according to the DealMakers' report of 2010, representing transactions worth a total of ZAR 211, 799 million. Alternatively, in terms of ranking of transaction flow (activity) the selected 8 participants represented 86 of the 101 M&A transactions reported to DealMaker in 2010, therefore representing a total coverage of 85.14% of the total market's transaction in 2010. Please see Chapter 4.2 for a summary of the number of responses and results achieved from this sample collected.

3.4 The research instrument

Before conducting the interview, the purpose of the research was explained to the interviewee, and an introductory letter was provided stating what the study involved, the likely duration of the interview (approximately thirty minutes) and the interviewee was assured about the strict confidentiality of the interview. All the interviews were conducted at interviewees' convenience, time and location. The general strategy for the interviews was to start off with broad questions and follow up on the interviewee's responses, to capture meanings and to avoid imposing any other view on the interviewee's response. Uninhibited speech was encouraged, and the respondents'

comments were used to guide the flow of the interview so as to gain as much of their experience as possible.

The interview agenda was semi-structured and the standardization of the questions asked allowed comparisons to be made from the various interviewees' answers (Creswell, 2003). This facilitated the research to deduce what the current realities of due diligence processes in practice are. These deductions have been analyzed and observations have been drawn and contrasted/compared with the literature reviewed. The approach was interactive and sensitive to the language and concepts used by the interviewee, and to keep the agenda flexible (Britten, 1995). The question on the effectiveness of the due diligence carried out by these respondents was asked a multiple of times in various ways, phrased and presented differently each time. Thus, multiple observations can be combined into an overall measure that is more reliable than a single question would be by itself (Kalof et al, 2008).

In line with Patton (1987) questions were open ended, unbiased, sensitive, and translucent to the candidate. Interviews commenced with enquiries that were straightforward thereafter more sensitive topics ensued (Patton, 1987). The interview agenda was based on Patton (1987). The interview explored the participants' views in detail and exposed new ideas that were not anticipated at the outset of the study. An understanding was given to the respondents' meanings instead of relying on the researchers own assumptions (Britten, 1995). This is particularly important because there was obvious potential for misunderstanding.

3.5 Procedure for data collection

A person-to-person interview with each of the interviewees was of great value, as it allowed all to speak freely and share past experiences and provided some useful insight to the research that otherwise would not have been detected. This benefit outweighs the disadvantage that personal interviews are more time-consuming than other forms of data collection (Kalof et al, 2008). Moreover, since only a segment of the population was used to conduct the interviews, it was easier to organize interviews as opposed to mail, web or telephone surveys. As all of the head-offices are based in Johannesburg, it did not prove to be costly in terms of travel costs to meet personally with the eight participants.

Willig (2008) finds that there are a variety of ways of recording qualitative interviews: during the interview, after the interview and using of modern technology to audio tape the interview. As per

their research, scribing during the interview often is distracting and impedes the flow of the interview, and scribing afterwards is often inaccurate and omits vital details. Therefore, audio taping is the best means and was used for the purposes of conducting the interview in this study. The user-friendly equipment was tested ahead of time.

Being a semi-structured interview could have proved to be problematic unless a voice recorder was used in addition to key points being written down whilst engaged in the interview. Since the majority of the questions to be asked were open-ended, focus needed to be placed on what the interviewee was saying and thus the use of a recorder was essential for the interview as reflected in the findings of Willig (2008). Whilst the audio recorder may have seemed imposing on the interviewee, a surety was provided that no one else would be able to have access to such recording beside the researcher and the consent form would have reminded him/her of this point. Thus, the essence of interview has not been lost and has been captured in writing when the researcher was less active.

Another benefit of audio recording the interviews is that it prevented the researcher from assuming that the interviewees' words were simple and reflects their feelings and thoughts. This permitted more time to be set aside to process the true meaning of their opinions and not how they chose to say it (Walker, 1985). This also gave rise to an opportunity to place their commentary in the greater context of the discussion, combating the issue of linguistic variability (Creswell, 2003). Bearing in mind that this was a non directive interview, it was ensured that no abuse of the informal ambience of the interview was encouraged, preventing the interviewee to reveal more than they feel comfortable with after the event. There was a sensitive and ethical negotiation of rapport be tween the interviewee and the interviewer (Willig, 2008). Patton (1987) suggests that most qualitative interviews have an agenda and key areas / questions that are intended to probe the interviewee for some meaning, as was the case for this research. During these interviews, the interviewer may decide to host further questions with the topic being discussed (Kalof et al, 2008). In such cases, the interviewer must use the interviewee's own words when framing these auxiliary questions (Britten, 1995). This was born in mind when conducting the interview.

Burgess and Whyte (1982) holds that 'qualitative interviews require considerable skill on the part of the interviewer on how directive they are being and whether leading questions are being asked, cues are picked up or not and whether the interviewees are given enough time to explain what they mean.' This was also borne in mind when conducting the interview. Burgess and Whyte (1982) devises a six point directiveness scale to assist researchers analyse their own interviewing technique:

1. Rendering promoting noises
2. Pondering upon applicants comments
3. Probing further of the applicants comments made
4. Probing further of the applicants' implicitly suggested ideas
5. Probing further of the applicants' explicitly suggested ideas
6. Initiating a new theme (1=least directive, 6=most directive)

The point is not that non-directiveness is always best, but that the amount of directiveness should be appropriate. Some applicants may be slightly more pompous / talkative than others, and therefore it is essential that the interviewer be in command of the interview (Burgess and Whyte, 1982). Patton (1987) provides three strategies for maintaining control: 'knowing the purpose of the interview, asking the right questions to get the information needed, and giving appropriate verbal and non-verbal feedback.' This method was applied for the purposes of this research.

3.6 Data analysis and interpretation

Once all the data was captured, it was analysed and a collective observation was made from narratives of due diligence practices, with the intent of creating themes from the emerging data through constant vigilant examination and comparison within and out of text (Kalof et al, 2008). Using the discussions held in the interview, the reality of due diligence practices was established based on these participants' notions. Since the interview agenda is somewhat standardized, the responses from the questions asked permits comparisons to be made from the various interviewees' answers and a deduction is able to be made on what the reality regarding the execution of traditional due diligence assessments in practice are.

In addition, reports and other detailed literature reviewed can be cross referenced and the differences/ similarities between the literature and current practice can be noted. By analysing the audio recordings using an approach suggested by Miles and Huberman (1984), the core principles on due diligence assessments were established and a conclusion was drawn so that future practitioners of due diligence may take heed. Miles and Huberman (1984) prescribe the 'Data Management System' which comprises of three linked sub-processes, and is used in this study:

1. Data Reduction

   The transcripts from recorded interviews are condensed into data summaries in order to in effect portray more of it. The reduced data is subjected to vertical and horizontal analysis. Using a descriptive content analysis method as recommended by Neuendorf (2002), key themes presented across all interviews was identified and any specific differences and inconsistencies have been noted. Beside identifying themes in the data, the researcher attempted to constantly discover any links, new categories or patterns.

2. Data Display

   The reduced set of data is then displayed in Chapter 4 to assist in readers' further interpretation and analysis.

3. Conclusion drawing/Verification

   This involves compare/contrast analysis as well as the noting of patterns and trends. The researcher seeks verification of these conclusions by use of 'triangulation' with alternative data sources (follow up interviews, press articles, internal documents, literature reviewed etc.) which furthermore provides verification of key findings in the study (Miles and Huberman, 1984).

3.7 Limitations of the study

There are many practitioners of due diligence in South Africa, and whilst this research is applicable to them as well, it is not feasible to interview all these firms. Instead, the practitioners behind the largest M&A's in the two years (who represent the largest deal flow activity in the market) have been selected. They represent a good coverage of the due diligence practices in the market, as they represent majority of the market share.

3.8 Validity and reliability

To improve the credibility of the findings of this research, the study utilized unswerving data collection strategies (discussed below) that were able to adequately solicit the representations and enabled the dependable drawing of conclusions from the data gathered. To ensure the validity and reliability of the information gathered, the responses gathered is analysed against the literature reviewed for plausibility of the commentary of the interviewee.

3.8.1 *External validity*

The research is also subjected to 'peer debriefing' with fellow colleagues within the School of Accountancy, to increase credibility of the research. Various aspects of the research were consulted on with an uninvolved person, so that other perspectives may be attained on the study. This helped clarify issues the researcher had, and helped identify what the researcher may have overlooked (Kalof et al, 2008).

3.8.2 *Internal validity*

To minimise the influence of the interviewers persona in the interview, and minimise the effects of interviewer-interviewee dynamics, objective and subjective experiences have been kept distinct as much as possible, (Kalof et al, 2008). Each interview was carried out in an identical manner, thereby facilitating comparison. The tone and choice of words when conducting the interview were kept as controlled and rehearsed as possible, thereby minimising the impact it may have had on the interviewees responding to questions posed.

3.8.3 *Reliability*

The questions asked in the interview was subject to 'member checking', wherein the participants were asked to review the research notes and audio records, as well as a summary of findings to see if they agree with the data and if they have anything else to add, (Kalof et al, 2008). This will ensure credibility to the data. The researcher also compared/contrasted the patterns and trends noted from the data to previous studies on due diligence observed, to previous statements in the literature reviewed regarding similar data, to the other respondents' arguments and to the consistency of the particular respondents' argument. The researcher attempted to verify any conclusions drawn with the use of 'triangulation' to alternative data sources – a follow up interview, reviewing of subsequent press articles, internal documents gathered, etc. which furthermore provides verification of the key findings in the study.

CHAPTER 4: PRESENTATION OF RESULTS

4.1 Introduction

The results pertaining to the interview have been summarised and have been presented in Section 4.5 below. The transcripts from the recorded interviews were condensed into data summaries using the descriptive content analysis method as recommended by Neuendorf (2002), as discussed earlier. It must be noted that none of the respondents' names have been mentioned, for confidentiality reasons, and therefore will here forth be known as Participant 1, Participant 2, and Participant 3 etc. Only partners and senior managers behind each of the participant firms Corporate Finance divisions were interviewed and therefore it can be assumed that the responses generated in this study are reliable and representative of the market.

4.2 Demographic profile of respondents

As mentioned in Chapter 3.3, the total sample selected, in terms of ranking by transaction value, represents 97.97% of the market share according to the DealMakers' report of 2010, which is indicative of transactions worth a total of ZAR 2,11799 billion. From these eight selected participants, a total of six respondents participated in this study. These six respondents represent 97.69% of the total sample size, or transactions worth a total of ZAR 2,11202 billion.

Alternatively, in terms of ranking of transaction flow (activity) the selected sample of the eight participants represent 86 of the 101 M&A transactions reported to DealMaker in 2010, therefore representing a total coverage of 85.14% of the total market's transaction in 2010. From the selected 8 participants, the 6 respondents of this selected sample represent 76.23% of the total sample size, or 77 of the 101 transactions.

	TRANSACTION VALUE	%	TRANSACTION FLOW ACTIVITY	%
TOTAL POPULATION	216, 200 million	100	101	100
SELECTED SAMPLE FROM POPULATION	211, 799 million	97.97	86	85.14
RESPONDENTS IN THIS STUDY	211, 202 million	97.69	77	76.23

4.3 Results pertaining to close-ended questions

Questions 2-8 were close ended questions, which required (in their bare minimal) a 'yes' or 'no' or 'cannot answer.' Participants were encouraged however, to add any additional information if they so wished. The results were as follows:

Table 6: Results of Survey Responses to Questions 2-8

QUESTION	YES	%		NO	%		CANT ANSWER	%		TOTAL
2	0	0.0		6	100.0		0	0.0		6
3	2	33.3		4	66.7		0	0.0		6
4	0	0.0		4	66.7		2	33.3		6
5	4	66.7		2	33.3		0	0.0		6
6	5	83.3		1	16.7		0	0.0		6
7	6	100.0		0	0.0		0	0.0		6
8	3	50.0		2	33.3		1	16.7		6

4.4 Results pertaining to subjective-ranking questions

In Question 9, Participants were asked to rank the following nine categories in order of importance wherein 1= most important and 9= least important. The results were as follows:

Table 7: Results of Survey Responses to Question 9:

	CATEGORIES:	PARTICIPANTS					
1	Identifying the M&A strategy early on	1	1	1	1	1	1
2	Arranging finance	4	5	6	9	9	5
3	Skillfully identifying, screening and prioritising targets	2	2	2	2	4	2
4	Synergy evaluation	6	3	4	6	5	4
5	Integration project planning, orchestrating and executing	9	9	8	4	7	3
6	Pricing the deal and negotiation	7	4	5	7	2	6
7	Picking management team and energising the organisation	8	8	7	3	8	9
8	Understanding and resolving cultural issues	3	7	9	8	6	7
9	Conducting due diligence	5	6	3	5	3	8

4.5 Summary of the results

The following is a high-level executive summary of the interviews held. The actual précis can be found in Appendix G.

1) What do you think the objectives of due diligence are in terms of Mergers/Acquisitions, and do you think due diligence achieves this objective? Please substantiate.

   - *To identify risks relating to a particular target's business and to provide clients with recommendations on how to address these risks.*
   - *To determine whether a potential acquirer should go ahead with an acquisition and if so, at what price.*
   - *Many companies in South Africa see due diligence as a confirmatory exercise, not an investigatory exercise. They have already made the decision to acquire and are actually not looking for the due diligence to "cause any problems". In these cases a due diligence does not achieve its objectives.*

2) Do you think your clients consider due diligence as just a confirmation of facts, a mere box ticking exercise?

   - *Some clients, particularly some private equity houses/consortiums, see financial due diligence as a mere box ticking exercise as they would have done extensive research into and analyses on the business already. They only require the due diligence for the purposes of presenting this to a bank in order to obtain funding for the deal from the bank. In this instance, even though the Private Equity house itself might see it as box-ticking, the due diligence is still essential to the bank which has to provide the funding.*
   - *Due to the evolution of business and the increasing number of corporate failures, due diligence is not seen as a tick box exercise. Clients understand that failure to carry out proper due diligence can be damaging to any company that is buying or selling.*

3) Do you feel that your clients have a pre-conceived notion/ stigma attached to due diligence before it is carried out? (Tedious, lengthy, costly etc.)

   - *The days of long and tedious due diligences are coming to a close and few clients express concern about this. Most clients are worried about cost but this is more a sign of the tight economic times we are living than their appetite for the due diligence.*
   - *In the greater scheme of things, the cost of a financial due diligence is miniscule in comparison to the whole deal value and in most cases less than the cost of M&A advisors and lawyers.*
   - *Yes at times the process of due diligence may be seen as tedious, time consuming and costly. The majority of clients understand that failure to do proper and thorough due diligence can result in negative consequences. A minority of clients are so focused on getting the deal done that they do cut corners because of the above mentioned perception.*

4) Are due diligence assessments often seen as an 'audit' by your clients?

   - *A client who sees the due diligence as an 'audit' would typically be an inexperienced deal maker or someone that is doing a transaction for the first time.*

- *The possibility does exist that with inexperienced deal making clients they deem a due diligence to be an audit. At the outset it is imperative that they understand the purpose, nature and limitations of the service. Once they get this understanding, they are clear about due diligence.*
- *We occasionally (less than 5%) come across a client who does not fully understand due diligence and possibly confuses the due diligence with an 'audit'.*

5) Do you ever incorporate non-financial elements in the conduction of your due diligence?

- *Usually no, it depends on the type of due diligence and the scope requested. As accountants we focus on financial, taxation and commercial due diligences and don't stray outside of our expertise areas.*
- *Yes - our due diligence reviews are focused on meeting the client's needs and therefore at times incorporate non-financial elements. We find that due diligences differ from deal to deal and depend on the level of knowledge that the parties have of the industry, the target company, future prospects of the entity being acquired etc.*

6) Do your clients often restrict / limit the due diligence due to its cost implications?

- *Yes, the scope of due diligence can often be limited in order to keep costs in check. Areas often taken out of the scope include looking at the forecast (which the client often then prefers to look at themselves) and leaving out some non-key entities from the tax due diligence.*
- *No – we would typically scope the due diligence after obtaining a proper understanding of the specific needs and/or transaction. The scope would typically determine the fee. Our client's see the value in the due diligence and therefore cost is seldom a determining factor.*

7) In your experience, is the acquiring of quality data impeded if the Mergers/Acquisition deal is hostile? That is, does the type of Merger/Acquisition affect the type/nature of the due diligence conducted?

- *Definitely- the quality of info is key to the level of due diligence that is possible. Even in an organised bidding process where there is more than one potential buyer, restricted access to information and management can be a big impediment to performing a due diligence.*

8) In your experience, when a M&A has failed, was there a possibility that due diligence could have prevented that failure?

- *Yes however this is all relative. Due diligence is often completed prior to the finalising the price and Sale Purchase Agreement. There may be certain cases where the client asks for certain items to be followed up during the merger process and there are also instances where clients may ask for a top up due diligence on certain "effective date" balances.*
- *Perhaps but not likely. Our view is that failures of mergers have a lot more to do with the parties not doing it for the right reasons and/or not spending as much time and effort on integration post-merger, as they did on actually getting the deal signed-off. Getting two businesses with completely different business models and cultures to fit is no easy task and something often left to happen spontaneously which is unsurprisingly not very successful.*
- *Yes, only effective and adequately planned and resourced due diligence could have prevented failure. Due diligence is a process of evaluating the history, to be certain of its nature. Undertaking such research will ensure that a company becomes involved with a business that is not only currently successful but will continue to be so in the future.*

- *The due diligence should focus on value and valuation issues (including synergy benefits, valuation drivers, etc.). A due diligence that is not properly focused is likely not to prevent an unsuccessful transaction. A M&A transaction however also often fails as a result of poor implementation (post-deal).*

9) What do you think are the negative aspects of conducting due diligence?

- *I don't believe that there are any negative aspects of conducting a due diligence. A due diligence is an integral part of any purchase decision.*
- *The negative aspects of any due diligence includes not covering all the risk areas, costs incurred by client if the potential transaction is not successful and lack of co-operation by target entity. Due diligence can also be seen as time consuming as it distracts target management from focusing on the running of their business.*
- *A due diligence can disrupt the normal running of a business, i.e. distract management and place an overly burdensome strain on management time.*

10) Has due diligence assessments performed by your firm ever identify potential causes of merger failure? Elaborate.

- *We have experienced a number of transactions that have failed post-due diligence. Some common causes for transactions to fail post due diligence are the risk of undisclosed tax or financial liabilities, significant valuation adjustments that make the price unattractive to the seller, lack of sustainable earnings trend, etc.*

11) How do you combat buyer/seller dynamics? Buyer/seller dynamics typically include the seller having nothing to gain by giving a buyer time to probe and question. Whilst the buyer, on the other hand, having to gather and digest a lot of information in a very short time with less than perfect access to the sources of information.

- *We tend not to get involved in these dynamics apart from ensuring that our client's interest comes first. In a bilateral scenario I don't see the buyer/seller dynamics as you put it as being particularly troublesome. If both parties want the deal to work they will find a way to compromise on timing/access so both parties get comfortable in the end.*
- *Generally, by the time the due diligence exercise is commissioned, the seller and buyer have agreed access to information. Where the seller restricts access to information, this generally then translates to more onerous Sale Purchase Agreement conditions which are not in their best interest. Therefore, in most cases, sellers are willing to engage on the due diligence process.*
- *A transaction needs to be done so that value is created. Sellers often share in the future upside (either through incentives or pricing). Our experience is that a buyer is always willing to pay a fair price for a target (and this often incorporates paying for some of the synergies).*

12) Has the execution of due diligence ever changed in your practice? That is, have your due diligence techniques ever been modified, and how/why so? Any elements of change/innovation/creativity?

- *Our due diligence methodology is continuously being innovated and improved to ensure that we deliver on clients' expectations. The due diligence product is also continuously improved on to keep ahead of competition.*

- *Our analysis expands on the current historic financial focused analysis to encompass all areas affecting delivery of the business strategy, therefore drawing on deep experience within our firms multiple service offerings to understand the impact of the key drivers on the current and future financial performance. By doing so we are able to form a more complete, integrated view and provide our clients with more value-add advice through the seamless integration of wider service offerings.*
- *Our global methodology is refined on an ongoing basis as we attempt to differentiate ourselves to our competitors. On other services we offer a more holistic due diligence offering.*

13) Are there any shortcomings, constraints or limitations of the due diligence process in your experience? If any, how do you counterbalance them?

- *There is of course incentive for the seller to try and hide things, but that is why it is important to have an experienced due diligence team and a thorough due diligence scope to ensure that these "hidden" things are identified. Every transaction is different. It is however true that in most cases transactions are concluded under tight timelines. The tight deadlines can be overcome by ensuring that the transaction process (including the due diligence) is properly planned and appropriately resourced (staff or external service providers that have required experience).*
- *The only major constraint is access to information and management during the due diligence process. If our access is restricted, the due diligence output is not very meaningful for our client. This is combated by a clear understanding and effective communication i.e. by gaining a comprehensive understanding of the client's needs, having understood the macro and micro reasons why our client is doing the deal, the expected synergies, etc.*
- *Due diligence is mainly about determining what is not given to you, not looking at what is given to you. Therefore, experience is a very important asset but most people conducting due diligence work do not have enough experience.*

14) Do you feel that the typical types of due diligence are sufficient and provide adequate coverage? Typical types include financial, legal, commercial due diligence.

- *Yes, there are numerous specialist areas that can be used on transactions in order to provide a more specialist or fuller evaluation of the transaction.*
- *Every transaction/transaction process is different. Depending on the buyers understanding of the target company, the stage of negotiations and other factors the scope of the due diligence (including need for legal, financial, commercial, HR, tax, IT due diligence etc.) should be set.*

15) Do you feel that your due diligence efforts are as effective as they could/should be? If not, what could you do to make it more strategic/effective?

- *Yes, although in practice, some entities may commission their internal finance team to perform the due diligence. Our experience is that due diligences undertaken by non-due diligence professionals often lack the necessary depth and focus on deal issue and hence are not as effective as they should be.*
- *Our firm continuously seeks to improve its service to its clients. Industry knowledge and experience is a factor. In addition, a properly scoped due diligence is key to ensuring that the process adds value to the client.*

CHAPTER 5: DISCUSSION OF THE RESULTS

5.1 Introduction

This chapter discusses and explain the results displayed in Chapter 4, and has been analysed and collectively observed with the intent of creating themes from the narratives gathered, by constant vigilant examination and comparison within and out of text (both vertically and horizontally), in line with the studies of Kalof et al (2008). Since the interview agenda was somewhat standardized, the responses from the questions solicited permitted comparisons to be made from the various interviewees' answers and a deduction was able to be made on what the reality regarding the execution of traditional due diligence assessments in practice are. In addition, detailed reports, previous scholars' findings and other detailed literature reviewed were cross referenced and the differences/ similarities between these were noted.

