


Exploring traditional due diligence processes in South Africa

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The effectiveness of due diligence (DD) processes, and whether they contribute to merger and acquisition (M&A) success or failure, is an ongoing debate in auditing and assurance research. This article contributes to the debate by examining traditional DD in South Africa (SA) using a qualitative research approach. A data set of traditional DD processes was compiled from the literature, which formed the basis for an interview agenda which was conducted with corporate finance and audit practitioners in SA. The findings indicate that the DD process is considered to be an evolving process, where DD processes of the last decade are considered to be significantly different from DDs required in acquisitions today. Traditional DD, while considered to be indispensable, has its shortcomings in execution rather than the model. At present, it is found that much focus is placed on accounting and legal aspects, while other critical issues are neglected; macro-environment, management information systems, marketing and productions are such overlooked aspects. This article proposes a critical new trend in the forms and manner of the currently flawed DD processes in SA which is useful for DD practitioners in the present and in the future for local M&A success.

Introduction

Due diligence (DD) is the process that an acquiring party undertakes in a merger and acquisition (M&A) transaction to investigate the target party in order to make an informed business decision on whether to proceed with the transaction (Wangerin 2016). The results of a survey on M&A activity performed by a KPMG global survey showed that DD was the most crucial of the pre-deal activities. According to the study, companies which prioritised DD improved their chance of a successful deal by 6%. However, research conducted by Sherer et al. (2016) found that many companies define and understand the term 'due diligence' mainly as a study of the profit and loss and the financial position of the acquired company; with this in mind, DD processes have traditionally been restricted to a review of financial, legal and limited technical aspects (Moeller 2009; Sherer et al. 2016). This has resulted in many executives relying on only financial reports to make their decisions, without taking into account other factors (Howson 2016; Moeller 2009; Sherer et al. 2016).

Research conducted by Spedding (2009) showed that, globally, companies generally require more information than that provided by the traditional DD process – which only provides the acquiring party with an intimate understanding of a business, a heightened focus on cash flow, working capital and earnings quality. This need for more information has led to a trend where information on the future prospects of the company to be acquired, its management quality, systems and potential opportunities are obtained and then used to renegotiate the price and contract terms of the M&A (Spedding 2009). A survey by the Accenture/Economist Intelligence Unit Global M&A Survey (2006) also substantiated the fact that businesses are not satisfied with the information provided by DD. The survey found that globally only 17% of the participants were satisfied with the rigour and accuracy of DD. Howson (2016) argues that in the zero-tolerance environment in which businesses now operate, the term 'due diligence' has gained new significance. Today, DD includes not only data analysis but also analysis of every aspect of the value chain of the acquired company, including subtle issues such as cultural fit and integration, minimising any reputational risk and communication with employees (Howson 2016; Papadakis 2007).

When taking a 21st century stance, traditional DD processes are essential for M&A success (Accenture/Economist Intelligence Unit Global M&A Survey 2006). However, it should only account for 10% – 25% of a complete DD process (Spedding 2009). In this regard, the existing research attempts to establish the current reality of traditional DD processes in South Africa (SA). By conducting a review of traditional DD processes in SA, this research provides a base for studies

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involving its strategic outcome in practice going forward. This article is organised as follows: the next section gives an overview of the literature on DD as background to the stated research objectives and methodology, followed by a discussion of the research methodology. Finally, the 'Findings' section provides the detailed findings of the empirical research which was conducted to meet the research objectives and the final section provides the conclusion and areas for future research.

Literature review

The objectives of traditional due diligence processes

Due diligence is a process whereby the acquiring party investigates the target entity to eliminate misapprehensions and to ensure that the anticipated price is appropriate (Mikesell & Wood 2016). Traditionally, DD has involved the inspection of extensive available documentation (Sherer et al. 2016). According to Spedding (2009), traditional DD 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. (p. 3)

In many ways, DD affords comfort to the buyer's senior management, the board and ultimately the shareholders, who all count on a rigorous DD as a means of