5.2 Discussion of the Results

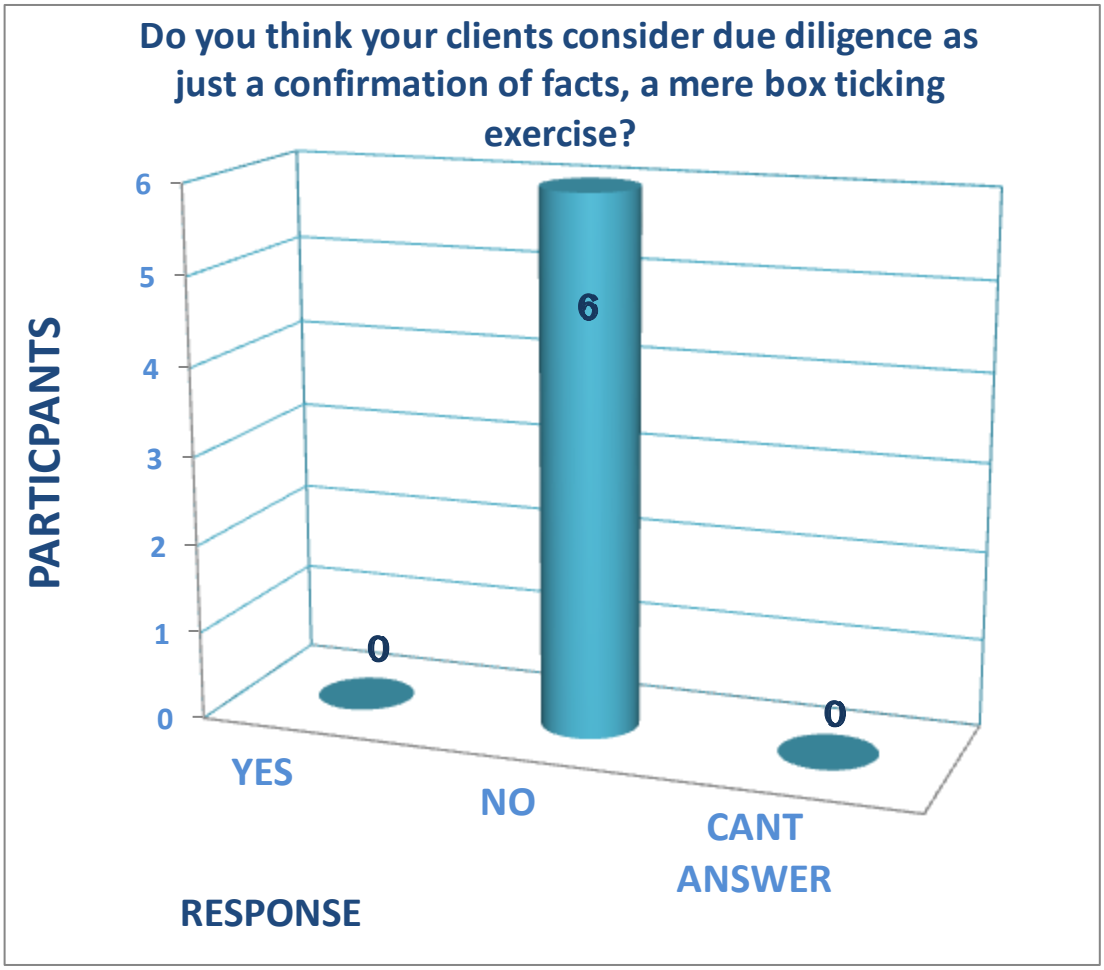
The participants were first asked what they thought the objectives of due diligence were. From all six participants, only one produced a model answer which correctly reflects the true essence of what due diligence entails as detailed in Chapter 2.1. The rest produced somewhat unsatisfactory answers which attempted to discuss the meaning of due diligence. Participant 3 stated that *"companies in South Africa see due diligence as a confirmatory exercise, not an investigatory exercise."* The participant further noted that *"they* [the acquiring companies] *have already made the decision to acquire and are actually not looking for the due diligence to 'cause any problems'. It is within these cases that due diligence does not achieve its objectives..."* This is particularly interesting as the literature reviewed details due diligence as a process that should commence from the initiation of a deal in an attempt to search for matters such as finance, employees, IT, legal, risk management systems, culture, innovation, and ethics (Harvey and Lusch, 1995). Evidently, although it is seen as an investigatory exercise in theory, it appears to be applied rather narrowly still by some practitioners.

What is also worthy of note is that two participants answered the question merely defining financial due diligence. This displays the notion that practitioner firms often mistake M&A due diligence to be no more than financial due diligence, a concept argued by Moeller (2009) as observed in Chapter 3. The author contended that many companies mistakenly define the term "due diligence" as a study of the profit and loss and the financial position of the acquired company, and therefore the due diligence assessment was historically always restricted to a review of the financial aspects only as

they were understood to be straightforward and easier to conduct. Further, this resulted in many practitioners relying on financial reports to make their decisions without taking into account other factors. Evidently, this still manifests in some due diligence assessments of today.

Participant 1 asserted that due diligence achieves its objectives only when, "*the due diligence is properly scoped and the target makes adequate disclosure."* Participant 5 correspondingly noted that when due diligence is conducted properly compliant with its desired objective, it should result in significant cost savings, as evidenced by the savings that one of their clients achieved: *"On a recent buy-side transaction that our firm assisted a listed client with, the client managed to acquire a business for R70 million subsequent to the detailed due diligence review. The client's initial non-binding offer for the business was R115 million. The findings of the due diligence were used to re-negotiate the deal achieving a saving of some R45 million."*This signifies that due diligence can result in significant cost-savings to entities if properly scoped and outfitted.

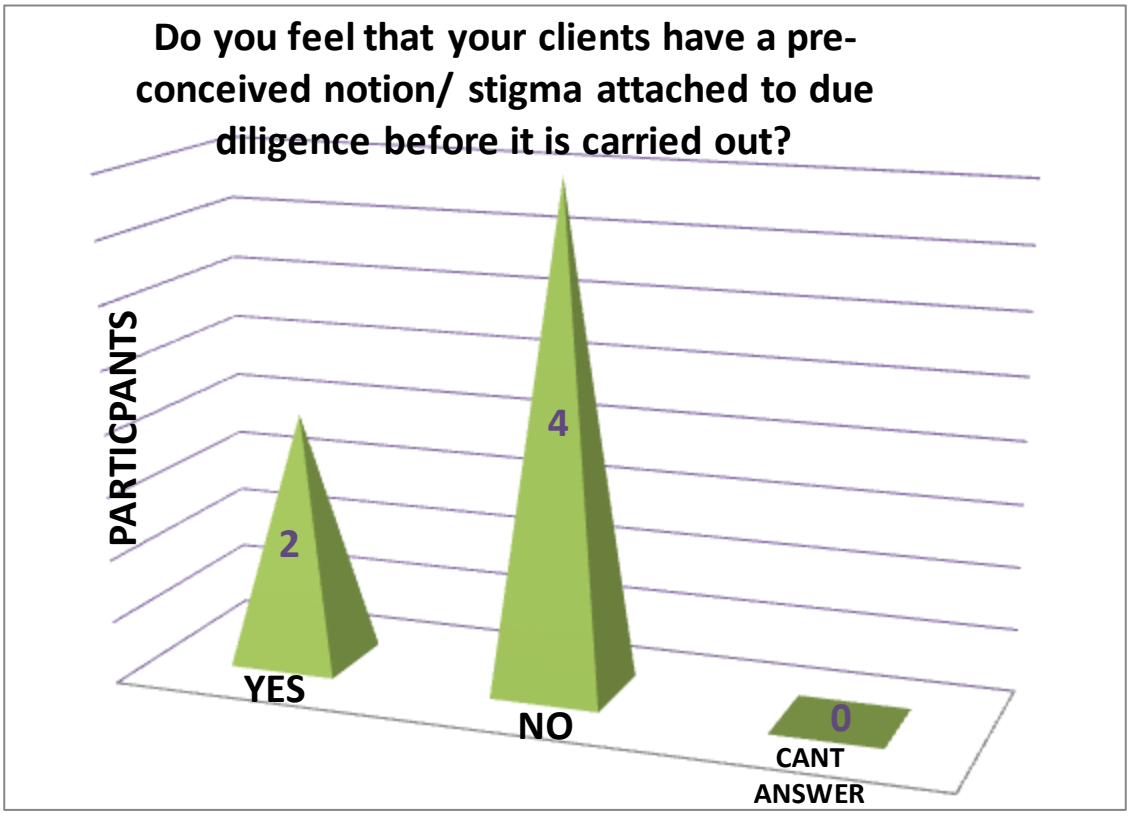
Illustration 1:



When the participants were asked whether their clients considered due diligence to be a mere box-ticking exercise, all the respondents answered unanimously in the negative. All of the respondents commonly agreed that due to the evolution of the commerce world and the increasing number of corporate failures, due diligence is no longer seen as a tick box exercise and that their clients understand that failure to carry out proper due diligence can be damaging to any company involved. This is in line with the findings of Price et al (1998) who states that although due diligence is seen to be a mere box ticking exercise, the role of the due diligence process needs to be expanded to include an investigation prior and post to a M&A deal in order to aid the amalgamation of the two operating entities into one. According to the respondents, their clients understand the need to conduct a more thorough due diligence in the present day, as emphasized by Price et al (1998).

What is of interest to note is that Participant 2 avowed that "*some clients, particularly some private equity houses/consortiums, see financial due diligence as a mere box ticking exercise as they would have done extensive research into and analyses on the business already. They only require the due diligence for the purposes of presenting this to a bank in order to obtain funding for the deal from the bank."* This denotes that practitioner firms are at times contractually required to conduct their due diligence efforts in limited and narrowed measures, as this is what is demanded of them by their clients' financiers. However, to the avail of due diligence, the participant further continued, "*in this instance, even though the Private Equity house itself might see it as box-ticking, the due diligence is still essential to the bank which has to provide the funding."* Therefore, it is crucial that there be a probing of a wide variety of due diligence areas to counterbalance to the short-termism of traditionally limited financial and legal due diligence, helping acquirers to understand how markets and competitive environments will affect their purchase, and confirming that the acquisition is a prudent one to assume from a commercial and strategic point of view.

Illustration 2:



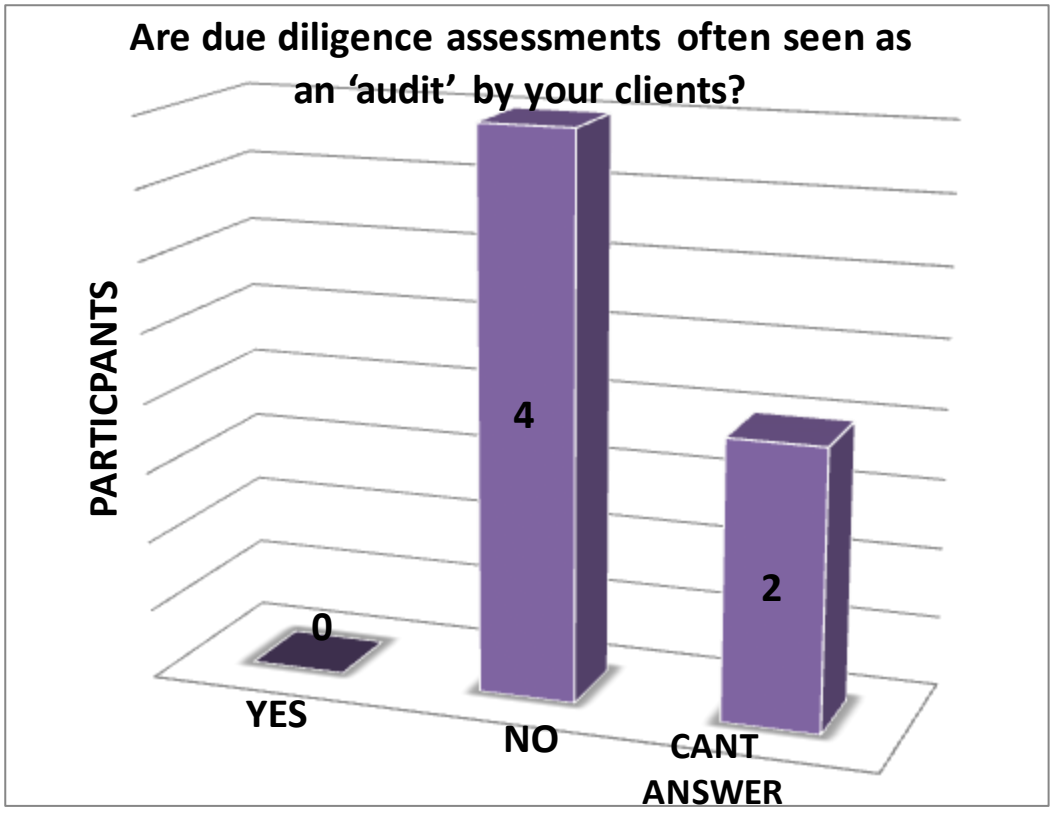
When the participants were asked about whether they felt there existed a stigma attached to due diligence before its conduction, the majority of the respondents retorted in the negative. In particular, Participant 4 noted that at times the process of due diligence is tedious, time consuming and costly. However, they claimed that the majority of their clients understood that failure to conduct proper and thorough due diligence could result in greater negative consequences. They further asserted that in their experience, only a minority of their clients are so focused on getting the deal done, that they cut corners because of the above mentioned perception. This agrees with literature analysed, as according to Moeller (2009), due diligence should be seen as an opportunity for a buyer to ensure that there are no skeletons in the cupboard big enough to break the deal and provides them with an ideal opportunity to negotiate a possible price reduction.

Conversely, Participant 2 noted that for their firm, the days of long and tedious due diligences are coming to a close, and few of their clients express concern about this. They declare that most clients of theirs are worried about cost, but this is supposedly more a sign of the tight economic times that our markets are experiencing and not a reflection of their appetite for the due diligence. In the greater scheme of things, the cost of a due diligence according to the participant is miniscule in comparison to the whole deal value, and in most cases, less than the cost of M&A advisors and

lawyers. It would seem that the expensive exercise that is due diligence (as analyzed by Harvey and Lusch (1995)) may not be obtainable to all clientele. However, this is not a reflection of due diligence, but rather economic factors which palpably play a role in the conduction of due diligence. It is therefore asserted that both the respondents, as well as the theory observed, concur that devoting time and resources to performing an effective due diligence is always favourable and should be regarded as necessary.

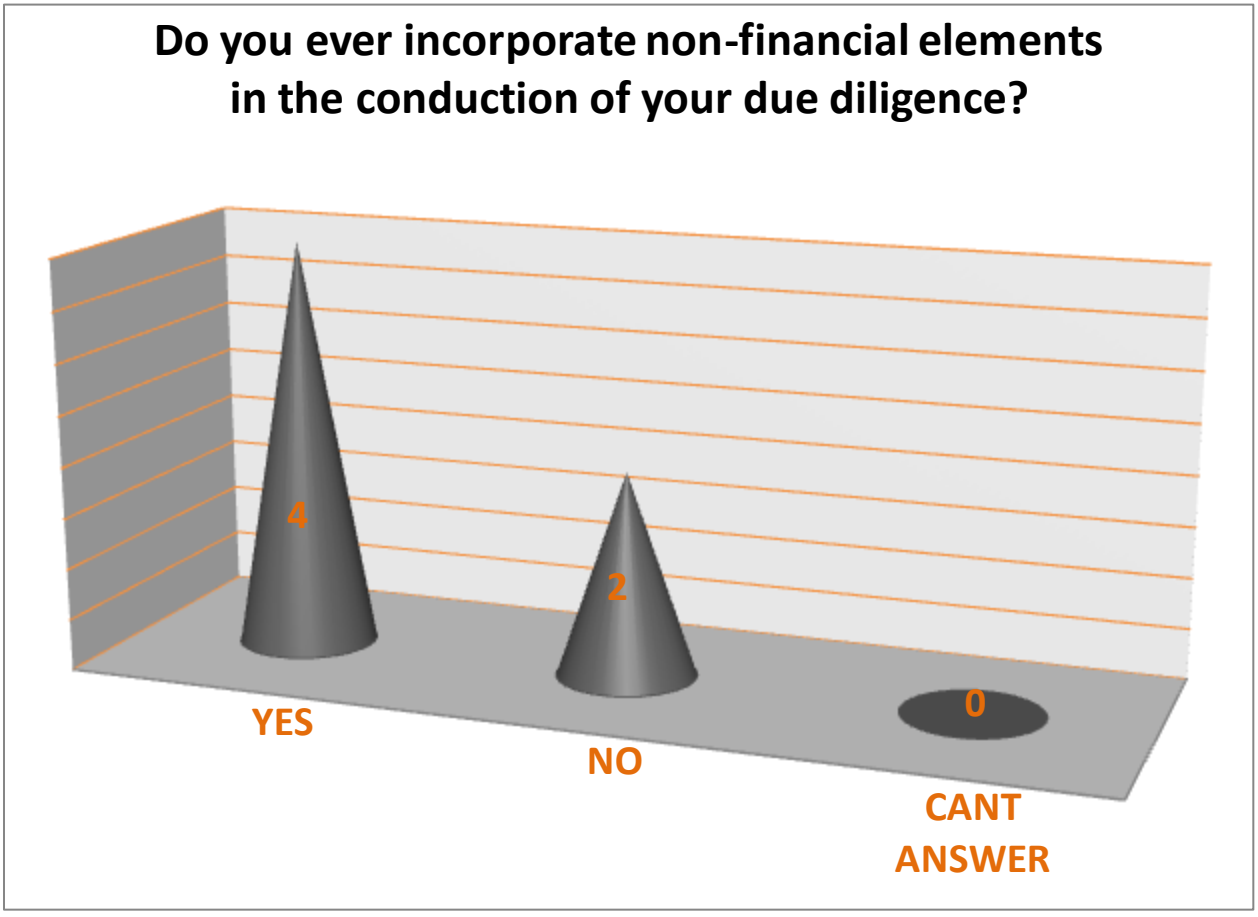
Next, the participants were each asked whether their clients often confused due diligence as an audit. The bulk of the participants averred that their clients do not see due diligence as an audit, which contradicts the findings of Howson (2003) who maintains that due diligence is too often seen as an 'audit' by clients. Howson (2003) however, asserted that due diligence auditing is dissimilar in the sense that whilst the aim of an audit is to verify results, due diligence seeks to explain results. He further added that due diligence assessments also differ in that they are often characterised by extremely tight deadlines that restrict the amount of time available for data gathering and evaluation (Howson, 2003). In light of this, Participant 5 stated that a client who saw due diligence as an 'audit' would typically be an inexperienced deal maker or someone that is doing a transaction for the first time. They further added that their approach is to fully understand the client's proposed transaction (needs), and then to explain the value of a due diligence approach to the client. Accordingly, they occasionally (less than 5% of the time) come across a client who does not fully understand due diligence and possibly confuses the due diligence with an 'audit'.

Illustration 3:



Participant 4 identified a key proposition for practitioner firms. They propose: *"We as the due diligence team need to inform our clients that we are not expressing any formal opinion or any other form of assurance with respect to the financial statements (audit or review). Nor are we presenting the financial data in the form of financial statements for management (compilation). Rather, we are performing an investigative analysis of the financial and operating activities of the target so that the client can make an informed decision of what impact our findings have on the valuation, sale and purchase agreement, and on post deal issues."*

Illustration 4:



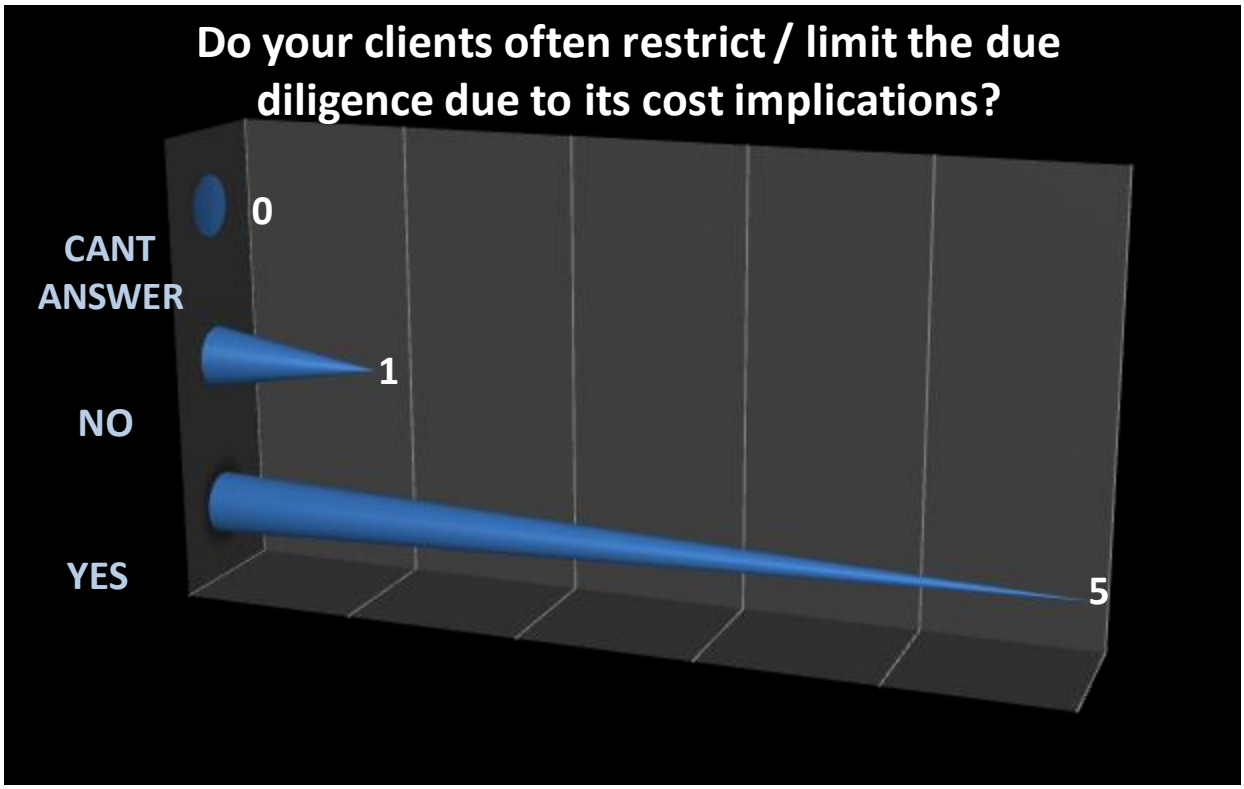
When the participants were questioned about whether they incorporate non-financial elements in their conduction of due diligence, as per the findings of Reichardt (2006) who advises on the importance of considering aspects of non-financial performance as a part of the due diligence assessment process, the majority of the firms responded in the affirmative. This inquiry explores the inherent risks of not factoring such risks into the overall project and provides some insight on the

structuring of due diligence assessments and teams to ensure that the full risk profile of a project can be identified i.e. a more holistic risk management which considers financial as well as non-financial risk to better the chance that areas of risk will be proactively managed throughout project life if considered during the due diligence assessment cycle (Reichardt, 2006).

Participant 4 identified non-financial aspects of due diligence which they include as part of their assessments and maintained that these elements all fall within the ambit of a commercial due diligence. Elements identified which were incorporated within their due diligence efforts were aspects such as Human Resources, Information Technology etc. This is in line with the research of Epstein (2005) who also maintains that due diligence should include numerous non-financial elements, including the evaluation of organizational fit, ability to merge cultures, technological and human resources capabilities and fit, and a variety of other factors (Epstein, 2005). Further, in line with this author, the lack of assessment in both financial as well as soft personnel and organizational issues, that are both critical to organizational success, frequently result in M&A failure. The majority of participants, in this regard, valued the importance of incorporating non-financial aspects in their conductions. Participant 5 asserted that their due diligence reviews were focused on meeting the client's needs and therefore at times incorporated non-financial elements. The participant further stated they find that due diligences differ from deal to deal and depend on the level of knowledge that the parties have of the industry, the target company, future prospects of the entity being acquired etc. Specialists that they claimed they would typically involve include: i) financial; ii) tax; iii) human resources; iv) market and commercial; v) legal vi) information technology etc.

Conflicting with this, Participant 3 stressed that they generally did not incorporate any non-financial elements in their due diligence assessments. They maintained that it depended on the type of due diligence and the scope requested. As an accountant firm, they stated that they focused mainly on the financial, taxation and commercial due diligences and do not usually stray outside of their expertise areas. This contradicts the literature reviewed, which identifies that reporting accountants are generally known to be well-trained business professionals who spend a lot of time in the target company and can be an extremely good source of both financial and non-financial, business information about the target (Howson, 2003).

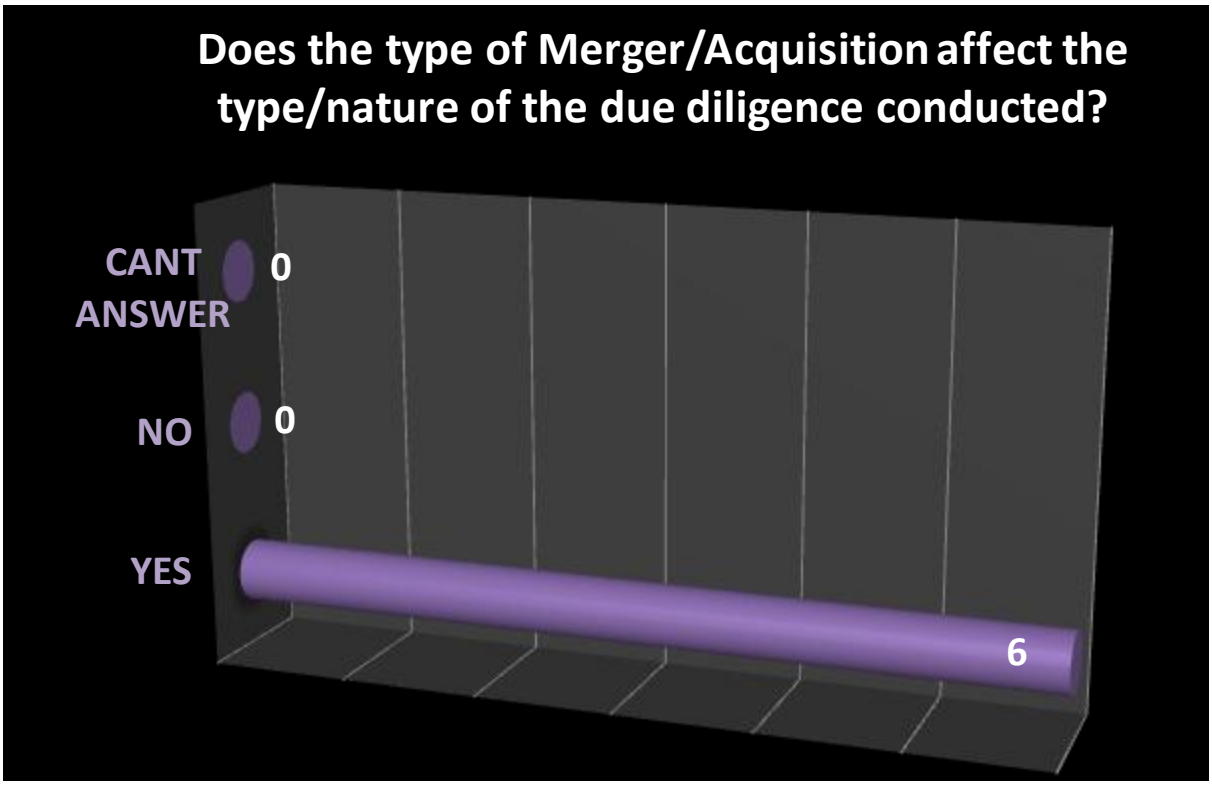
Illustration 5:



The literature observed that time and cost constraints are often present in the conduction of due diligence, and it is often the case that the effective examination of the target acquisition, beyond the major financial, legal, tax, and future sales projections, does not occur (Crisafio and Schliebs (1989) as cited in Harvey and Lusch (1995). Therefore, this would mean that choices and judgments need to be made about which issues are critical and need to be pursued. In this regard, 83% of the participants agreed that this was true *"in almost all cases,"* although, it was *"dependent on the deal value and the size of the target company relative to their client* [the acquiring company]."

The one respondent who replied in the negative (i.e. that due diligence is not limited by its cost implications), declared that their firm would typically scope the due diligence only after obtaining a proper understanding of the M&A. The scope would typically determine the fee and therefore their client would see the value in the due diligence and therefore cost is seldom a determining factor. What is interesting to note is that Participant 1 stated that due diligence is limited due its cost implications, however later in the interview asserted that only *"inexperienced transactors consider due diligences to be expensive."* Overall, the greater part of the participants experienced the time and cost constraints maintained by Weiner (2010), Harvey and Lusch (1995), Harmon (1992), Nigh and Boschetti (2006) and Angwin (2001) as examined in Chapter 2.2.2.4.

Illustration 6:



As per the literature reviewed, a good due diligence investigation takes time, and depending on the size and complexity of the target, and the structure of the deal, the time necessary to perform a complete due diligence investigation can be quite substantial (Weiner, 2010). Further the literature observed that the amount of time available for data gathering and assessment is often limited, given that the majority of due diligence exercises are conducted against an aggressive time frame (particularly in the case of a competitive bid) and remote accessibility of the site. Hostile bids, aggressive time frames and remote site location may restrict the due diligence team to a desk top review of available data (Reichardt, 2006).

When the respondents were asked about the nature of the M&A having an effect on the due diligence conducted, the respondents unanimously agreed that it did, in line with the literature observed above. They added that a deal/transaction involving companies operating in the same industry would typically have stricter confidentiality arrangements and therefore sensitive information (for example customer revenue and profitability information) may be withheld. They further added that quite similarly, hostile transactions often rely on publicly available information only. This was unerringly in agreement with the findings of Reichardt (2006), who maintains that obtaining internal information of high-quality is simplified if a M&A is friendly and the due diligence

conducted in unfriendly deals sometimes never develops further than publicly accessible data (Reichardt, 2006). In the same way, Participant 2 confirmed that "*the quality of the information is key to the level of due diligence that is possible. Even in an organised bidding process where there is more than one potential buyer, restricted access to information and management can be a big impediment to performing a due diligence."*This is in accordance with the research observed by Moeller (2009), who asserts that firms must start their due diligence process with external sources, although these rarely provide a sufficient overview of an organization at the level required to obtain a proper understanding. He maintains that secondary sources do equip management with valuable information, allowing them to strategize and develop honed and more focused questions for their further internal due diligence on the prospective acquisition (Moeller, 2009).

Further, Participant 4 added that hostile takeovers would often result in the following scenario, as per their experiences:

- Limited access to management and information- as a result, the report is rather high level as opposed to detailed.
- If there is no buy in from management and shareholders, the due diligence process may be obstructive.
- Restricted available information- with listed entities, we are limited to the annual financial statements, analyst presentations, analyst reviews / reports. In South Africa there is no financial information on private companies that is publicly available.

In this regard, it must be noted that Participant 3 emphasized that these 'hostile takeovers' are limited in South Africa in comparison to M&A transactions globally.

Illustration 7:



Before completion of the yes/no questions, the participants were asked whether their due diligence efforts ever picked up a potential cause of M&A failure, before it ensued. Interestingly enough, only 50% of the respondents said yes, whilst two participants replied in the negative, and one could not answer the question in absolute terms. Participant 4 stated that only effective and adequately planned and resourced due diligence could have prevented failure and that in their view, due diligence is a process of evaluating the history, to be certain of its nature. Undertaking such research will ensure that a company becomes involved with a business that is not only currently successful but will continue to be so in the future. According to Participant 5, a properly scoped due diligence review may prevent such a 'failure' or highlight the risks (that ultimately may lead to failure). Accordingly, the due diligence should focus on value and valuation issues (including synergy benefits, valuation drivers, etc.) and a due diligence that is not properly focused is likely not to prevent an unsuccessful transaction. The participants agreed in this regard- they both maintained that a due diligence effort can only be successful in its aims if it is properly resourced and scoped, a concept not foreign to the literature observed in Chapter 2.1.

Participant 5 however, further asserted that a M&A transaction however also often fails as a result of poor implementation - *post-deal*. These failures may be ascribed to management differences, cultural differences between organisations, poor communication leading to staff morale issues and/or management/staff losses, IT failures, synergy benefits not being realised as envisaged by the 'original deal' etc. Similarly, Participant 1 stated that there are *"certain cases where the client asks for certain items to be followed up during the merger process and there are also instances where clients may ask for a top up due diligence on certain "effective date" balances."*This reveals that due diligence cannot be said to be the cause of M&A failure when it is imposed narrowly and restrictively scoped. Similarly, Participant 2 responded that their due diligence efforts did not pick up M&A failure because *"failures of mergers have a lot more to do with the parties not doing it for the right reasons and/or not spending as much time and effort on integration post-merger, as they did on actually getting the deal signed-off. Getting two businesses with completely different business models and cultures to fit is no easy task and something often left to happen spontaneously which is not surprisingly not very successful…"*Thus, due diligence cannot be held accountable for failing to detect all M&A catastrophe before it occurs, especially when equally important aspects such as unseemly purchase intentions, lack of strategy, inadequate integration etc. are often neglected. Due diligence efforts should be continued through to the very end of a M&A deal, as per Price et al (1998). However, when this is not the case and due diligence is applied in restricted measures, the practitioner firms behind these due diligences should therefore not be held accountable for the subsequent failure thereof.

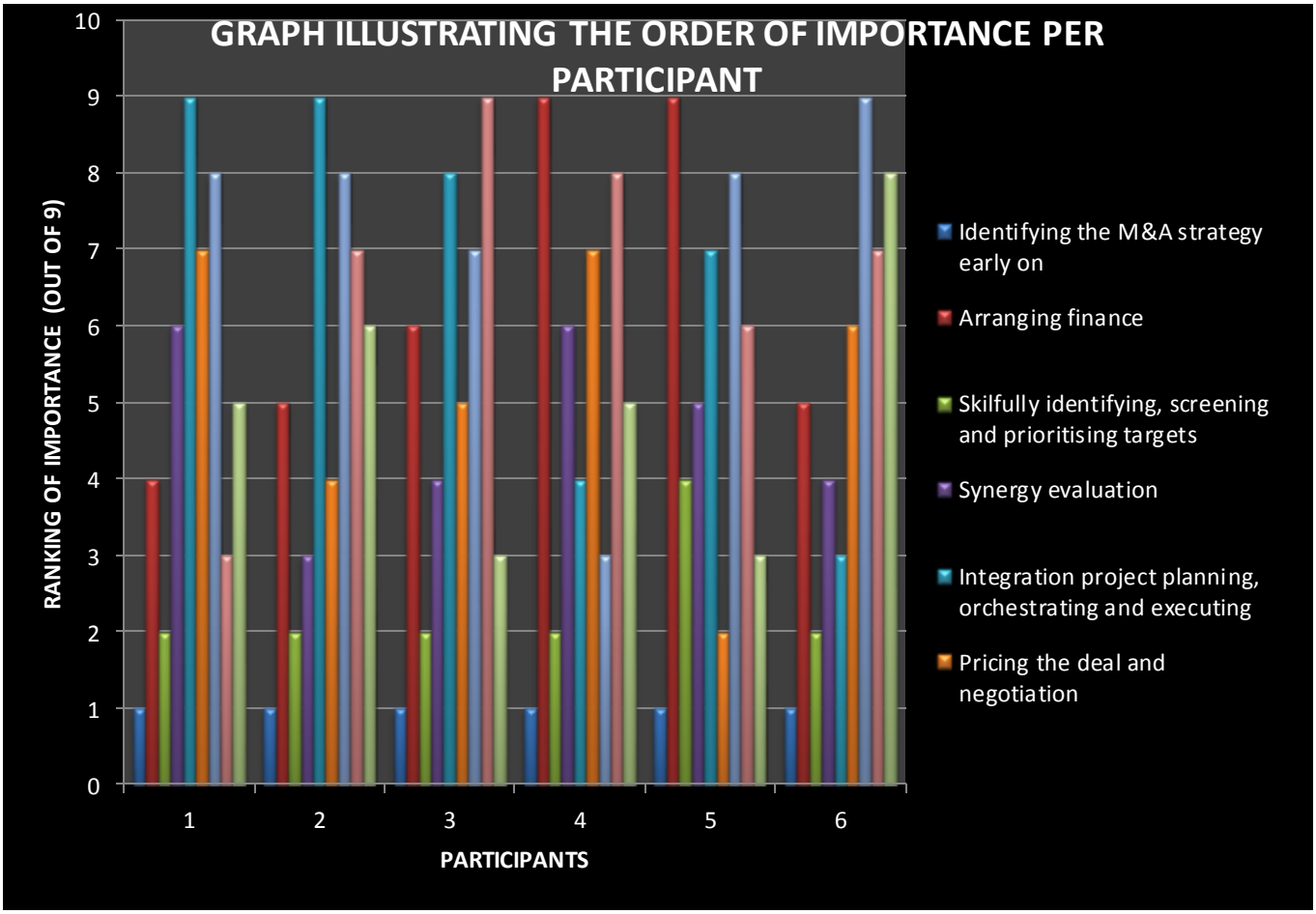
Respondents were asked to rank nine categories in order of importance, with one being the most important and nine being the least. The graphs on this inquiry produced noteworthy reflections and have been analysed in two ways, the result per participant and the result per category.

Illustration 8:

	CATEGORIES:	PARTICIPANTS						CUM:	RANK:
1	Identifying the M&A strategy early on	1	1	1	1	1	1	6	1
2	Arranging finance	4	5	6	9	9	5	38	6
3	Skillfully identifying, screening and prioritising targets	2	2	2	2	4	2	14	2
4	Synergy evaluation	6	3	4	6	5	4	28	3
5	Integration project planning, orchestrating and executing	9	9	8	4	7	3	40	7 or 8
6	Pricing the deal and negotiation	7	4	5	7	2	6	31	5
7	Picking management team and energising the organisation	8	8	7	3	8	9	43	9
8	Understanding and resolving cultural issues	3	7	9	8	6	7	40	7 or 8
9	Conducting due diligence	5	6	3	5	3	8	30	4

	RANK IN ORDER OF CUMULATIVE SIGNIFICANCE:
1	Identifying the M&A strategy early on
2	Skillfully identifying, screening and prioritising targets
3	Synergy evaluation
4	Conducting due diligence
5	Pricing the deal and negotiation
6	Arranging finance
7	Integration project planning, orchestrating and executing / Understanding and resolving cultural issues
8	Integration project planning, orchestrating and executing / Understanding and resolving cultural issues
9	Picking management team and energising the organisation

Illustration 9:



What is of importance to note here is how each of the participants clearly ranked *"Identifying the M&A strategy early on* "as their most critical category, followed by "*Skilfully identifying, screening and prioritising targets",* in which 83% of the participants selected as their second most important task. The remaining categories produce no defined pattern or sequence which is able to be identified, and each participant varied in the way the prioritised each of the residual categories.

Illustration 10:

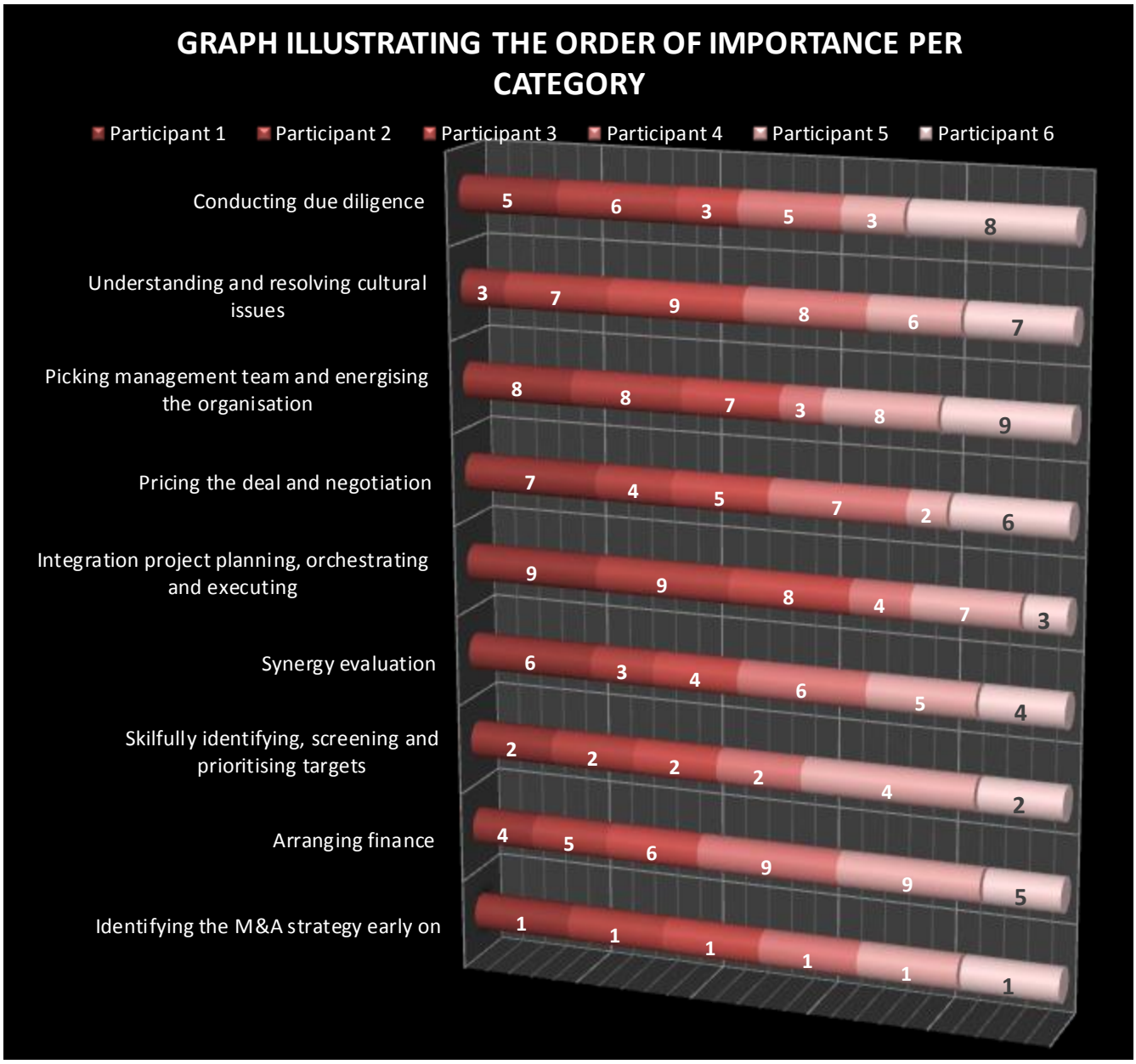
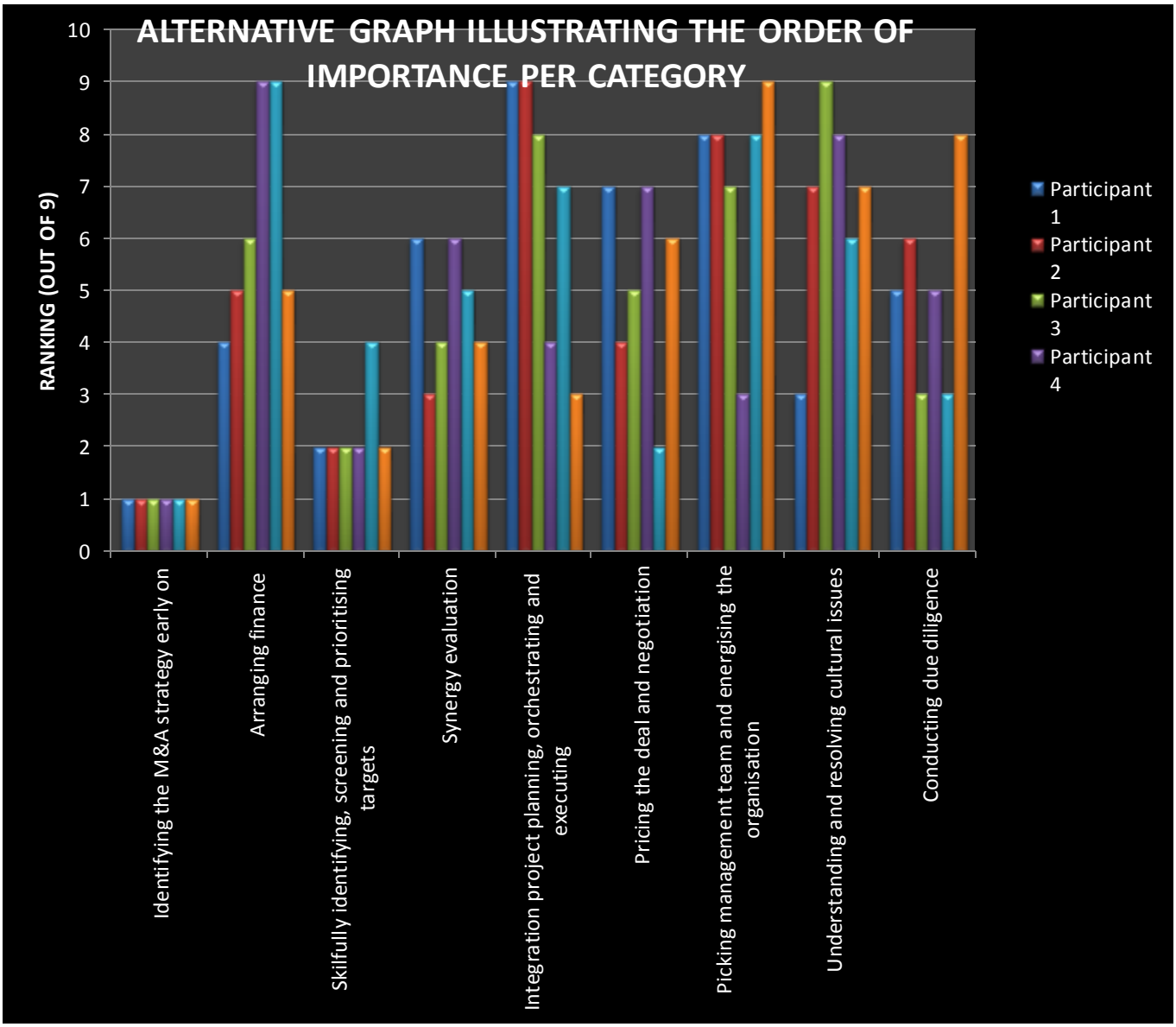


Illustration 11:



The results in a similar survey on M&A activity performed by KPMG (1999) showed that due diligence was the most crucial of the pre-deal activities, which is evidently dissimilar to the results of this study. According to the KMPG (1999) survey, companies which prioritised due diligence bettered their chance of a successful deal. However, the respondents of this survey, ranked due diligence the fourth most important, out of the possible nine categories, in terms of cumulative significance. KMPG (1999) also demonstrated that companies focusing their attention on arranging finance or on legal issues to the detriment of other areas were less likely than average to have a successful deal. In

terms of this study, the participants collectively thought arranging finance ranked sixth most significant, before *Integration planning, orchestrating and executing* and the soft due diligence aspects.

In keeping with the KMPG study, successful companies achieved long-term success by prioritising three key activities: synergy evaluation, integration project planning and due diligence in the pre-deal phase of a merger which has a tangible impact on ability to deliver financial benefits from the deal. These three pre-deal activities each, in their own way; contribute to deal success; however there is overlap between them. They can therefore have greatest impact if brought together in a single pre-deal process which presents the acquirer essential data about risks, benefits and operational issues. This information can then assist in deal negotiations and shape the post-deal integration programme to ensure shareholder value is increased. As per the participants in the study, of these three key activities, both synergy evaluation and the conduction of due diligence remained in the top five most important activities. However Integration planning, orchestrating and executing ranked second-last. This is concerning as one would imagine more focus would be given to this aspect given its direct relation to the success of M&A's. Additionally Integration planning, orchestrating and executing goes hand in hand with synergy evaluation as a key to merger success. The KPMG (1999) survey confirms, through its objective benchmark, that the chances of merger success are increased if the process of working out '*how*' is started well *before* the completion of the deal. Accordingly, the survey found that those companies that put priority on pre-deal synergy evaluation were 28% more likely than average to have a successful deal and for integration project planning the figure was 13%.

What is also interesting to note is how the participants ranked the soft due diligence aspects (i.e. "*Understanding and resolving cultural issues"* and "*Picking the management team and energising the organisation)."* 83% of the respondents ranked these soft categories in the "least important" region. This is despite the research conducted by Spedding (2008) who maintains that M&A failures are overwhelmingly attributable to 'culture clash' issues that occur when two organisations are merged. The reality is that merging two organisational cultures is extremely difficult, if not impossible; the inevitable result is an expensive demerger (Spedding, 2008). In this connection, it is important for practitioners to understand how to avoid the culture clash and what to do post-merger when expected results have not occurred. Perhaps by assessing the characteristics of both organisations' cultures as soon as possible in the merger process, potential culture clash problems can be predicted, prioritised and focused on in a comprehensive cultural integration plan.

As this study highlights, it is quite apparent that management tend to put their resources and energy into the more traditional financial and operational measures, whilst key factors and dozens of others issues are overlooked or minimized- especially measures aimed at determining the cultural fit of the merging organizations. These are probably ignored, or at least given superficial attention, because they are perceived to be more difficult or even impossible to objectively identify and evaluate by comparison to the traditional measures. Frequently, these factors are even viewed as less important than the more traditional measures - however, as per Dodgen (2011) these elements are often the root cause of the failure of M&A's. It is critical that an appropriate balance between traditional operational measures and these ignored cultural measures be reached in order to have the highest probability of success in any M&A. Albeit they appear on the surface to be qualitative and difficult to accurately measure, with the appropriate approach and the application of proven empirical disciplines, a much more comprehensive and accurately predictive analysis may be used to improve the chances of a successful M&A.

As per the KPMG (1999) study, those companies that gave top priority to the selection of the management team at the pre-deal planning stage, thereby reducing the organisational issues created by uncertainty, were 26% more likely than average to have a successful deal. Furthermore, deals were 26% more likely than average to be successful if they focused on resolving cultural issues, and those acquirers who left cultural issues until the post-deal period severely hindered their chance of deal success, compared with those who dealt with them early in the process. This emphasizes the importance of soft aspects of due diligence which historically have been neglected.

On the subsequent question, the participants seemed to think that the negatives to due diligence were that it generally can disrupt the normal running of a business, i.e. distract management and place an overly burdensome strain on management time. In addition it was understood that due diligence conducted by management (without independent assistance from for example an accounting firm) often resulted in management becoming too close to the transaction and therefore making a poor investment decision. The other negative aspects of due diligence apart from the plausible time and cost constraints identified by the respondents, include *"not covering all the risk areas, costs incurred by client if the potential transaction is not successful and lack of co-operation by target entity. Due diligence can also be seen as time consuming* [from the perspective of the acquiring company also] *as it distracts target management from focusing on the running of their business."* This was surprisingly unlike the negatives identified in the studies of Spencer (2008), wherein the author identifies that the reality of due diligence assessments are conducted in a tight environment with reduced liquidity, low consumer demand and the threat of insolvency.

When the participants were asked for specifics on the potential causes of M&A failure detected by their firms, the firms who did elaborate on this question (due to strict confidentiality agreements some could not answer this question), acknowledged *"in some cases 'deal-breaker' issues have been identified (e.g. material undisclosed liabilities) and… …issues that can become price negotiation points."* This is in line with Moeller (2009) who maintains that due diligence provides acquirers with the ideal opportunity to negotiate a possible price reduction. Another participant further added that in one of their conductions, they identified that the main source of revenue for the business was linked to a contract that was going to soon expire or where the financial controls in the business were so poor that they expressed significant concern regarding the reliability of the financial information and in this sense their due diligence efforts help prevent a potential M&A failure.

What is also interesting to note is what Participant 1 remarked that they have experienced a number of transactions that have failed post-due diligence. A different participant also inserted that they typically found various causes of a transaction that has not been successful post their due diligence . The common causes they mutually cite are:

i) Poorly negotiated deals (wherein acquirers paid too much);
ii) Overly optimistic financial forecasts;
iii) Regulatory factors
iv) Cultural and management style differences between organisations;
v) The risk of undisclosed tax or financial liabilities and
vi) Lack of sustainable earnings trend; etc.

This is rather interesting as these are all aspects of due diligence which should ideally be covered within their due diligence efforts according to the findings of Price et al (1998) who identifies that due diligence should provide decision-makers with information on opportunities as well as potential problems. This includes the mechanical verification of legal, accounting, and tax matters, as well as the more intangible functions, so that a more fully developed picture of the potential benefits and liabilities of M&A's can be painted. The due diligence found in the research of Price et al (1998) would have seen to all of the above aspects. It would seem that the due diligence in the case seen above, is neither in line with the findings of Moeller (2009), who identifies that the scope and extent of the due diligence process has drastically been redefined over time and an effective due diligence effort is required today which goes far beyond merely verifying the history of a target entity. As opposed to an ineffective effort to project the future of a target company based on its history, this

effective due diligence imparts an insight of the target company, across a variety of factors – which should be the case for this practitioner firm too.

When questioned about the buyer seller dynamics experienced by them, Participant 4 commented that this was combated by maintaining a clear understanding and effective communication i.e. by gaining a comprehensive understanding of the client's needs, understanding the macro and micro reasons as to why their client is doing the deal, the expected synergies, etc. Participant 2, however, stated that they did not see the buyer/seller dynamics as being particularly troublesome. Accordingly, if both the buyer and seller want the deal to work, they would find a way to compromise on timing/access so both parties *"get comfortable in the end."* They admit that while there is incentive for the seller to try and hide things, it is for this reason that an experienced due diligence team be employed and a more broad and thorough due diligence scope be espoused to ensure that these *"hidden things"* are identified.

Participant 5 maintains that while every transaction is different, in most cases, transactions are generally concluded by their firm under tight timelines. Correspondingly, *"the tight timelines/deadlines can be ascribed to the seller wanting to conclude the transaction in a short time frame, thereby limiting disruption to his business, and limiting uncertainties."* However, Participant 5 maintains that these tight deadlines can be overcome by ensuring that the transaction process (including the due diligence) is properly planned and appropriately resourced (staff or external service providers that have required experience). Nigh and Boschetti (2006) stated that that it is hardly startling that the M&A failure rate is so high when the allure of M&A pushes acquirers to rush into acquisitions, rushing the due diligence in effect. Quite the opposite, Participant 1 commented that their firm does not perceive these particular dynamics as a difficulty. They claim that "*by the time the due diligence exercise is commissioned, the seller and buyer have agreed access to information. Where the seller restricts access to information, this generally then translates to more onerous Sale Purchase Agreement conditions which are not in their best interest."*Therefore, in their experience, sellers were willing to engage in the due diligence process and to date, they have not encountered information accessibility tribulations.

The participants were asked whether their execution of due diligence has ever changed within their practice, specifically soliciting whether there have been any modifications and elements of innovation/change/creativity. The common theme which arose from the respondents was that their practices and due diligence methodology was continuously being innovated and improved to ensure that they delivered on their clients' expectations and ironically, to keep ahead of their competition.

Generally, all the respondents found that the process has changed over the years, and that it was constantly evolving based on what the market requested and what their international counterparts were doing. Some respondents chose their right not to answer the question, they maintained that this was a competitive advantage issue and therefore would not divulge any information. Overall, the responses from the participants were commonly in line with the literature as all participants seem to recognize that newer areas of due diligence are developing rapidly, such as risk management, innovation, and ethical (including corporate social responsibility) due diligence etc. This recognition and appreciation, has encouraged them to perform due diligence with fresh research and analysis, instead of using existing sources or management assumptions and therefore encourages a more accurate and efficient evaluation of the value and risk involved in a transaction.

The respondents were then asked how they counterbalanced any shortcomings, constraints and limitations (if any) in conducting their due diligence efforts. Most of the respondents noted that information constraints/limitations occurred from time to time. The reasons for these constraints varied but include: information simply not being available (due to confidentiality considerations or other reasons); incomplete or irrelevant information being supplied; the transaction being concluded in a short time period; undeveloped markets in which the target business operates (for example, African markets which are possibly more difficult to fully understand). In addition, the participants noted that the due diligence process is impacted by the deal negotiations. Accordingly, a reluctant seller may impose constraints on the due diligence such as a lack of access to key personnel or lack of cooperation by target management; a short time period, limited access to certain information. In an effort to combat these constraints, some participants noted that they report any limitations to the client and attempt to refine their approach. They also document these constraints in their final report, which basically states any limitations encountered in the scope of their work. What is worthy of note was what one respondent said: *"Due diligence is mainly about determining what is not given to you, not looking at what is given to you. Therefore, experience is a very important asset but most people conducting due diligence work do not have enough experience."* In this regard, it is apparent that the participant considers the level of experience of practitioners (or the general lack of) as one of the constraints/limitations to due diligence.

The respondents were asked whether they thought the typical types of due diligence (financial, legal, commercial due diligence) were sufficient and provide adequate coverage. Moeller (2009) states that due diligence assessment have historically always been restricted to a review of the financial, legal and limited technical aspects and many practitioners, up until present, consider this to be effective and adequate to ensure M&A success. Most of the participants in this study stated

that it was difficult to answer this question in absolute terms, as it depended on the nature of the transaction and target. On balance, their answers all seemed to agree in conclusion: it would appear these types of due diligence were sufficient depending on how much the acquirer was willing to spend on transaction fees and the amount of time available and therefore, every transaction was different. Thus, depending on the buyers understanding of the target company, the stage of negotiations as well as the other factors regarding the scope of the due diligence (including the need for legal, financial, commercial, HR, tax, IT and other types of due diligence etc.) should be consequently set.

Lastly, the respondents were asked whether they thought their due diligence efforts were as effective as they could/should be, and what they could do to improve it if it was not. Unsurprisingly, all the firms unanimously agreed that their due diligences were strategic and effective, adding value to their clients, and were continuously being improved. A respondent even cited that as a firm they go to great lengths to ensure that their client's expectations are fully understood and met. Furthermore they stated that their clients typically saw the following benefits from their due diligence conduction: i) improved position in negotiations; ii) support for their valuation model/proposition; and iii) post-deal value (synergies, cost savings, etc.). The participant went on and added that their clients typically use the due diligence to support their investment decision and/or to negotiate a price (price adjustment).

Even though the participants unanimously agreed on the topic of the efficacy of their due diligence assessments, effective due diligence, as per the literature reviewed, is only achieved when an entity does the appropriate planning, identifying, prioritizing, collecting and analyzing of the suitable and relevant data. Only then is an efficient and methodical approach formed which can support fundamental purchase decisions (Dodgen, 2011). It was unclear whether this was the truly the case for the respondents. What was evident, however, was that the participants' conclusions disagreed with the research findings of Spedding (2008) who stated that practitioners" never question whether the foundations of traditional due diligence are sound, but it is a widespread practice [for them] to look no further into a prospective M&A beyond the mere basics."Seemingly, the participants' inferences opposed this comment, as they acknowledged the need to continuously improve their efforts to meet the ever changing needs of the market place.

Whilst all the participants strongly believe in their value adding services, Participant 1 noted something rather fascinating. The firm stated that "*in practice, some entities may commission their internal finance team to perform the due diligence…* [Their] *experience is that due diligences undertaken by non-due diligence professionals often lack the necessary depth and focus on deal*

issues and hence are not as effective as they should be." In this regard, caution should be taken by acquiring firms in determining whether to outsource the due diligence function to qualified professionals, or designate the task to be performed internally; perhaps a cost verse benefit analysis could help in this regard.

5.3 Conclusion on discussion of results

The participants produced noteworthy reflections on the execution of due diligence in South Africa. From their awareness of what due diligence entails, the research cognised that there still exist some practitioners, however few that may be, that apply limited, traditional due diligence efforts in spite of years of unwavering scholars' research showing the disastrous effects of such. The research attempted to determine whether due diligence was still seen as a mere box-ticking exercise, and exposed that in the present day, most clientele have understood that failure to carry out proper due diligence could be damaging to any company involved. In the same light, the research saw that although there did indeed exist a stigma attached to due diligence (tedious, time consuming, costly etc.), the majority of the participants affirmed that their clients understood that failure to conduct thorough due diligence could result in greater negative consequences, and therefore regarded the devoting of the required time and resources as favourable and absolutely necessary. Hence, the participants asserted that they often incorporate non-financial elements in their conduction of due diligence.

As the bulk of the participants averred that their clients did not see due diligence as an audit in present day, the research ruled out the common misunderstanding that due diligence is seen as an audit in practice. In addition, the research produced significant reflections regarding time and cost constraints which are often present in the conduction of due diligence. It demonstrated that a proficient due diligence investigation takes time and depends on the size and complexity of the target, as well as the structure of the deal, and hence quite a substantial amount of time is necessary to perform a complete due diligence investigation. The research also demonstrated that these time constraints are often combated quite easily, and some participants identified they did not experience these "issues" at all. Furthermore, what was revealed was that the nature of a M&A had a direct relation to the level of due diligence conducted, and the respondents unanimously agreed that it consequently was quite often the case that the effective examination of the target acquisition, beyond the major financial, legal, tax, and future sales projections, did not occur in takeovers, hostile bids or aggressive time frames.

What was most striking is that only 50% of the respondents replied in the affirmative when asked whether their due diligence efforts ever picked up a potential cause of M&A failure, before it ensued. Incidentally, the participants confirmed that a due diligence effort can only be successful in its aims if it is properly resourced and scoped, which was beyond their control, a concept not foreign to the literature. The research also produced quite a fascinating outcome when the respondents were asked to rank nine categories in order of importance. In terms of the order of importance for due diligence, the respondents ranked it the fourth most important. What is also of interest to note is that integration project planning ranked second-last, which is concerning as would one imagine more focus would be given to this key aspect, given its direct relation to the success of M&A's. Moreover, in spite of the research conducted by Spedding (2008) who maintains that M&A failures are overwhelmingly attributable to 'culture clash' issues that occur when two organisations are merged, 83% of the respondents ranked these soft categories in the "least important" region. In light of this reflection, it is critical that an appropriate balance between traditional operational measures and these ignored cultural measures be reached in order to have the highest probability of success in any M&A.

Whilst the participants identified distinctive negative aspects of due diligence not cited in the literature, they also identified some assenting characteristics of due diligence, as they detailed narratives regarding the valuable information they provided to clients that was so heavily sought after, and the opportunities their due diligence made available, i.e. the prospect to negotiate a possible price reduction. The research also attempted to explore the buyer/seller dynamics of due diligence conductions in practice, and those participants who identified any, explained that it was combated by maintaining a clear understanding and effective communication with their client i.e. by gaining a comprehensive understanding of the client's needs, understanding the macro and micro reasons why their client is doing the deal, the expected synergies, etc. The research endeavoured to understand the reality of the practice of these participants, and once appreciated, began to question its role and efficiency in practice.

The participants argued that their due diligence conductions were mostly adequate and sufficient in their aims, but could not draw a general conclusion as it depended on random variables, such as how much the acquiring firm was willing to spend on transaction fees or the amount of time available etc. As a participant cited, "every transaction was different." Thus, depending on the buyers understanding of the target company, the type of M&A at hand and the time and resources available, the scope of the due diligence, including the need for other types of due diligence, should be set. Concerning the effectiveness of these due diligence efforts, the respondents unanimously

agreed that their due diligences were strategic and effective, adding value to their clients, and were continuously being improved to ensure their client's expectations were fully understood and met. Furthermore, they emphasized that their practices and due diligence methodology was continuously being innovated and improved to ensure that they delivered on their clients' expectations and to keep ahead of their competition. For the most part, the respondents found that the due diligence process has changed rather dramatically over the years, and that it was constantly evolving based on what the market requested and what their international counterparts were doing. They accentuated that an abysmal effort to project the future of a target company based on its history was not enough, and that a more 'effective due diligence' was required to impart an insight of the target company across a wide variety of factors to produce more useful information required for decision-making. This was overall, in line with the literature reviewed as observed in Chapter 2, wherein it was shown that the scope and extent of due diligence has drastically been redefined over time and that an 'effective due diligence' effort is required today, which goes far beyond merely verifying the history of a target entity, in an attempt to meet the markets' ever-changing demands. Most importantly, the participants concluded that this was the way forward for due diligence endeavours, and should be observed by all practitioner firms in their due diligence conductions to ensure a fighting chance for M&A success.

CHAPTER 6: CONCLUSION AND FURTHER RESEARCH

6.1 Conclusion of the study

M&A's are known to be enormously complex undertakings that are as risky as they are rewarding. Therefore, when two organizations with different internal controls, management styles, and processes attempt to integrate, the risk increases exponentially. To combat such high levels of risk, and the drastic changes that accompany such mergers, due diligence must be initiated to collect and sift through vast amounts of data to make a reasoned purchase decision and ensure the successful marriage of these two firms, as this research observed. Due diligence identifies, confirms or disputes the business reasons for proposed M&A transactions. However, the challenge for many M&A teams is the immense amount of pressure placed on them to provide broad and deep data analysis often under extremely tight time constraints. This research observed many possible reasons for M&A failure, and noted significant statistical data regarding these sobering M&A attempts. This study observed the significant changes of the implementation of due diligence within the last decade so as to match the ever-changing requirements of M&A's.

Despite the high risks associated with M&A's, in line with the findings of Spencer (2008), while there is liquidity in the mid-market, high quality deals will continue to be completed, although investors will not act hastily. This does not necessarily mean that they will be doing more due diligence than a decade ago, but the evaluations they undertake will be tailored to the deal's needs and that these efforts must be more strategic and effective in their aims. As this research has revealed, what must be understood by practitioners is that due diligence is no longer a review of the balance sheet and income statement, but encompasses all pertinent aspects of a company's activities and should be used as the catalyst to drive improvements post deal close. Investors should know exactly where they are heading well in advance of setting off. This can be difficult, but in distressed times, this more 'strategic due diligence' may be the only way to maximise profitability in the long term. By knowing what information is needed, where and how to get it, and how the various due diligence professionals, lawyers and accountants as well as management consultants, drive the due diligence process to become a more manageable, less time consuming and more cost-effective process, the study has flagged the path to a more effective, strategic due diligence which has been identified as absolutely necessary given current trends to ensure the success of M&A's in the future.

In line with the research presented, due diligence was once commonly described as tedious, pricey and prolonged. To many, it was a way of spending a lot of money to tell what them what they already knew and was commonly understood to be a non-value creating procedure, or 'audit,' that was done more out of routine than need. However, in the present day, in line with the research findings, most clientele have understood that failure to carry out proper due diligence could be damaging to any company involved, and therefore regard the devoting of the required time and resources to a thorough, strategic due diligence as favourable and absolutely necessary. Moreover, the study has shown that the stigmas once attached to due diligence are not as sensational as they appear in the literature, or are no longer a stigma in present day practice. Whilst the study did identify distinctive negative aspects of due diligence not cited in the literature, the study in the same light identified some assenting characteristics of due diligence and ascertained the opportunities due diligence made available. The study has also identified fundamental concerns regarding the execution of due diligence efforts in practice, such as the regard of soft due diligence aspects ((i.e. "*Understanding and resolving cultural issues"* and "*Picking the management team and energising the organisation).*

Due diligence should not be perceived as an expense, but rather as a means to obtain maximum benefit from the merged firm to minimise the risk of M&A failure. Therefore, the due diligence team should ideally be seen as valuable and insightful discernments, as they gather essential insights for the acquiring entity. What is a cause for concern is that despite years of research of unswerving scholars, this study has shown that an outdated orientation to due diligence is still used by some firms in practice today, however a minority they might be. This study has found that the due diligence process has changed rather dramatically over the years, and that it is constantly evolving based on what the market requested and what competitive practitioners are doing. In line with these findings, an effort to project the future of a target company based on its history is not enough, a more 'effective due diligence' is required to impart an insight of the target company across a wide variety of factors to produce more useful information required for decision-making. This recognition and appreciation supposedly encourages practitioners to perform due diligence with fresh research and analysis, instead of using existing sources or management assumptions and therefore encourages a more accurate and efficient evaluation of the value and risk involved in a transaction.

In the current form, due diligence is essential to M&A success and its importance cannot be over emphasized. However, as this report has determined, due diligence is an evolving process. The deficiency in due diligence is not in the concept in itself, rather in its execution. The due diligence of

the last decade is significantly different from the due diligence required in acquisitions today. Traditionally, due diligence assessments were too heavily focused on the accounting and legal aspects of a M&A. Undoubtedly, these are important areas, but one must understand and appreciate the target firms' macro-environment, marketing, production, management and information systems to avoid acquiring a firm with further dilemmas. Moeller (2009) recognises that even though due diligence is only one element of an acquisition, in many ways it is the most significant aspect of the M&A process.

The arguments presented in this research report can be summed up referring to a quote from the studies from Perry and Herd (2004): "the danger is not that companies fail to do due diligence, but that they fail to do it well..."

6.2 Suggestions for further research

- This study was limited in the sense that it only reviewed the failure of M&A's that could have been prevented solely by means of carrying out an effective due diligence assessment and no other reasons. Whilst there exists other reasons for M&A failure, as studied by Zweig (1995) and Epstein (2005), such as the lack of compelling strategic rationale; unrealistic expectations of possible synergies; overpaying; conflicting corporate cultures; failure to integrate the two companies, this study did not look at these factors. Perhaps, to ensure the success of M&A's in the future in South African markets, more research needs to be performed on these aspects to determine their current status and value in practice, and the role they play in local M&A's, as was done for the due diligence aspect in this study.

- Similarly, further research should be done on other types of due diligence conductions, beside what this research endeavoured to investigate. The aim of this research was limited to observing the effectiveness of traditional due diligence procedures only. There exists far more due diligence assessments such as cultural, management, tax, pension, environmental, IT, technical and operational due diligence, to which further studies are needed to determine whether they are indeed successful in their aims and can be better improved in some manner or form.

- According to Shimizua et al (2004), target selection is a crucial concern in the due diligence process. In fact, depending on the acquisition motives, the focal firm searches for target firms with different characteristics such as size, complementary resources, local network ties etc. This study did not see to or investigate this key aspect of due diligence. Despite the importance of this process, we lack studies specifically focused on the due diligence deviancies and shortcomings in practice in a *South African* context and this should be considered as a topic for further research.

- Very and Schweiger (2001) identifies that firms that make multiple acquisitions learn from their prior experiences. As the importance of and opportunities from cross-border M&A's are likely to increase further in the global economy, learning from acquisition experience could be a critical source of competitive advantage. However, the extant research on learning from acquisition experiences is rather limited and contradictory (Finkelstein and Haleblian, 2002). Moreover, given the high failure risk of M&A's, firms must be prepared for

unforeseen events and respond to them effectively. Virtually no research has been done in the area of learning from relatively large failures, such as divestitures or liquidation M&A's (Shimizu et al, 2004). Although mistakes and failures are not a pleasant topic for practitioners, opening this black box and providing managerial insights would significantly inform scholarly research and practitioners. Thus, further research is required on the reality and effectiveness of due diligence conductions which are carried across borders, as well as research on various types of M&A's – reverse takeovers, white knight purchases etc.

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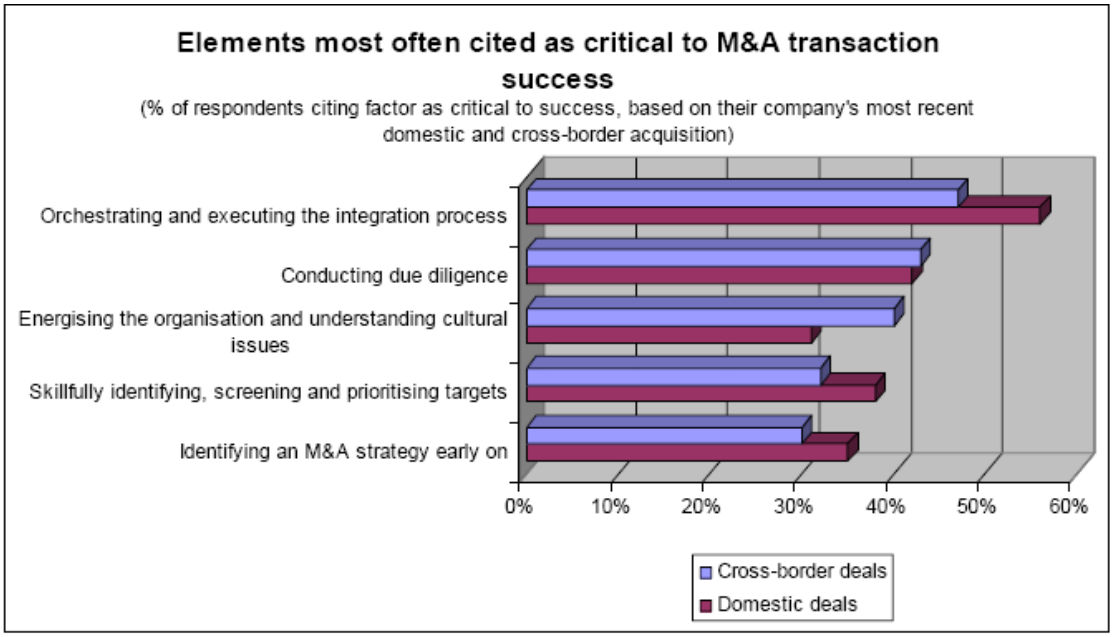
APPENDIX A: NOTEWORTHY GRAPHS ON DUE DILIGENCE

GRAPH 1:



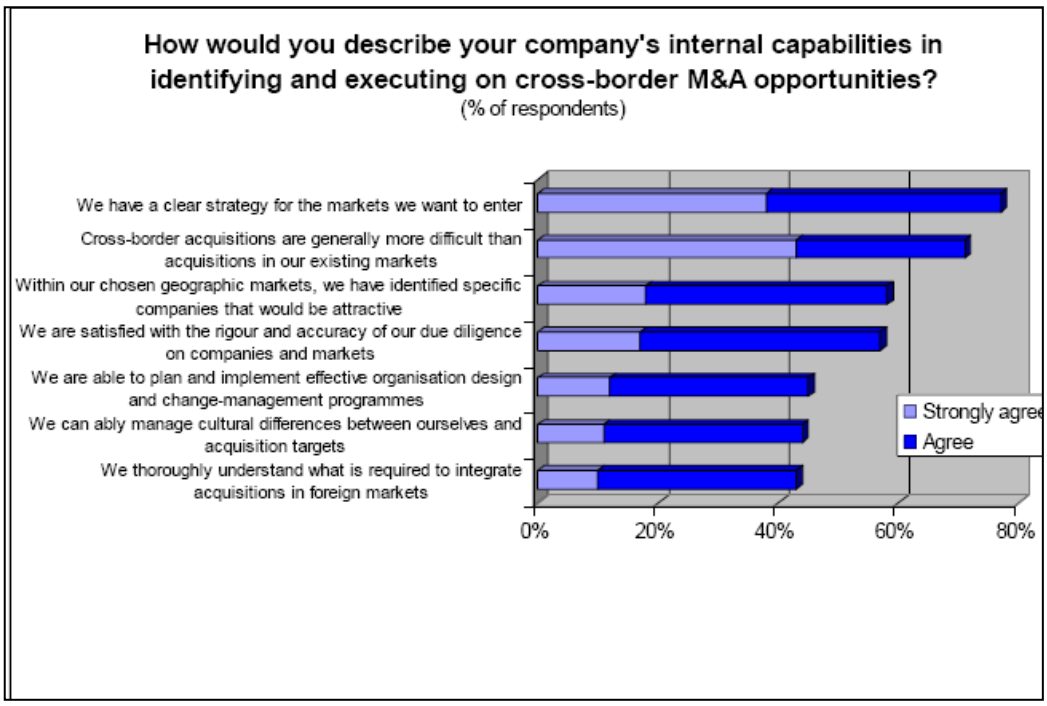
"When asked to draw on their recent experience to identify the critical elements of a successful cross-border M&A transaction, respondents most often cited "orchestrating and executing the integration process" (a factor cited by 47%), **conducting due diligence (43%),** and energising the organisation and understanding cultural issues (40%). These same factors are generally seen as key to successful domestic transactions, too, though cross-border deals obviously place greater emphasis on culture and integration."

Extracted from 'Accenture / Economist Intelligence Unit 2006 Global M&A Survey. (2006). Global M&A Survey. Accenture.'

Available online at:

http://www.accenture.com/NR/rdonlyres/7FF8E735-5756-43AC-8929-F61CF10407E1/0/ExecutiveSummary.pdf

GRAPH 2:



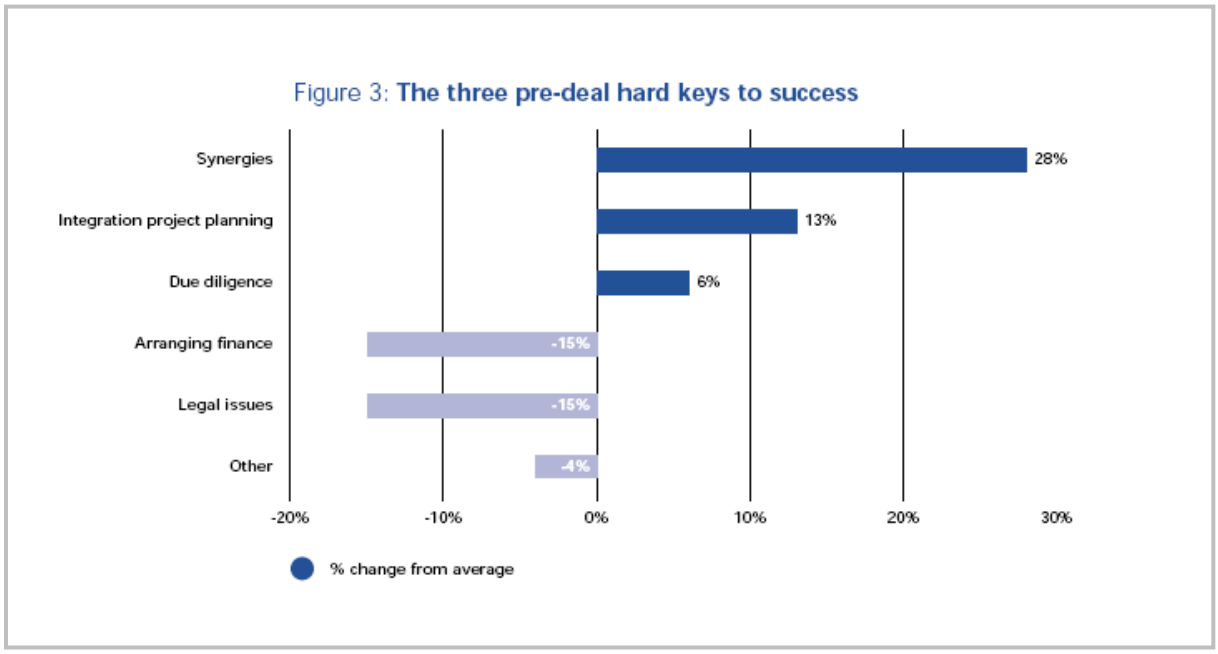
*"*Respondents were a little more satisfied with their due diligence capabilities —**57%** said they were **satisfied with the rigour and accuracy of their due diligence** on companies and markets. However, only 17% were highly satisfied with those capabilities, and one might reasonably hope for more widespread confidence in such a key element of M&A…"

Extracted from 'Accenture / Economist Intelligence Unit 2006 Global M&A Survey. (2006). Global M&A Survey. Accenture.'

Available online at:

http://www.accenture.com/NR/rdonlyres/7FF8E735-5756-43AC-8929-F61CF10407E1/0/ExecutiveSummary.pdf

GRAPH 3:



"The survey results suggest that successful companies were managing to achieve long-term deal **success by prioritising** three hard key components in the pre-deal phase. These were synergy evaluation, integration project planning, and **due diligence**. This planning helped them to achieve swift and substantial value extraction on completion of the deal. It also offered evidence of where less successful companies are going wrong, by *concentrating* on mandatory activities such as legal and financing…"

Extracted from 'KPMG. "Unlocking shareholder value: Keys to success." London: KPMG, 1999.'

Available Online at:
www.imaainstitute.org/docs/m&a/kpmg_01_Unlocking%20Shareholder%20Value%20%20The%20Keys%20to%20Success.pdf

APPENDIX B: THE DEALMAKERS REPORT (2010):

GENERAL CORPORATE FINANCE

RANKING THE SOUTH AFRICAN TOMBSTONE PARTIES

INVESTMENT ADVISERS*

Rankings by Transaction Value

Rank	Company	Transaction Values R'm	Market Share
1	Rand Merchant Bank	124,135	26.78%
2	Morgan Stanley	37,649	8.12%
3	Investec Bank	35,288	7.61%
4	JPMorgan	30,983	6.68%
5	Deutsche Bank	26,709	5.76%
6	Nedbank Capital	26,104	5.63%
7	Grant Thornton	18,431	3.98%
8	Java Capital	18,277	3.94%
9	PSG	17,400	3.75%
10	Fidelis Partners	17,220	3.71%
11	Macquarie First South Advisors	16,163	3.49%
12	UBS	15,512	3.35%
13	Rothschild	14,978	3.23%
14	Sasfin	13,898	3.00%
15	Citigroup Global Markets	8,938	1.93%
16	RMB	7,764	1.67%
17	Absa	5,699	1.23%
18	Standard Bank	5,513	1.19%
19	Absa Capital	4,813	1.04%
20	PSG Capital	3,268	0.70%
21	One Capital	2,643	0.57%
22	Ubuntu Resources	2,445	0.53%
23	Vunani Corporate Finance	1,815	0.39%
24	Merrill Lynch	1,752	0.38%
25	Deloitte	935	0.20%
26	PricewaterhouseCoopers Corporate Finance	750	0.16%
27	BDO Corporate Finance	640	0.14%
28	RMB Morgan Stanley	575	0.12%
29	To the Point	507	0.11%
30	Lumco	465	0.10%
31	Manchester Capital	332	0.07%
32	QuestCo	301	0.06%
	Vunani	301	0.06%
34	Ernst & Young	245	0.05%
35	Bridge Capital	232	0.05%
36	Cadiz Corporate Solutions	164	0.04%
37	Absa Corporate Finance	136	0.03%

Rankings by Transaction Flow (Activity)

Rank	Company	No of Transactions	Market Share	Transaction Values R'm
1	Rand Merchant Bank	41	16.60%	124,135
2	Investec Bank	36	14.57%	35,288
3	Nedbank Capital	18	7.29%	26,104
4	Java Capital	12	4.86%	18,277
5	Morgan Stanley	11	4.45%	37,649
	BDO Corporate Finance	11	4.45%	640
7	Macquarie First South Advisors	7	2.83%	16,163
	PSG Capital	7	2.83%	3,268
9	JPMorgan	6	2.43%	30,983
	RMB	6	2.43%	7,764
	Standard Bank	6	2.43%	5,513
	Ubuntu Resources	6	2.43%	2,445
13	Deutsche Bank	5	2.02%	26,709
	One Capital	5	2.02%	2,643
	Vunani Corporate Finance	5	2.02%	1,815
16	UBS	4	1.62%	15,512
	Rothschild	4	1.62%	14,978
	Citigroup Global Markets	4	1.62%	8,938
	Manchester Capital	4	1.62%	332
20	Sasfin	3	1.21%	13,898
	Absa	3	1.21%	5,699
	Deloitte	3	1.21%	935
	PricewaterhouseCoopers Corporate Finance	3	1.21%	750
	Lumco	3	1.21%	465
	Cadiz Corporate Solutions	3	1.21%	164
	Absa Corporate Finance	3	1.21%	136
27	Grant Thornton	2	0.81%	18,431
	PSG	2	0.81%	17,400
	Absa Capital	2	0.81%	4,813
	Ernst & Young	2	0.81%	245
	Charles Orbach Corporate Finance	2	0.81%	133
	Transhistoria Capital	2	0.81%	108
	Grindrod Bank	2	0.81%	53
34	Fidelis Partners	1	0.40%	17,220
	Merrill Lynch	1	0.40%	1,752
	RMB Morgan Stanley	1	0.40%	575
	To the Point	1	0.40%	507

* Investment advisers incorporate Merchant & Investment Banks and others claiming this category

INVESTMENT ADVISERS* (Continued)

Rankings by Transaction Value

Rank	Company	Transaction Values R'm	Market Share
38	Charles Orbach Corporate Finance	133	0.03%
39	Renaissance Capital	120	0.03%
40	Touchstone Capital	108	0.02%
41	AMB Capital	102	0.02%
42	Purple Capital	100	0.02%
43	Grindrod Bank	53	0.01%
44	Exchange Sponsors	14	n/a
45	Nodus Capital	12	n/a
46	River Group	4	n/a
47	GeoCoal Services	not disclosed	n/a

Rankings by Transaction Flow (Activity)

Rank	Company	No of Transactions	Market Share	Transaction Values R'm
	QuestCo	1	0.40%	301
	Vennya	1	0.40%	301
	Bridge Capital	1	0.40%	232
	Renaissance Capital	1	0.40%	120
	AMB Capital	1	0.40%	102
	Purple Capital	1	0.40%	100
	Exchange Sponsors	1	0.40%	14
	Nodus Capital	1	0.40%	12
	River Group	1	0.40%	4
	GeoCoal Services	1	0.40%	not disclosed

SPONSORS

Rankings by Transaction Value

Rank	Company	Transaction Values R'm	Market Share
1	**Rand Merchant Bank**	**126,459**	**33.14%**
2	Merrill Lynch	48,869	12.81%
3	Investec Bank	41,632	10.91%
4	PricewaterhouseCoopers Corporate Finance	36,027	9.44%
5	Deutsche Securities	33,086	8.67%
6	Java Capital	19,153	5.02%
7	UBS	18,333	4.80%
8	Rothschild	14,490	3.80%
9	Nedbank Capital	10,310	2.70%
10	PSG Capital	8,226	2.16%
11	JPMorgan	5,544	1.45%
12	Standard Bank	4,621	1.21%
13	One Capital	4,436	1.16%
14	Deloitte	2,742	0.72%
15	Saxlin Capital	1,615	0.42%
16	Macquarie First South Advisers	1,255	0.33%
17	QuestCo Sponsors	1,180	0.31%
18	Accy Moela Sponsors	1,016	0.27%
19	BDO Corporate Finance	605	0.16%
20	Grindrod Bank	547	0.14%
21	Vunani Corporate Finance	535	0.14%
22	Merchantec Capital	421	0.11%
23	Bridge Capital	322	0.08%
24	Exchange Sponsors	96	0.03%
25	KPMG	44	0.01%
26	River Group	4	n/a

Rankings by Transaction Flow (Activity)

Rank	Company	No of Transactions	Market Share	Transaction Values R'm
1	**Rand Merchant Bank**	**57**	**16.76%**	**126,459**
2	Investec Bank	40	11.76%	41,632
3	PSG Capital	26	7.65%	8,226
4	Java Capital	25	7.35%	19,153
5	Accy Moela Sponsors	21	6.18%	1,016
6	Merrill Lynch	19	5.59%	48,869
7	Nedbank Capital	17	5.00%	10,310
	Saxlin Capital	17	5.00%	1,615
9	Deloitte	15	4.41%	2,742
10	Deutsche Securities	13	3.82%	33,086
11	Merchantec Capital	11	3.24%	421
12	One Capital	10	2.94%	4,436
13	PricewaterhouseCoopers Corporate Finance	9	2.65%	36,027
14	Macquarie First South Advisers	7	2.06%	1,255
15	JPMorgan	6	1.76%	5,544
	BDO Corporate Finance	6	1.76%	605
	Grindrod Bank	6	1.76%	547
	Exchange Sponsors	6	1.76%	96
19	UBS	5	1.47%	18,333
	Standard Bank	5	1.47%	4,621
	Vunani Corporate Finance	5	1.47%	535
	Bridge Capital	5	1.47%	322
23	QuestCo Sponsors	4	1.18%	1,180
24	Rothschild	2	0.59%	14,490
	KPMG	2	0.59%	44
26	River Group	1	0.29%	4

* Investment advisers incorporate Merchant & Investment Banks and others claiming this category

LEGAL ADVISERS

Rankings by Transaction Value

Rank	Company	Transaction Values R'm	Market Share
1	Edward Nathan Sonnenbergs	98,698	27.77%
2	Webber Wentzel	78,338	22.04%
3	Cliffe Dekker Hofmeyr	45,566	12.82%
4	Bowmans Gilfillan	27,171	7.65%
5	Werksmans	22,968	6.46%
6	Java Capital	17,234	4.85%
7	Werksmans	14,712	4.20%
8	Deneys Reitz	14,748	4.15%
9	Ebsworth Pvlk	9,301	2.62%
10	Primbos, Treville & Andreopoulos	7,195	2.02%
11	Vani Chetty	6,835	1.93%
12	Fluxmans	2,949	0.83%
13	Read Hope Phillips	1,631	0.46%
14	Bell Dewar	1,204	0.34%
15	Van Hulstuyns	938	0.26%
16	Glyn Morris	856	0.24%
17	Eversheds	637	0.18%
18	Mkhabela Huntley Adakayo	490	0.14%
19	Garlicke & Bousfield	441	0.12%
20	Thomson Wilks	308	0.09%
21	Russell Turner	262	0.07%
22	Falcon & Horne	238	0.07%
23	Hilton Gilchen	232	0.07%
24	Shepstone & Wylie	119	0.03%
25	Gordon, Stevens & Ranchhoojee	93	0.03%
26	Edelstein Beerson	90	0.03%
27	Schindlers	65	0.02%

Rankings by Transaction Flow (Activity)

Rank	Company	No of Transactions	Market Share	Transaction Values R'm
1	Edward Nathan Sonnenbergs	34	20.24%	98,698
2	Cliffe Dekker Hofmeyr	32	19.05%	45,566
3	Bowmans Gilfillan	16	9.53%	27,171
4	Webber Wentzel	14	8.33%	78,338
5	Werksmans	13	7.74%	14,712
6	Java Capital	9	5.36%	17,234
7	Deneys Reitz	6	3.57%	14,748
8	Vani Chetty	4	2.38%	6,835
	Fluxmans	4	2.38%	2,949
10	Taleworks	3	1.79%	22,968
	Ebsworth Pvlk	3	1.79%	9,301
	Primbos, Treville & Andreopoulos	3	1.79%	7,195
	Eversheds	3	1.79%	637
	Garlicke & Bousfield	3	1.79%	441
	Thomson Wilks	3	1.79%	308
16	Read Hope Phillips	2	1.19%	1,631
	Bell Dewar	2	1.19%	1,204
	Glyn Morris	2	1.19%	856
	Mkhabela Huntley Adakayo	2	1.19%	490
	Shepstone & Wylie	2	1.19%	119
	Gordon, Stevens & Ranchhoojee	2	1.19%	93
22	Van Hulstuyns	1	0.60%	938
	Russell Turner	1	0.60%	262
	Hilton Gilchen	1	0.60%	232
	Falcon & Horne	1	0.60%	238
	Edelstein Beerson	1	0.60%	90
	Schindlers	1	0.60%	65

REPORTING ACCOUNTANTS

Rankings by Transaction Value

Rank	Company	Transaction Values R'm	Market Share
1	PricewaterhouseCoopers	102,783	47.54%
2	Deloitte	51,490	23.82%
3	PKF	26,534	12.27%
4	KPMG	16,033	7.42%
5	Ernst & Young	9,692	4.48%
6	Stowe Woodside VCP	4,670	2.16%
7	Grant Thornton	1,421	0.66%
8	Haworth Lawton Bowe	1,208	0.56%
9	Charles Orbach	1,190	0.55%
10	BDO	491	0.23%
11	ACT Solutions	262	0.12%
12	LDP	232	0.11%
13	Mazars	106	0.05%
14	SAIBCT	65	0.03%
15	Saffrys Scantlebury Kei	23	0.01%

Rankings by Transaction Flow (Activity)

Rank	Company	No of Transactions	Market Share	Transaction Values R'm
1	PricewaterhouseCoopers	25	34.25%	102,783
2	Deloitte	16	15.84%	51,490
	KPMG	16	15.84%	16,033
4	PKF	13	12.87%	26,534
5	Ernst & Young	6	5.94%	9,692
	BDO	6	5.94%	491
7	Grant Thornton	4	3.96%	1,421
	Charles Orbach	4	3.96%	1,190
9	Haworth Lawton Bowe	3	2.97%	1,208
	Mazars	3	2.97%	106
11	Stowe Woodside VCP	1	0.99%	4,670
	ACT Solutions	1	0.99%	262
	LDP	1	0.99%	232
	SAIBCT	1	0.99%	65
	Saffrys Scantlebury Kei	1	0.99%	23

APPENDIX C: ETHICS CLEARANCE

Research Office

HUMAN RESEARCH ETHICS COMMITTEE (NON MEDICAL)
H111107 Patel

CLEARANCE CERTIFICATE	**PROTOCOL NUMBER H111107**
PROJECT TITLE	Deficient due Diligence?
INVESTIGATOR(S)	Mr A I Patel
SCHOOL/DEPARTMENT	Accountancy
DATE CONSIDERED	11 November 2011
DECISION OF THE COMMITTEE	Approved Unconditionally
EXPIRY DATE	30 November 2013

DATE 19 January 2012 **CHAIRPERSON**
(Professor R Thornton)

cc; Professor G Swartz

DECLARATION OF INVESTIGATOR(S)

To be completed in duplicate and **ONE COPY** returned to the Secretary at Room 10005, 10th Floor, Senate House, University.

I/We fully understand the conditions under which I am/we are authorized to carry out the abovementioned research and I/we guarantee to ensure compliance with these conditions. Should any departure to be contemplated from the research procedure as approved I/we undertake to resubmit the protocol to the Committee. **I agree to completion of a yearly progress report.**

Adam
Signature

31 / 01 / 2012
Date

APPENDIX D: THE INTERVIEW AGENDA.



UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG

THE SCHOOL OF ACCOUNTANCY

INTERVIEW AGENDA:

This document is to serve as the Interview Agenda, and lists the questions that will be asked if participating in the study I am conducting on the practice of Due Diligence in South Africa as part of my Master's degree in the School of Accountancy at the University of Witwatersrand, under the supervision of Professor Gary Swartz.

PART A:

Initial Question:

1) What do you think the objectives of due diligence are in terms of Mergers/Acquisitions, and do you think due diligence achieves this objective? Please substantiate.

Yes/No: (Please feel free to add any additional comments though, if you so wish):

2) Do you think your clients consider due diligence as just a confirmation of facts, a mere box ticking exercise?
3) Do you feel that your clients have a pre-conceived notion/ stigma attached to due diligence before it is carried out? (Tedious, lengthy, costly etc.)
4) Are due diligence assessments often seen as an 'audit' by your clients?
5) Do you ever incorporate non-financial elements in the conduction of your due diligence?
6) Do your clients often restrict / limit the due diligence due to its cost implications?
7) In your experience, is the acquiring of quality data impeded if the Mergers/Acquisition deal is hostile? That is, does the type of Merger/Acquisition affect the type/nature of the due diligence conducted?
8) In your experience, when a M&A has failed, was there a possibility that due diligence could have prevented that failure?

PART B: Closed ended Question:

9) Rate the following in order of importance: (1 =most important and 9= least important)

Identifying the M&A strategy early on and developing the company's overall M&A strategy.

Arranging finance

Skilfully identifying, screening and prioritising targets

Synergy evaluation

Integration project planning, orchestrating and executing

Pricing the deal and negotiation

Picking management team and energising the organisation

Understanding and resolving cultural issues

Conducting due diligence

PART C: Open ended Questions:

10) What do you think are the negative aspects of conducting due diligence?

11) Has due diligence assessments performed by your firm ever identify potential causes of merger failure? Elaborate.

12) How do you combat buyer/seller dynamics? Buyer/seller dynamics typically include the seller having nothing to gain by giving a buyer time to probe and question. Whilst the buyer, on the other hand, having to gather and digest a lot of information in a very short time with less than perfect access to the sources of information.

13) Has the execution of due diligence ever changed in your practice? That is, has your due diligence techniques ever been modified, and how/why so? Any elements of change/innovation/creativity?

14) Are there any shortcomings, constraints or limitations of the due diligence process in your experience? If any, how do you counterbalance them?

15) Do you feel that the typical types of due diligence are sufficient and provide adequate coverage? Typical types include financial, legal, commercial due diligence.

16) Do you feel that your due diligence efforts are as effective as they could/should be? If not, what could you do to make it more strategic/effective?

Thank You for your participation.

APPENDIX E: THE DUE DILIGENCE CHECKLISTS.

The checklists below have all been adapted from *The Due Diligence Handbook: Corporate Governance, Risk Management And Business Planning by Spedding, L. (2008), CIMA Publishing*.

Topics usually covered by traditional due diligence

Topic	Examples
Assets	Primarily, assets are considered tangible property, such as buildings, computers, furniture, etc. However, other important assets include people, contractors, business ideas, and product relevance in the marketplace.
Contracts	Contracts for work to be done and commitments by others to do work for the company. The contract can be with individuals or companies. Keep in mind that it is not just the contract terms but whether the terms are in fact enforceable. A lot of employment contracts have appropriate terms, but if the individual has a serious accident and is incapacitated, none of the work-related terms may be enforceable.
Customers	Customers for products and services are important elements – who they are and where they are. When reviewing this topic, consider whether there is a secondary market for the resale of products such as through Amazon or eBay. Customer support may start to come from locations not anticipated.
Employee agreements	This requires appropriate legal support to make sure that the agreement is not so restrictive that the employee could easily break the agreement for it being unfair, etc. These agreements may also require consistency which is a process that due diligence can support.
Employee benefits	This is not just about health insurance. Due diligence requires the comparison of planned benefits with the benefits that are actually received.
Environmental issues	These can form a significant part of any due diligence activity. Environmental impact statements have to be considered a never-ending part of business operations as well as the business planning. Regulators from government agencies as well as non-governmental organised groups can delay or prevent a specific development project (see also **CHAPTER 16** for further discussion of environmental issues).
Facilities, plant and equipment	Classically, this item is included within the asset category. It is separated here to indicate the requirements for a continuing due diligence for the potential retirement or sale of any old facility that is no longer effectively supporting the enterprise business. Examples of this can be old buildings. In the USA recently many municipalities have torn down old sports stadiums to construct new ones with 21st century features like adequate bathrooms and enough executive suites.

Topic	Examples
Financial condition	Traditionally this is the province of the accountant. It has expanded to recognise the confluence of cash availability, debt limitations and restrictions, the industry's economic climate, the country's economic climate and the global economy. All of these components can be monitored on a continuing basis as part of the overall financial review of the business.
Foreign operations and activities	Globalisation is the major element of 21st century business. Outsourcing, multiple worldwide locations, different business and governmental regulations, currency conversions, transportation issues, employees and cultural differences all add up to substantial impact on company operations.
Legal factors	Legal issues from country to country, state to state, municipality to municipality all have to be considered and monitored.
Product issues	Product life cycles need to focus on old products, products about to be launched and products in the development pipeline. Moreover, due diligence includes the need to monitor competitor's products. It is a growing issue considering the expanding global economy.
Supplier issues	Companies are segmenting the manufacture and delivery of products and services. Some companies want to control all aspects of manufacture. As noted, trends in today's economic climate show that more companies are outsourcing parts of all of the development cycle. Due diligence needs to include the viability of the supplier's ability to deliver on time, on budget and within the established quality parameters. If the supplier declares bankruptcy there may be significant issues impacting the completion of company products as well as the financial impact of not receiving value for payments already made.
Tax issues	Tax increases, tax decreases and taxing authorities all need to be monitored. Due diligence needs to include the potential liability of taxes. On the other side of this coin is the potential for the impact of economic loss on the tax liability. In some cases, the liability may be greatly reduced and/or turn to a cash refund. In this event, due diligence needs to make sure that this is an accurate calculation and then consider what to do with the returned funds.

Financial Due Diligence Checklist

Executive summary

Provide a short executive summary dealing with the main financial risks and opportunities for the buyer in doing this deal along with an assessment of the likelihood of those risks materializing and the costs if they do. Summarize what warranty/indemnity protection should be negotiated, along with an indication of the priority for each point.

History and commercial activities

Provide a short history and development of the target and the activities undertaken along with a description of the Group's activities and its commercial objectives and policies.

- Outline the target's corporate structure.
- Give a breakdown of turnover by categories for the last [three] years and, where possible, an assessment of the size and development of the principal markets in which the target operates, its main customer type, potential customers and assessment of market share. Commercial due diligence colleagues may be able to help here.
- Outline the target's relationships with suppliers, assess the relative importance of each major source of supply and provide details of any particular commercial relationships.
- Show how the target finances its activities, including any special financial arrangements.
- Summarize any new activities planned, recently commenced or terminated.
- Provide details of trade associations, bonding arrangements, and so on.
- Provide details of the activities of and relationship with any other companies owned by, or in which an interest is held by, the shareholders or directors of the Company, having a trading or other relationship with the target.
- Assess the target's vulnerability to changes in market conditions, interest rate and any other significant factors.
- Liaise with legal due diligence and provide details of the target's properties including location, form and terms of tenure, current usage, date of acquisition, cost and current valuation, planned future expenditure, a schedule of the net book values of the properties (a professional open-market valuation of the properties may be undertaken by a firm of Chartered Surveyors and Valuers) and, in the case of any let properties, details of tenants, terms of lease, rental income and so on.

Organizational structure and employees

1. Provide details of:
    - management structure
    - directors and senior management, terms of employment including service contracts, bonus or commission payable, pensions, benefits, loans and expenses, if applicable.
2. Comment on any changes planned following the proposed acquisition.
3. Assess any management succession plans.

4. Liaise with [employment/legal] due diligence and provide broad details of the workforce including terms of employment, numbers, remuneration policy and staff relations, noting Trades Unions that are recognized, dates of salary/wage reviews and their current status, dates of profit-sharing and bonus schemes.
5. Comment on availability of staff, recruitment policy and training.
6. Liaise with [pensions/legal due diligence] and give details of pension schemes and an indication of their funding position.
7. Summarize any important relationships with outside contractors and professional advisers and the extent of the target's reliance upon them.

Accounting policies and information systems

1. Summarize the accounting policies adopted by the target and details of any recent changes in policy.
2. Describe and assess:

    - The financial records produced by the target and the systems of internal control. Compare with the acquirer's policies.
    - The target's costing systems and the budgetary control and forecasting systems.
    - The management information produced by the target including an assessment of auditors' management letters.

Trading results

- Provide a summary of the consolidated results of the target covering the last [three] years.
- Break down gross profit and analyse by each main activity for the last [three] years together with an explanation of significant variations.
- List adjustments to be made to the profit and loss accounts and balance sheets over the review period to reflect consistent accounting policies or the impact of exceptional items.
- Analyse overhead expenses and comment on significant fluctuations.
- Explain the major fluctuations in turnover and profits during the review period.
- Explain and comment on trends in the results and note any exceptional profits or losses.

Net assets

1. Provide a summary statement of the consolidated balance sheets of the target for the last three (or five) years.
2. Analyse and comment on the main assets and liabilities in the target's balance sheets for the last three (or five) years. In particular, comment on whether stock is valued appropriately, particularly where overheads are included, how long-term WIP is valued and profit recognized, and whether the depreciation rate is appropriate.
3. Compare notes with legal and give summary details of:

    - any material long-term and/or onerous contracts.
    - banking facilities available to the target, including covenants and any onerous conditions, breaches and renewal dates.
    - the target's capital structure.

Cash flows

Show the target's cash flows for the last three (or five) years, reconcile profit and cash and comment on the target's ability to continue to generate cash on the same basis.

Taxation

After discussion with tax and legal give summary details of the current position with regard to the agreement of taxation liabilities, deferred taxation, shortfall clearances and assessments and details of any unusual PAYE or VAT practices and the findings of the last inspection of these areas.

Financial projections

1. Review the target's profit and cash flow projections including:

    - The method of preparation
    - Arithmetical accuracy
    - The commercial assumptions made by the directors. Comment on any assumptions that appear unrealistic
    - Cash flow projections v borrowing facilities.

2. Provide a sensitivity analysis of the projections in relation to the key assumptions upon which they have been prepared and taking into account the findings of commercial due diligence.

Other matters

Discuss with legal due diligence and give summary details of any current, pending or threatened litigation or legal proceedings against or involving the target, details of any contingent liabilities and a summary of the target's insurance cover.

Legal Due Diligence Checklist:

Executive summary

Provide a short executive summary dealing with the main legal risks and opportunities in doing this deal, from the buyer's commercial point of view, along with an assessment of the likelihood of those risks materializing and the costs if they do. Summarize what warranty/indemnity protection should be negotiated, along with an indication of the priority for each point.

Corporate records

1. Determine exact corporate name and address.
2. Summarize Memorandum and Articles of Association, and all amendments of target and each subsidiary of target.
3. Verify location of certificate of incorporation and all statutory books of the target and its subsidiaries.
4. Summarize legal structure of company and subsidiaries. Provide:

    a. A list, with details of corporate name, address, activities and so on, of all dormant, joint-venture, subsidiary, group and associate companies.
    b. A family tree showing the relationship between them and the ownership chain to ultimate beneficial owners.
    c. Details of any branch, place of business or substantial assets outside the UK.
    d. Details during the last [six] years of any:

        - incorporations
        - acquisitions
        - disposals
        - windings-up

5. Review:

    - minutes of all Board of Directors, committee and shareholders' meetings.
    - material information or documents furnished to shareholders and to directors during the last two years.

Shares

1. Determine the capitalization and authorized and issued shares of the target and each subsidiary.
2. Provide a description of shares, summarize rights of each class of share capital.
3. Determine names of shareholders and holdings and whether any shareholders are under any legal disability (for example, as a result of mental illness).
4. Do any of the major shareholders have any interests in other businesses which could be in competition with the target?

5. Determine the existence of warrants, options, and other rights to acquire shares.
6. Summarize shareholder agreements and report on their effect, if any, on the proposed transaction (and, if they are to survive) the effect on any future transactions: for example agreements or other arrangements restricting the transfer or ownership of shares or the voting of shares.
7. Investigate whether any shares of stock of the target or any subsidiary have been issued in violation of company law.
8. Report on any encumbrances over shares.
9. Summarize stock option, stock purchase and other employee benefit plans and agreements.
10. Obtain and review copies of all correspondence and other communications with shareholders.
11. Confirm all dividends or distributions declared, made or paid since incorporation have been declared, made or paid in accordance with the Articles and the Companies Acts.
12. Obtain details of any

    - shares created or issued in the last [six] years.
    - other changes in share capital in the last [six] years.
    - issue of, or proposals to issue, share capital since the last year end.

Dispensations

Has the target or any group company passed a resolution to take advantage of any of the dispensations contained in the 1985 Companies Act, that is to dispense with:

- accounts before an AGM?
- annual appointment of auditors?
- holding AGMs?
- the need to renew the duration of an authority to allot shares and debentures beyond five years?

Debt

- Investigate the indebtedness of the target and subsidiaries, including a review of loan agreements, notes, mortgages, and security agreements. This should include a review of all financing arrangements, including sale and leaseback arrangements, capital leases, and hire purchases and terms and assignability of any loan agreements and must include any off-balance sheet financing arrangements and the use of Special Purpose Vehicles where there is recourse to the target.
- Review correspondence with lenders and demonstrate compliance with financial covenants.
- Report on any debt arrangements, guarantees or indemnification between officers, directors or shareholders and the company.

Insolvency

- Has any order been made, or resolution passed, for the winding up of the target or any subsidiary?
- Has any administration order been made, or any petition for such an order presented in respect of the target or any group company?

Property

1. Compile a list of relevant property, including complete addresses of all property owned or leased along with a description of their function and whether owned or leased.

2. Review:

    - title documents to property.
    - leases – term, renewal rights, rent, assignability.

3. Obtain copies of all appraisals.
4. If not covered elsewhere, obtain copies of all studies, site evaluations, and governmental filings and reports prepared by consultants or employees concerning the presence of hazardous materials or toxic substances on, under or about any property owned or leased by target or any subsidiary.

Intellectual property (if not covered elsewhere)

Confirm that the company's systems, software and technology are owned solely by the target and do not infringe on any other party's rights.

Agreements

Review major contracts, including contracts currently under negotiation (for term, appropriateness post-acquisition, assignability and any disputes and their term). Will the acquisition have any adverse effect on the trade of the target or be in breach of any contractual obligation?:

- sales contracts
- distribution contracts, including all agreements with independent sales representatives, distributors, and franchisees
- warranty agreements
- supply agreements
- employment contracts
- union agreements
- management contracts
- profit-share agreements
- consulting agreements
- licence/franchise arrangements granted by the target
- details of all licences or consents, permits or authorities necessary to carry on business
- partnership or joint-venture agreements of any partnership in which the target or any subsidiary is a member. If any partnership is material, additional due diligence will be necessary
- sponsorship agreements
- pension plans
- all insurance agreements in force with respect to target and each subsidiary
- all other material contracts. A material contract is one calling for the payment or receipt by target or a subsidiary of more than a specified amount during any 12-month period.

Employment (unless dealt with separately)

1. Obtain a list of the target's officers, directors, and employees earning more than a specified level.
2. Obtain a schedule showing the total number of employees, their job classifications, average compensation and location of employment.
3. Review:

    - all of the target's and subsidiaries' profit-sharing, pension, retirement, deferred compensation, incentive compensation, stock option, health and welfare, and other benefit plans and all correspondence relating to such plans, including with correspondence the tax authorities and actuaries. Review actuarial reports.

- all personnel policies.
- all employment, consulting, termination, golden parachute, and indemnity agreements.
- all collective bargaining and other labour agreements.

4. Investigate all pending litigation or administrative matters involving employees, including discrimination charges and unfair dismissal claims.

Compliance

1. Obtain and comment on:

   - any licences and permits needed to carry on business.
   - all governmental licenses and permits and all judgments, orders, or decrees to which target or any subsidiary is subject.
   - copies of reports or other documents filed with governmental agencies that have regulatory power over the target or a subsidiary.

2. Verify that the target complied with statutory requirements to file documents at Companies House. In particular, have all charges on the company's assets been properly recorded and filed?

Litigation

- Provide a summary of all pending or threatened material legal actions, administrative proceedings, governmental investigations, or inquiries against or involving the target or any subsidiary.
- Summarize recent or pending changes in the law that might affect the target's business.
- Review correspondence with customers or suppliers relating to complaints or disputes.
- Analyse and comment on any disputes with suppliers, competitors, or customers.
- Review correspondence with auditors or accountants regarding threatened or pending litigation, assessment or claims.
- Summarize and comment on any decrees, orders or judgments of courts or governmental agencies.
- Review settlement documentation.
- Obtain a description of any investigations pending or in progress into the affairs of the target.

Antitrust (unless covered elsewhere)

- Provide a list of where antitrust filing is required and a timetable for filing in each jurisdiction.
- Obtain the information required to file with each antitrust authority.
- Review all covenants not to compete, confidentiality agreements, and other restrictive agreements.
- Report on any anti-competitive behaviour, real and potential.

Insurance (unless covered elsewhere)

- Provide a summary of, and commentary upon, all the target's material insurance policies covering property, liabilities and operations, including product liabilities and any other insurance policies in force such as 'key man' policies or director indemnification policies.
- Review all other relevant documents pertaining to the target's insurance and liability exposure.

Commercial Due Diligence checklist:

Executive summary

Summarize the main findings including an assessment of the trends in the target's market, its competitive position and an overall assessment of prospects for sales [and gross margin], both for the target and for the combined entity (if applicable). The target's stand-alone prospects should be summarized in such a way that findings can be fed into the valuation model.

Analysis of the market for each product/service area

- Define the role of the target's [combined entity's] products in the value chain. Identify any complementary products and services and any alternative applications for products and services.
- Quantify market size, import penetration.
- Assess market cyclicality and the impact of economic variables, for example recession, interest rates, exchange rates.
- Describe market structure (market shares, routes to market and so on), how the structure has changed over time and determine the drivers of change, for example technology, legislation/regulation, consolidation, globalization, impact of e-commerce and their likely impact over the next 3–5 years.
- Segment the market and describe the differences in market trends between segments. Where does the target sit?
- Quantify relevant past growth and likely future growth. Give an opinion on the outlook for volume.
- Describe and assess the relevance for the target [combined entity] of each of the competitive forces based on Porter's five forces analysis (barriers to entry, bargaining power of buyers, bargaining power of suppliers, pressure from substitute products and industry rivalry). Give an opinion on the outlook for prices
- Assess industry attractiveness.

Customers (by segment)

Why do customers favour certain suppliers over others? Determine the relative importance of customers' key purchase criteria (KPCs). Rank the criteria and show the target's performance on each of the criteria relative to the competition. Key purchase criteria may include some, or all, of the following:

- quality/performance
- price
- technical support
- service
- delivery
- availability of stock
- availability of spare parts

- purchase decision process
- single-supplier v. multiple-sourcing.

The target company

- Describe and evaluate the target's market positioning v. competitors.
- Rate the target's performance against customers' key purchase criteria.
- Assess the target's [combined entity's] sources of competitive advantage.
- Conduct customer references.
- Assess target's market strategy.
- Comment on the relative strengths and weaknesses of the target's key products and services.

Competitors

Profile competitors:

- ownership
- size
- summary financial information
- main activities
- customers and segments served
- commitment to each market area
- sources of competitive advantage
- performance relative to KPCs
- relative strengths and weaknesses.

External views on management

Capture the market views (for example, those of customers, suppliers and competitors) on the capabilities and effectiveness of the target's top management both as individuals and as a team.

APPENDIX F: THE EXTRACTS ON DUE DILIGENCE ASSESSMENTS IN PRACTICE.

Many prominent deals of the past were done with superficial due diligence, which resulted in M&A's that produced sobering results. These various national and international deals have been summarized and discussed below but have not all been adapted from journal articles. However as they remain factual in nature and objective in their description, they have taken them into consideration and will be used as part of the literature review.

Extract 1:

Failure in Due Diligence: VeriSign's Purchase of Jamba

"In June 2004, VeriSign acquired privately held Berlin-based Jamba for US$273 million. VeriSign was an internet infrastructure services company which provided the services that enabled over 3,000 enterprises and 500,000 websites to operate. VeriSign had extensive experience with acquisitions, having made 17 acquisitions prior to Jamba, including four that were valued at more than this particular purchase. Jamba had millions of subscribers and was the leading provider of mobile content delivery services in Europe. It was best known for the Crazy Frog character used in the most successful ring tone of all time. But, beneath the surface, trouble was brewing that **could easily have been uncovered by even the most rudimentary due diligence:** complaints to regulators had noted that Jamster, the UK and US rebranding of Jamba, was targeting children, despite the fact that Jamster's mobile content services were intended for adult customers only. Perhaps more disturbingly, only days before the acquisition VeriSign discovered that a significant portion of Jamba's profits came from the distribution of adult content in Germany—despite a VeriSign policy of not supporting adult or pornographic companies. There were backlashes in Germany over other issues and Jamba was forced to make a declaration of discontinuance regarding many of its contracts. Other legal actions were pending in Germany and the United States..."

Adapted from, "Due Diligence Requirements in Financial Transactions" by Scott Moeller (2009)

Available online at:
http://www.qfinance.com/mergers-and-acquisitions-best-practice/due-diligence-requirements

Extract 2:

Uninspected Acquisitions: The Barrick Gold Corporation

"...the consequences of some of these pitfalls are well illustrated by Barrick Gold Corporation's troubled Bulyanhulu gold mine in Tanzania, which has been plagued by sustained NGO pressure and persistent allegations of human rights abuses since construction. A formal complaint was lodged by the Lawyers Environmental Action Team with the Compliance Advisor/Ombudsman (CAO) in January 2002 in respect of MIGA insurance guarantees issued to the project whilst it was under development by Sutton Resources Limited. Although the complaint was ultimately dismissed in January 2005 due to lack of evidence to substantiate the allegations, the CAO candidly concluded that, ''MIGA's **due diligence had been constrained by the lack of a site visit and any independent verification of the facts leading to the controversy**...''

Adapted from, Reichardt, C. (2006). Due diligence assessment of non-financial risk: Prophylaxis for the purchaser . Resources Policy 31 , 193–203.

Extract 3:

Commercial Due Diligence: Hewlett-Packard's acquisition of Compaq

"... In the classic case of Hewlett-Packard's acquisition of Compaq in 2001, the acquiring company had **not conducted any research prior to the deal on how consumers rated** Compaq **products**. When they did it, several months after the merger, they were astonished to reveal that consumers considered Compaq products to be inferior. However, it was too late to do anything about the merger itself..."

Adapted from, Papadakis, V. (2007). Growth through mergers and acquisitions: how it won't be a loser's game. Business Strategy Series , 43-50.

Extract 4:

Hostile Takeovers: Harmony and Gold Fields Limited

"**In the case of 'hostile' bids**, such as the abortive bid by Harmony for control of Gold Fields Limited in late 2004, the company being targeted for acquisition has no incentive to release data to the prospective purchaser. Under these circumstances, the prospective purchaser has **to make do with information from publicly available sources and may choose to explore legal mechanisms to access other relevant data**, for example, using the South African Promotion of Access to Information Amendment Act (No. 54 of 2002), although there is no guarantee that privileged information will be released as a result of such legal action. Even under these restrictive circumstances, a reasonable amount of information on non-financial risk can be pieced together from publically accessible sources..."

Adapted from, Reichardt, C. (2006). Due diligence assessment of non-financial risk: Prophylaxis for the purchaser . Resources Policy 31 , 193–203.

Extract 5:

Reverse Takeovers: T&N and Federal-Mogul

"In 1996, Federal-Mogul (a US auto parts company) bought T&N plc, Europe's leading supplier of gaskets. With sales of $3 billion, T&N was bigger than Federal-Mogul itself. July 1998, Federal-Mogul's share price was $72. By September 2001 it was $1. On October 1, 2001, the company filed under Chapter 11 of the US Bankruptcy Code. What went wrong?

Problems Picked Up in Due Diligence Not Acted On

T&N had at one time manufactured building products containing asbestos, and for years it paid out an increasing number of compensation claims for asbestos-related diseases. Following the takeover, the number of asbestos claims against T&N and its former subsidiaries exploded. In October 2001 there were 365,000 asbestos claims pending. By the end of 2001, Federal Mogul had paid out $1 billion in claims. While Federal-Mogul was aware of the asbestos issue, Federal-Mogul leaders **did minimal due diligence**, failed to appreciate just how serious it was, and believed that, because it operated in the United States, it would be able to manage the litigation better..."

Adapted from, "Identifying and Minimizing the Strategic Risks from M&A" by Peter Howson (2009)

Available online at:
http://www.qfinance.com/mergers-and-acquisitions-best-practice/identifying-and-minimizing-the-strategic-risks-from-m-and-a?full

Extract 6:

Fire Sales: Geita Gold Mine and Ashanti Goldfields

"…**a 'fire sale' scenario** occurs when a company has to offload assets due to financial constraints. An example of this is the sale of Geita Gold Mine in Tanzania during 2000, which Ashanti Goldfields was forced to sell this asset at short notice due to severe cash flow problems arising from its poorly advised hedging strategy. Under this scenario, the vendor has an interest in ensuring that the sale is concluded as quickly as possible so that the company can unlock the value of the asset, which **leaves little time for due diligence assessment**. In addition, such cash-strapped vendors are also likely to take steps to ensure that the purchase price is maximised, and may thus have an incentive to limit access to potentially negative information such as existing liabilities or situations of conflict. 'Fire sales' usually attract several prospective bidders (since the vendor is forced to offload attractive assets to ensure a quick sale), which further contributes to a pressured due diligence time frame..."

Adapted from, Reichardt, C. (2006). Due diligence assessment of non-financial risk: Prophylaxis for the purchaser . Resources Policy 31 , 193–203.

Extract 7:

Due Diligence Success: Inside Cadbury's sweet deal

“For years, growth for Britain's Cadbury Schweppes, a multi-billion dollar confectionery and beverage company, had always been accomplished the same way. The company made small “bolt on” acquisitions of regional brands. These acquisitions were not complicated; they did not require a sophisticated M&A process, nor did they trigger significant integration challenges.
But to compete globally, Cadbury needed to make a big move that would thrust it into the ranks of its major competitors. It targeted Adams, a confectionery company first owned by Warner-Lambert and then Pfizer. The Adams pursuit in 2002 was different from anything Cadbury had ever attempted. It was valued at more than US$4 billion, it was cross-border (Adams was based in New Jersey), it was a “carve out” that would require untangling of support services and business processes from Pfizer. Unlike a bolt-on, this acquisition would have to be integrated into Cadbury's existing regional confectionery businesses. At the same time, the company would have to clean up the problems from previous bolt-on acquisitions -- a major risk factor of the deal.

With so much at stake, the company could not rely solely on financial due diligence. The executive team **wanted to look at the key operational and management drivers** that would affect the success of the acquisition. And Cadbury needed to have a high degree of confidence in its valuation of the target, since competitors, all with deeper pockets, would also be bidding on the Adam's business. With little experience in acquisitions of this scale, Cadbury sought out subject matter experts, including A.T. Kearney, to determine the deal’s potential value. The experts **ran workshops to determine synergies, developed action plans and identified other sources of value. All were documented and incorporated into the company's acquisition case, greatly improving management's confidence in the acquisition model's rigor and accuracy.**

Cadbury also needed to address the risk of business disruption that could result from “decoupling” the Adams business from Pfizer's infrastructure. One step was to help Cadbury challenge assumptions around how much transitional back-office support would be required from Pfizer post-closing. Another was to identify ways to simplify and speed up the untangling process while reducing Adams' reliance on Pfizer for basic services.

Armed with a rich perspective, including an eyes-open understanding of integration risks, Cadbury was confident in its valuation of the target and was successful in the auction with a US$4.2 billion bid -- a more aggressive bid than both the market and competitors had expected.

The story did not end here. **After Cadbury won the deal, the de-risking process continued well into the merger integration. Key members of the valuation or "deal" teams stayed involved to ensure that knowledge gained during the enhanced due diligence process was used to develop and execute the pre-integration plan.** This allowed Cadbury to "flip the switch" upon signing the deal, and have a perfect "day one" with no business disruption..."

Adapted from, Perry and Herd (2004). Mergers and Acquisitions: Reducing M&A risk through improved due diligence. STRATEGY & LEADERSHIP , 12-19.

Extract 8:

Due Diligence Blogs - An examination of reality:

"... It is **amazing how far along companies**, especially small to mid size companies, **will go along the road to merger or acquisition without first subjecting themselves to the kinds of due diligence examinations that a really good law firm and accounting firm will conduct in pre merger due diligence** for the opposite party.

If you're lucky, what turns up will only be embarrassing and humiliating. More often than one might wish to imagine, what turns up involves improprieties that cast aspersions on your company's integrity and honesty, and criminal activity of the felonious sort. Enron Corporation brought the introduction of heightened sensitivity (to put it mildly) about what must be done with "hot" information.

In the old days, if there were no pending litigation or government investigation regarding the hot information, you simply destroyed the evidence. Then, thirty some years ago, government enforcement policy was potentially less aggressive if you took the initiative to "fess up". The first to confess got the best deal, especially if what was discovered was something like a price fixing conspiracy, a felony under the Sherman Antitrust Act. About the same time, highly placed corporate officers started invoking their Fifth Amendment right against self incrimination in those kinds of investigations. When they did that, government prosecutors would decide in many cases to arrange for them to obtain testimonial immunity from prosecution, which enabled them to be forced to testify because with immunity they had no more risk of incrimination.

Today, the discovery of hot information in the course of a due diligence examination can create a very delicate and painful dilemma, especially if it is discovered by somebody else. There is only one way to avoid this. **You have to subject yourself to an intensive forensic due diligence examination before anyone else does.** Contemplation of mergers and acquisitions without doing that is a form of Russian Roulette. How you go about conducting that self examination, including who does it, seriously affects your options if sensitive information turns up..."

Adapted from, "Preparing for Due Diligence" by Richard Solomon
Available online at:
http://www.allbusiness.com/legal/antitrust-trade-law-restraint/11470323-1.html

Extract 9:

Due Diligence Practitioners- A due diligence assessment in practice:

"At Cooper Industries, a Houston-based manufacturer of electrical products, tools, and hardware with 28,100 employees and $3.6 billion in 1998 sales, M&A activity is a regular part of the picture. The company typically pulls the trigger on 10 to 15 deals a year, acquiring both public and private companies. George Moriarty, assistant director of pension design, typically spends several days poring over records, with the assistance of a detailed checklist. Among other things, he examines day-to-day business costs and looks for potential liability, especially related to retiree medical benefits, severance pay obligations and employment contracts for executives. When the deal involves an overseas acquisition, he often spends hours interviewing senior executives of the targeted firm.

The entire due diligence process usually takes a week to 10 days, though complex deals can require three or four weeks of analysis. Cooper Industries uses anywhere from 7 to 20 people, depending on the complexity of the due diligence. Moriarty is one of three or four HR professionals who focus on different aspects of the deal. He says, '**The idea is to understand exactly what you are buying. It's rare to spot something that kills the deal, but it isn't uncommon to uncover some information that leads to re-valuing of the deal.'** Moreover, the due diligence can identify personnel who are crucial to the transaction. That allows Cooper Industries to enter long-term contracts with key executives and others, or lower the value of the deal based on the possibility that these individuals might leave for another company..."

Adapted from, Schuler R. and Jackson S. (Vol. 19, No. 3, 2001), HR Issues and Activities in Mergers and Acquisitions. European Management Journal, pp. 239–253.

Extract 10:

A look at Strategic Due Diligence. A view from Sadat Associates Incorporated (SAI):

"SAI has for several years provided a type of targeted strategic due diligence for redevelopment projects that allows for the identification of potential liability, remedial options, and costs early in the process to facilitate a go/no-go decision. Not intended to take the place of traditional due diligence efforts to satisfy requirements of a regulatory agency and/or financial institution, the strategic analysis identifies early the remedial options to complete a given project. If plans need to be modified to address site conditions and regulatory constraints, knowing these needs early saves money in the long run by facilitating the site's design.

An example of just how valuable this strategic due diligence is can be seen with a recent investigation undertaken by SAI personnel. The Client had the opportunity to develop a parcel of land in a prime location. The purchase price was reasonable and the market study clearly indicated the potential for success with the specific redevelopment plan. The only "problem" was that the land was an abandoned landfill. SAI scientists and engineers conducted a series of targeted investigations and proposed a rather unusual but clearly sound management plan for the site. Based on certain cost assumptions, this project was determined to be a reasonable investment and the Client proceeded with the negotiations, equipped with sufficient information to assist in setting a cost.

The information critical to that decision process would not have resulted from "traditional" due diligence - file reviews, preliminary site visits, and other components of the Preliminary Assessment effort. While this traditional information is necessary and a requirement of the process and financial institutions were involved in the deal, the information critical to this decision included additional geotechnical investigations and meetings and discussions with regulators. Together, this information, with SAI's assessment of engineering costs and regulatory time frames, was part of what was needed by the Client to develop the pro forma for the project, and the decision to move forward. While working to develop sound remedial strategies that allow our Clients to reach their redevelopment goals, strategic due diligence can also identify very early in the process when a **site is unsuitable and/or the "deal" inappropriate**. SAI recently evaluated a site for a Client that contained levels of toxins that could impact and possibly deter redevelopment. Although SAI was confident that there were ways to make the site buildable, the asking price for the land was unrealistic. **Armed with this knowledge our Client was able to attempt to renegotiate the selling price.**

Each case, each site is different. SAI is proud of the efforts it has undertaken on behalf of its Clients to incorporate standard procedures for due diligence activities with in-depth knowledge of

regulations, remedial options and engineering controls to assist our Clients in critical decisions related to property acquisition and redevelopment..."

Adapted from, "Strategic Due Diligence" by Sadat Associates Incorporated.
Available online at: http://www.sadat.com/Strength/Strategic.html

Extract 11:

The effects of Limited Financial Due Diligence

"...The case of Caparo Industries v Dickman established all of the above. The case went as follows. A UK listed company called Fidelity issued a profit warning in March 1984. Fidelity's share price fell sharply. In May the (unqualified) **audited accounts were issued and the directors announced that profits were lower than had earlier been predicted.** On 8 June Caparo began to acquire Fidelity's shares. By 6 July it had bought 29.9 per cent of Fidelity's issued share capital and in September it mounted a full bid which was successful.

Caparo subsequently alleged that Fidelity's **accounts were inaccurate and misleading.** It was suggested, for example, that **stock was overvalued and that credit notes due to customers had been understated**. The alleged effect was that the accounts should have recorded a loss of around £ 1.3 million.

Audited accounts had been sent to shareholders on 13 June were based on those (inaccurate) accounts. **It claimed that had it known of Fidelity's true position it would not have purchased those shares nor would it have made the eventual bid at the price paid, if at all.** It suggested that the auditors should have been aware that Fidelity was vulnerable to a bid following the fall in Fidelity's share price after the March profits warning, that any potential bidder would be likely to rely on the accounts when assessing a bid and that a bidder would suffer a loss if the accounts were inaccurate.

The general rules of the law of tort would look at foresee ability, proximity and fairness before giving a ruling on whether an auditor owes a duty of care to people who rely on negligently audited financial statements. **It would not have paid as much for the bulk of its shareholding if it had known that the accounts were overstating profits by some £1.7 million.**

The court of Appeal and the House of Lords ruled that not only is there no duty of care between an auditor and potential investors in a company, but there is not even a duty of care to existing shareholders. Apparently, (according to Lord Oliver) and auditor's report is not issued for 'the purposes of individual speculation with a view to profit..."

Adapted from, Howson, P., (2003)., Due Diligence: The Critical Stage in Mergers and Acquisitions . Gower Publishing Limited, Chicago.

APPENDIX G: THE INTERVIEW EXCERPTS:



UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG

THE SCHOOL OF ACCOUNTANCY

REALITY OF DUE DILIGENCE PRACTICES IN SOUTH AFRICA:

PARTICIPANT #1

Initial Question:

2) What do you think the objectives of due diligence are in terms of Mergers/Acquisitions, and do you think due diligence achieves this objective? Please substantiate.

The objective of a due diligence is to identify risks relating to a particular target's business and to provide clients with recommendations on how to address these risks, for example, to include additional Sale Purchase Agreement conditions or adjust the valuation, etc. If the due diligence is properly scoped and the target makes adequate disclosure, the due diligence exercise will achieve the objective.

Yes/No: (Please feel free to add any additional comments though, if you so wish):

16) Do you think your clients consider due diligence as just a confirmation of facts, a mere box ticking exercise?

No

17) Do you feel that your clients have a pre-conceived notion/ stigma attached to due diligence before it is carried out? (Tedious, lengthy, costly etc.)

No. However, some inexperienced transactors may consider due diligences to be expensive.

18) Are due diligence assessments often seen as an 'audit' by your clients?

No

19) Do you ever incorporate non-financial elements in the conduction of your due diligence?

Yes, for example, Human resources, Information technology

20) Do your clients often restrict / limit the due diligence due to its cost implications?

Yes

21) In your experience, is the acquiring of quality data impeded if the Mergers/Acquisition deal is hostile? That is, does the type of Merger/Acquisition affect the type/nature of the due diligence conducted?

Yes, in most cases.

22) In your experience, when a M&A has failed, was there a possibility that due diligence could have prevented that failure?

Yes however this is all relative. Due diligence is often completed prior to the finalising the price and Sale Purchase Agreement. There may be certain cases where the client asks for certain items to be followed up during the merger process and there are also instances where clients may ask for a top up due diligence on certain "effective date" balances.

Closed ended Question:

23) Rate the following in order of importance: (1= most important, and 9= least important)

- Identifying the M&A strategy early on and developing the company's overall M&A strategy. **1**
- Arranging finance **4**
- Skilfully identifying, screening and prioritising targets **2**

- Synergy evaluation **6**
- Integration project planning, orchestrating and executing **9**
- Pricing the deal and negotiation **7**
- Picking management team and energising the organisation **8**
- Understanding and resolving cultural issues **3**
- Conducting due diligence **5**

Open ended Questions:

24) What do you think are the negative aspects of conducting due diligence?

I don't believe that there are any negative aspects of conducting a due diligence. A due diligence is an integral part of any purchase decision.

25) Has due diligence assessments performed by your firm ever identify potential causes of merger failure? Elaborate.

We have experienced a number of transactions that have failed post-due diligence. Some common causes for transactions to fail post due diligence are the risk of undisclosed tax or financial liabilities, significant valuation adjustments that make the price unattractive to the seller, lack of sustainable earnings trend, etc.

26) How do you combat buyer/seller dynamics? Buyer/seller dynamics typically include the seller having nothing to gain by giving a buyer time to probe and question. Whilst the buyer, on the other hand, having to gather and digest a lot of information in a very short time with less than perfect access to the sources of information.

Generally, by the time the due diligence exercise is commissioned, the seller and buyer have agreed access to information. Where the seller restricts access to information, this generally then translates to more onerous Sale Purchase Agreement conditions which are not in their best interest. Therefore, in most cases, sellers are willing to engage on the due diligence process.

27) Has the execution of due diligence ever changed in your practice? That is, has your due diligence techniques ever been modified, and how/why so? Any elements of change/innovation/creativity?

Our due diligence methodology is continuously being innovated and improved to ensure that we deliver on clients' expectations. The due diligence product is also continuously improved on to keep ahead of competition.

28) Are there any shortcomings, constraints or limitations of the due diligence process in your experience? If any, how do you counterbalance them?

The only major constraint is access to information and management during the due diligence process. If our access is restricted, the due diligence output is not very meaningful for our client.

29) Do you feel that the typical types of due diligence are sufficient and provide adequate coverage? Typical types include financial, legal, commercial due diligence.

Yes. However, these would vary based on the nature of the transaction and Target.

30) Do you feel that your due diligence efforts are as effective as they could/should be? If not, what could you do to make it more strategic/effective?

Yes, although in practice, some entities may commission their internal finance team to perform the due diligence. Our experience is that due diligences undertaken by non-due diligence professionals often lack the necessary depth and focus on deal issue and hence are not as effective as they should be.

Thank You for your participation.

End.

UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG

THE SCHOOL OF ACCOUNTANCY

REALITY OF DUE DILIGENCE PRACTICES IN SOUTH AFRICA:

PARTICIPANT #2

Initial Question:

1) What do you think the objectives of due diligence are in terms of Mergers/Acquisitions, and do you think due diligence achieves this objective? Please substantiate.

The purpose of a Financial Due Diligence is to:

- *Understand underlying revenue, cost, profitability and cash flow trends of a business so that the buyer has an insight into the businesses operations and its ability to generate sustainable future cash flows. This also feeds into the buyers valuation model which as a direct impact on the purchase price.*
- *Understand working capital management and requirements in order to establish the cash required to fund the business on a day-to-day basis.*
- *Understand the capital structure of the business (fixed assets, debt and equity) and identify off-balance sheet contingencies.*
- *Assist in establishing the key elements in the Purchase Price Mechanism (such as Net Debt and Normal Working Capital).*

I believe a well executed due diligence addresses each of these elements to such an extent that the buyer can make a more informed decision about the value of the business and protect itself against eventualities in the Sale Purchase Agreement.

Yes/No: (Please feel free to add any additional comments though, if you so wish):

2) Do you think your clients consider due diligence as just a confirmation of facts, a mere box ticking exercise?

No in most cases, yes in some. Some clients, particularly some private equity houses/consortiums, see financial due diligence as a mere box ticking exercise as they would have done extensive research into and analyses on the business already. They only require the due diligence for the purposes of presenting this to a bank in order to obtain funding for the deal from the bank. In this instance, even though the Private Equity house itself might see it as box-ticking, the due diligence is still essential to the bank which has to provide the funding.

3) Do you feel that your clients have a pre-conceived notion/ stigma attached to due diligence before it is carried out? (Tedious, lengthy, costly etc.)

No. The days of long and tedious due diligences are coming to a close and few clients express concern about this. Most clients are worried about cost but this is more a sign of the tight economic times we are living than their appetite for the due diligence. In the greater scheme of things, the cost of a financial due diligence is miniscule in comparison to the whole deal value and in most cases less than the cost of M&A advisors and lawyers.

4) Are due diligence assessments often seen as an 'audit' by your clients?

Only to new clients who have never had a due diligence done before. Once clients have gone through the process, they see it much more than an audit.

5) Do you ever incorporate non-financial elements in the conduction of your due diligence?

Yes, although these will be included in order to understand or interpret financial indicators. For instance, for a mining company, it's important to understand the run-of-mine and processed production tonnages in order to analyse revenue and cost trends.

6) Do your clients often restrict / limit the due diligence due to its cost implications?

Yes, scope of due diligence can often be limited in order to keep costs in check. Areas often taken out of the scope include looking at the forecast (which the client often then prefers to look at themselves) and leaving out some non-key entities from the tax due diligence.

7) In your experience, is the acquiring of quality data impeded if the Mergers/Acquisition deal is hostile? That is, does the type of Merger/Acquisition affect the type/nature of the due diligence conducted?

Definitely. The quality of info is key to the level of due diligence that is possible. Even in an organised bidding process where there is more than one potential buyer, restricted access to information and management can be a big impediment to performing a due diligence.

8) In your experience, when a M&A has failed, was there a possibility that due diligence could have prevented that failure?

Perhaps but not likely. Our view is that failures of mergers have a lot more to do with the parties not doing it for the right reasons and/or not spending as much time and effort on integration post-merger, as they did on actually getting the deal signed-off. Getting two businesses with completely different business models and cultures to fit is no easy task and something often left to happen spontaneously which is unsurprisingly not very successful.

Closed ended Question:

9) Rate the following in order of importance: (1= most important, and 9= least important)

- Identifying the M&A strategy early on and developing the company's overall M&A strategy. **1**
- Arranging finance **5**
- Skilfully identifying, screening and prioritising targets **2**
- Synergy evaluation **3**
- Integration project planning, orchestrating and executing **9**
- Pricing the deal and negotiation **4**
- Picking management team and energising the organisation **8**
- Understanding and resolving cultural issues **7**
- Conducting due diligence **6**

Open ended Questions:

10) What do you think are the negative aspects of conducting due diligence?

It can be disruptive to the target's operations and if the deal is particularly confidential, it is difficult to keep it quiet to staff once the due diligence arrives on-site.

11) Has due diligence assessments performed by your firm ever identify potential causes of merger failure? Elaborate.

Yes. For instance where we identified that the main source of revenue for the business was linked to a contract that was going to soon expire or where the financial controls in the business is so poor that we expressed significant concern regarding the reliability of the financial information

12) How do you combat buyer/seller dynamics? Buyer/seller dynamics typically include the seller having nothing to gain by giving a buyer time to probe and question. Whilst the buyer, on the other hand, having to gather and digest a lot of information in a very short time with less than perfect access to the sources of information.

We tend not to get involved in these dynamics apart from ensuring that our client's interest comes first. In a bilateral scenario I don't see the buyer/seller dynamics as you put it as being particularly troublesome. If both parties want the deal to work they will find a way to compromise on timing/access so both parties get comfortable in the end.

There is of course incentive for the seller to try and hide things, but that is why it is important to have an experienced due diligence team and a thorough due diligence scope to ensure that these "hidden" things are identified.

13) Has the execution of due diligence ever changed in your practice? That is, has your due diligence techniques ever been modified, and how/why so? Any elements of change/innovation/creativity?

Not at liberty to say – this is a competitive advantage issue.

14) Are there any shortcomings, constraints or limitations of the due diligence process in your experience? If any, how do you counterbalance them?

Due to there almost always being time constraints, the due diligence practitioner is forced to cover a lot of ground in a very short period of time. There is often not time, or it is not wanted by the buyers, to have the report reviewed by the company's management to confirm factual accuracy. This could lead to the Buyers' decisions potentially being based on inaccurate or slightly misleading information that could have been more accurate with some management input.

15) Do you feel that the typical types of due diligence are sufficient and provide adequate coverage? Typical types include financial, legal, commercial due diligence.

Yes

16) Do you feel that your due diligence efforts are as effective as they could/should be? If not, what could you do to make it more strategic/effective?

Yes

Thank You for your participation.

End.

UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG

THE SCHOOL OF ACCOUNTANCY

REALITY OF DUE DILIGENCE PRACTICES IN SOUTH AFRICA:

PARTICIPANT #3

Initial Question:

1) What do you think the objectives of due diligence are in terms of Mergers/Acquisitions, and do you think due diligence achieves this objective? Please substantiate.

The objectives of a due diligence are primarily to determine whether a potential acquirer should go ahead with an acquisition and if so, at what price.

Many companies in South Africa see due diligence as a confirmatory exercise, not an investigatory exercise. They have already made the decision to acquire and are actually not looking for the due diligence to "cause any problems". In these cases a due diligence does not achieve its objectives.

Yes/No: (Please feel free to add any additional comments though, if you so wish):

2) Do you think your clients consider due diligence as just a confirmation of facts, a mere box ticking exercise?

Depends on the type of client and their level of understanding as to what a due diligence is. For many, the answer is probably no.

3) Do you feel that your clients have a pre-conceived notion/ stigma attached to due diligence before it is carried out? (Tedious, lengthy, costly etc.)

Yes, very much so

4) Are due diligence assessments often seen as an 'audit' by your clients?

No, in most cases

5) Do you ever incorporate non-financial elements in the conduction of your due diligence?

Usually no. It depends on the type of due diligence and the scope requested. As accountants we focus on financial, taxation and commercial due diligences and don't stray outside of our expertise areas.

6) Do your clients often restrict / limit the due diligence due to its cost implications?

Yes, in almost all cases.

7) In your experience, is the acquiring of quality data impeded if the Mergers/Acquisition deal is hostile? That is, does the type of Merger/Acquisition affect the type/nature of the due diligence conducted?

Of course. If hostile (although this manner of M&A in SA is limited) no access to information is granted and due diligence is usually limited to "desktop due diligence".

8) In your experience, when a M&A has failed, was there a possibility that due diligence could have prevented that failure?

Difficult to answer conclusively. In some cases, absolutely but in other cases the deal fails for reasons which could not have been identified during the due diligence.

Closed ended Question:

9) Rate the following in order of importance: (1= most important, and 9= least important)

- Identifying the M&A strategy early on and developing the company's overall M&A strategy. **1**
- Arranging finance **6**

- Skilfully identifying, screening and prioritising targets **2**
- Synergy evaluation **4**
- Integration project planning, orchestrating and executing **8**
- Pricing the deal and negotiation **5**
- Picking management team and energising the organisation **7**
- Understanding and resolving cultural issues **9**
- Conducting due diligence **3**

Open ended Questions:

10) What do you think are the negative aspects of conducting due diligence?

Time and cost can become material issues. Outsourcing due diligence to professional advisers can also prevent the acquirer from really understanding the target prior to ownership.

11) Has due diligence assessments performed by your firm ever identify potential causes of merger failure? Elaborate.

Yes. In some cases "deal-breaker" issues have been identified (e.g. material undisclosed liabilities) and in many cases we identify issues that can become price negotiation points.

12) How do you combat buyer/seller dynamics? Buyer/seller dynamics typically include the seller having nothing to gain by giving a buyer time to probe and question. Whilst the buyer, on the other hand, having to gather and digest a lot of information in a very short time with less than perfect access to the sources of information.

Very difficult to answer but one needs to understand the motives of the parties for deciding to get to this stage of the transaction.

13) Has the execution of due diligence ever changed in your practice? That is, has your due diligence techniques ever been modified, and how/why so? Any elements of change/innovation/creativity?

We constantly try to evolve our practices based on what we see the market requesting and what comes out of our international offices.

14) Are there any shortcomings, constraints or limitations of the due diligence process in your experience? If any, how do you counterbalance them?

Due diligence is mainly about determining what is not given to you, not looking at what is given to you. Therefore, experience is a very important asset but most people conducting due diligence work do not have enough experience.

Scope limitation from the client is also a big problem.

15) Do you feel that the typical types of due diligence are sufficient and provide adequate coverage? Typical types include financial, legal, commercial due diligence.

Difficult to answer as it depends on the nature of the transaction and target. E.g. in resource transactions geology, minerals, engineering, logistics etc. are usually far more important.

Again, it comes back to how much the acquirer is willing to spend on transaction fees and the amount of time available

16) Do you feel that your due diligence efforts are as effective as they could/should be? If not, what could you do to make it more strategic/effective?

I think that our due diligence are effective and add value.

Thank You for your participation.

End.

UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG

THE SCHOOL OF ACCOUNTANCY

REALITY OF DUE DILIGENCE PRACTICES IN SOUTH AFRICA:

PARTICIPANT #4

Initial Question:

1) What do you think the objectives of due diligence are in terms of Mergers/Acquisitions, and do you think due diligence achieves this objective? Please substantiate.

The objective of due diligence is to perform effective fact finding, analysis work and interpret the results to support robust conclusions and provide practical advice. In doing so we assist our client in assessing the potential transaction by discussing the risks, opportunities arising and the potential impact thereof.

The objective is achieved as the due diligence team makes inquiries and performs analysis based on information made available to them by clients and the subject of the transaction (usually known as the target). The due diligence team also seeks to interpret the results to assist their clients in its analysis of the Target and makes recommendations with regard to the impact on the price to be paid, and or any conditions to be included in the sale and purchase agreement.

An objective is also to improve the client's understanding of the issues surrounding the proposed transaction and to provide clients with comments as to whether these issues are: deal breakers, valuation points, negotiation points or matters to be managed post-acquisition.

Inquiries are generally directed at, and the data obtained from, selected target personnel, customers, distributors, auditors, legal advisers and other advisers. As such it must be stressed that, the ability to undertake effective due diligence procedures and the overriding objective is dependent upon the availability of information and the co-operation of the target.

Yes/No: (Please feel free to add any additional comments though, if you so wish):

2) Do you think your clients consider due diligence as just a confirmation of facts, a mere box ticking exercise?

No, due to the evolution of business and the increasing number of corporate failures due diligence is not seen as a tick box exercise. Clients understand that failure to carry out proper due diligence can be damaging to any company that is buying or selling.

3) Do you feel that your clients have a pre-conceived notion/ stigma attached to due diligence before it is carried out? (Tedious, lengthy, costly etc.)

Yes at times the process of due diligence may be seen as tedious, time consuming and costly. The majority of clients understand that failure to do proper and thorough due diligence can result in negative consequences. A minority of clients are so focused on getting the deal done that they do cut corners because of the above mentioned perception.

4) Are due diligence assessments often seen as an 'audit' by your clients?

The possibility does exist that with inexperienced deal making clients they deem a due diligence to be an audit. At the outset it is imperative that they understand the purpose, nature and limitations of the service. Once they get this understanding, they are clear about due diligence.

We as the due diligence team need to inform our clients that we are not expressing any formal opinion or any other form of assurance with respect to the financial statements (audit or review). Nor are we presenting the financial data in the form of financial statements for management (compilation). Rather, we are performing an investigative analysis of the financial and operating activities of the target so that the client can make an informed decision of what impact our findings have on the valuation, sale and purchase agreement, and on post deal issues.

5) Do you ever incorporate non-financial elements in the conduct of your due diligence?

Yes a due diligence can include the following aspects:

1. *Building an understanding of the competitive position of the business.*
2. *Providing an independent, fact-based commercial and market analysis.*
3. *Identifying the key areas that must be addressed in order to improve the business and maximize the exit value.*
4. *Obtaining an understanding of the IT systems in place, their adequacy and ability to be able to handle significant growth in processing. Human resources aspects, including pensions and medical aid. In some parts of the globe (in particular UK) we have incorporated elements of operational and technical due diligence.*

The above mentioned falls within the ambit of a commercial due diligence.

6) Do your clients often restrict / limit the due diligence due to its cost implications?

Yes, this is dependent on the deal value and the size of the target company relative to the client.

7) In your experience, is the acquiring of quality data impeded if the Mergers/Acquisition deal is hostile? That is, does the type of Merger/Acquisition affect the type/nature of the due diligence conducted?

Yes, hostile takeovers results in the following scenario:

- *Limited access to management and information- as a result, the report is rather high level as opposed to detailed.*
- *If there is no buy in from management and shareholders, the due diligence process may be obstructive.*
- *Restricted available information- with listed entities, we are limited to the annual financial statements, analyst presentations, analyst reviews / reports. In SA there is no financial information on private companies that is publicly available.*

8) In your experience, when a M&A has failed, was there a possibility that due diligence could have prevented that failure?

Yes, only effective and adequately planned and resourced due diligence could have prevented failure. Due diligence is a process of evaluating the history, to be certain of its nature. Undertaking such research will ensure that a company becomes involved with a business that is not only currently successful but will continue to be so in the future.

Closed ended Question:

9) Rate the following in order of importance: (1= most important, and 9= least important)

- Identifying the M&A strategy early on and developing the company's overall M&A strategy. **1**
- Arranging finance **9**
- Skilfully identifying, screening and prioritising targets **2**
- Synergy evaluation **6**
- Integration project planning, orchestrating and executing **4**
- Pricing the deal and negotiation **7**
- Picking management team and energising the organisation **3**
- Understanding and resolving cultural issues **8**
- Conducting due diligence **5**

Open ended Questions:

10) What do you think are the negative aspects of conducting due diligence?

The negative aspects of any due diligence includes not covering all the risk areas, costs incurred by client if the potential transaction is not successful and lack of co-operation by target entity. Due diligence can also be seen as time consuming as it distracts target management from focusing on the running of their business.

11) Has due diligence assessments performed by your firm ever identify potential causes of merger failure? Elaborate.

Yes post deal next steps and Sale Purchase Agreement considerations are included in every report.

This is done as we seek to improve our client's understanding of the issues surrounding the proposed transaction and to provide our client with comments as to whether these issues are: deal breakers, valuation points, negotiation points or matters to be managed post-acquisition.

12) How do you combat buyer/seller dynamics? Buyer/seller dynamics typically include the seller having nothing to gain by giving a buyer time to probe and question. Whilst the buyer, on the other hand, having to gather and digest a lot of information in a very short time with less than perfect access to the sources of information.

This is combated by a clear understanding and effective communication i.e. by gaining a comprehensive understanding of the client's needs, having understood the macro and micro reasons why our client is doing the deal, the expected synergies, etc.

A transaction needs to be done so that value is created. Sellers often share in the future upside (either through incentives or pricing).

Our experience is that a buyer is always willing to pay a fair price for a target (and this often incorporates paying for some of the synergies).

13) Has the execution of due diligence ever changed in your practice? That is, has your due diligence techniques ever been modified, and how/why so? Any elements of change/innovation/creativity?

Yes our approach has been refined to look at a business through the eyes of the CEO (and not only the CFO).

Our analysis expands on the current historic financial focused analysis to encompass all areas affecting delivery of the business strategy, therefore drawing on deep experience within our firms multiple service offerings to understand the impact of the key drivers on the current and future financial performance.

By doing so we are able to form a more complete, integrated view and provide our clients with more value-add advice through the seamless integration of wider service offerings.

Our global methodology is refined on an ongoing basis as we attempt to differentiate ourselves to our competitors. On other services, we offer a more holistic due diligence offering.

14) Are there any shortcomings, constraints or limitations of the due diligence process in your experience? If any, how do you counterbalance them?

Yes there are obstacles and limitations that we experience for e.g. lack of cooperation by target management, limited access to key personnel and incomplete or irrelevant information.

Where this hinders our work we report this to the client and attempt to refine our approach. Our report also states any limitations in the scope of our work.

Our approach is also one of healthy skepticism, and polite persistence which helps to overcome the attitude.

We also ask several people the same question and utilize appropriate professional skepticism to corroborate what we have been told.

Often data room constraints.

15) Do you feel that the typical types of due diligence are sufficient and provide ade quate coverage? Typical types include financial, legal, commercial due diligence.

Yes, there are numerous specialist areas that can be used on transactions in order to provide a more specialist or fuller evaluation of the transaction. Some areas are traditional parts of financial due diligence, such as taxation, and others fall outside of financial due diligence, such as environmental due diligence and commercial due diligence. These other disciplines consist of specialists in their field e.g. they consist of commercial and industry specialists.

16) Do you feel that your due diligence efforts are as effective as they could/should be? If not, what could you do to make it more strategic/effective?

Yes they are.

Thank You for your participation.

End.



UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG

THE SCHOOL OF ACCOUNTANCY

REALITY OF DUE DILIGENCE PRACTICES IN SOUTH AFRICA:

PARTICIPANT #5

Initial Question:

1) What do you think the objectives of due diligence are in terms of Mergers/Acquisitions, and do you think due diligence achieves this objective? Please substantiate.

The objective of a due diligence is to maximise the return on the proposed transaction (M&A). This is achieved by providing the buyer (or seller) with relevant information to: i) support the assessment of the target company; ii) support the valuation model; iii) to assess the risks in the business; and iv) to support the negotiation process.

A properly conducted due diligence typically achieves this objective, as evidenced by savings that our clients typically achieve. On a recent buy-side transaction that our firm assisted a listed client with, the client managed to acquire a business for R70 million subsequent to the detailed due diligence review. The client's initial non-binding offer for the business was R115million. The findings of the due diligence were used to re-negotiate the deal achieving a saving of some R45 million.

Yes/No: (Please feel free to add any additional comments though, if you so wish):

2) Do you think your clients consider due diligence as just a confirmation of facts, a mere box ticking exercise?

No, our clients typically use the due diligence to support their investment decision and/or to negotiate a price (price adjustment)

3) Do you feel that your clients have a pre-conceived notion/ stigma attached to due diligence before it is carried out? (Tedious, lengthy, costly etc.)

No, as a firm we go to great lengths to ensure that our client's expectations are fully understood and met. Our clients typically see the benefits from the due diligence process. These benefits include amongst others: i) improved position in negotiations; ii) support for their valuation model/proposition; and iii) post-deal value (synergies, cost savings, etc.)

4) Are due diligence assessments often seen as an 'audit' by your clients?

No - a client who sees the due diligence as an 'audit' would typically be an inexperienced deal maker or someone that is doing a transaction for the first time.

Our approach is to fully understand the client's proposed transaction (needs), and then to explain the value of a due diligence approach to the client. We occasionally (less than 5%) come across a client who does not fully understand due diligence and possibly confuses the due diligence with an 'audit'.

5) Do you ever incorporate non-financial elements in the conduction of your due diligence?

Yes - our due diligence reviews are focused on meeting the client's needs and therefore at times incorporate non-financial elements. We find that due diligences differ from deal to deal and depend on the level of knowledge that the parties have of the industry, the target company, future prospects of the entity being acquired etc.
Specialists that we would typically involve include: i) financial; ii) tax; iii) human resources; iv) market and commercial; v) legal vi) information technology etc.

6) Do your clients often restrict / limit the due diligence due to its cost implications?

No – we would typically scope the due diligence after obtaining a proper understanding of the specific needs and/or transaction. The scope would typically determine the fee. Our client's see the value in the due diligence and therefore cost is seldom a determining factor.

7) In your experience, is the acquiring of quality data impeded if the Mergers/Acquisition deal is hostile? That is, does the type of Merger/Acquisition affect the type/nature of the due diligence conducted?

Yes - the transaction process is impacted by the specific deal/transaction. A deal/transaction involving companies operating in the same industry would typically have stricter confidentiality arrangements as example and therefore sensitive information (for example customer revenue and profitability information) may be withheld. Similarly hostile transactions may rely on publicly available information only.

8) In your experience, when a M&A has failed, was there a possibility that due diligence could have prevented that failure?

Yes - if I understand your question correctly, you are referring to a scenario where a merger has not been successful. Typically, a properly scoped due diligence review may prevent such a 'failure' or highlight the risks (that ultimately may lead to failure).

The due diligence should focus on value and valuation issues (including synergy benefits, valuation drivers, etc.). A due diligence that is not properly focused is likely not to prevent an unsuccessful transaction. A M&A transaction however also often fails as a result of poor implementation (post-deal).

These failures may be ascribed to management differences, cultural differences between organisations, poor communication leading to staff morale issues and/or management/staff losses, IT failures, synergy benefits not being realised as envisaged by the 'original deal' etc.

Closed ended Question:

9) Rate the following in order of importance: (1= most important, and 9= least important)

- Identifying the M&A strategy early on and developing the company's overall M&A strategy. **1**
- Arranging finance **9**
- Skilfully identifying, screening and prioritising targets **4**
- Synergy evaluation **5**
- Integration project planning, orchestrating and executing **7**
- Pricing the deal and negotiation **2**
- Picking management team and energising the organisation **8**
- Understanding and resolving cultural issues **6**
- Conducting due diligence **3**

Open ended Questions:

10) What do you think are the negative aspects of conducting due diligence?

A due diligence can disrupt the normal running of a business, i.e. distract management and place an overly burdensome strain on management time.
A due diligence conducted by management (without independent assistance from for example an accounting firm) may result in management becoming 'too close' to the transaction and therefore making a poor investment decision.

11) Has due diligence assessments performed by your firm ever identify potential causes of merger failure? Elaborate.

We follow-up with our clients regarding the success or otherwise of a transaction that has been concluded. There are typically various causes of a transaction that has not been successful:
i) Poorly negotiated deal (paid too much)
ii) Overly optimistic financial forecasts
iii) Poorly implemented deal (value lost/eroded during the post-deal phase of the transaction
iv) Cultural and management style differences between organisations
v) Regulatory factors etc.

12) How do you combat buyer/seller dynamics? Buyer/seller dynamics typically include the seller having nothing to gain by giving a buyer time to probe and question. Whilst the buyer, on the other hand, having to gather and digest a lot of information in a very short time with less than perfect access to the sources of information.

Every transaction is different. It is however true that in most cases transactions are concluded under tight timelines.

The tight timelines/deadlines can be ascribed to the seller wanting to conclude the transaction in a short time frame, thereby limiting disruption to his business, limiting uncertainties (for example a transaction process that is delayed may lead to staff uncertainties, customer/supplier uncertainties if the transaction becomes public knowledge etc.).

The tight deadlines can be overcome by ensuring that the transaction process (including the due diligence) is properly planned and appropriately resourced (staff or external service providers that have required experience).

13) Has the execution of due diligence ever changed in your practice? That is, has your due diligence techniques ever been modified, and how/why so? Any elements of change/innovation/creativity?

We have found that the process has changed over the years, i.e. greater number of due diligences being concluded using virtual data rooms (rather than direct access to the target company or physical data rooms).
This has allowed our firm to utilise to a greater extent specific expertise (industry or other) that we have available in our organisation across the globe.

14) Are there any shortcomings, constraints or limitations of the due diligence process in your experience? If any, how do you counterbalance them?

Information constraints/limitations occur from time to time. The reasons for these constraints are varied but include: information is simply not available; information is not made available due to confidentiality considerations; transaction concluded in short time period; markets in which the target business operates (African markets which are possibly more difficult to fully understand).

The due diligence process is impacted by the deal negotiations. A reluctant seller may impose constraints on the due diligence (no access to management, short time period, limit access to certain information etc.).

The due diligence process may be impacted by the number of shortlisted buyers for a particular business. In such instances, the seller may wish to commission an independent vendor due diligence, which is then made available to all short listed buyers. This allows for the running of an 'auction style process'.

15) Do you feel that the typical types of due diligence are sufficient and provide adequate coverage? Typical types include financial, legal, commercial due diligence.

Every transaction/transaction process is different. Depending on the buyers understanding of the target company, the stage of negotiations and other factors the scope of the due diligence (including need for legal, financial, commercial, HR, tax, IT due diligence etc.) should be set.

16) Do you feel that your due diligence efforts are as effective as they could/should be? If not, what could you do to make it more strategic/effective?

Our firm continuously seeks to improve its service to its clients. Industry knowledge and experience is a factor. In addition, a properly scoped due diligence is key to ensuring that the process adds value to the client.

Thank You for your participation.

End.

UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG

THE SCHOOL OF ACCOUNTANCY

REALITY OF DUE DILIGENCE PRACTICES IN SOUTH AFRICA:

PARTICIPANT #6

Initial Question:

1) What do you think the objectives of due diligence are in terms of Mergers/Acquisitions, and do you think due diligence achieves this objective? Please substantiate.

The objectives of a financial due diligences are as follows:

- *Confirm that historical financial statements are prepared in accordance with IFRS*
- *Confirm the reasonability and accuracy of cash and profit forecasts*
- *Identify unrecorded liabilities, contingent or otherwise*
- *Confirm the valuation used to determine the price*
- *Confirm perceived synergies*

Provided the due diligence is performed with sufficient care and skill it achieves its objectives.

Yes/No: (Please feel free to add any additional comments though, if you so wish):

2) Do you think your clients consider due diligence as just a confirmation of facts, a mere box ticking exercise?

This may be the case where management is obliged through corporate governance to perform a due diligence, but generally this is not the case.

3) Do you feel that your clients have a pre-conceived notion/ stigma attached to due diligence before it is carried out? (Tedious, lengthy, costly etc.)

No

4) Are due diligence assessments often seen as an 'audit' by your clients?

No

5) Do you ever incorporate non-financial elements in the conduction of your due diligence?

Hardly ever

6) Do your clients often restrict / limit the due diligence due to its cost implications?

Always

7) In your experience, is the acquiring of quality data impeded if the Mergers/Acquisition deal is hostile? That is, does the type of Merger/Acquisition affect the type/nature of the due diligence conducted?

Yes

8) In your experience, when a M&A has failed, was there a possibility that due diligence could have prevented that failure?

No

Closed ended Question:

9) Rate the following in order of importance: (1= most important, and 9= least important)

- Identifying the M&A strategy early on and developing the company's overall M&A strategy. **1**

- Arranging finance **5**
- Skilfully identifying, screening and prioritising targets **2**
- Synergy evaluation **4**
- Integration project planning, orchestrating and executing **3**
- Pricing the deal and negotiation **6**
- Picking management team and energising the organisation **9**
- Understanding and resolving cultural issues **7**
- Conducting due diligence **8**

Open ended Questions:

10) What do you think are the negative aspects of conducting due diligence?

Target Company is exposed as confidential information is disseminated

11) Has due diligence assessments performed by your firm ever identify potential causes of merger failure? Elaborate.

Yes – as a result of confidentiality agreements we may not elaborate

12) How do you combat buyer/seller dynamics? Buyer/seller dynamics typically include the seller having nothing to gain by giving a buyer time to probe and question. Whilst the buyer, on the other hand, having to gather and digest a lot of information in a very short time with less than perfect access to the sources of information.

My advice to the buyer is to obtain all requested information. If seller is not prepared to make this available then the buyer should walk away.

13) Has the execution of due diligence ever changed in your practice? That is, has your due diligence techniques ever been modified, and how/why so? Any elements of change/innovation/creativity?

Due diligence procedures are specifically tailored for every assignment

14) Are there any shortcomings, constraints or limitations of the due diligence process in your experience? If any, how do you counterbalance them?

The due diligence procedures need to be tailored to focus on the risks.

15) Do you feel that the typical types of due diligence are sufficient and provide adequate coverage? Typical types include financial, legal, commercial due diligence.

Yes, if conducted by appropriately qualified and experienced personnel and with due care.

16) Do you feel that your due diligence efforts are as effective as they could/should be? If not, what could you do to make it more strategic/effective?

Yes although sometimes they are less effective due to scope restraints (mainly cost related).

Thank You for your participation.

End.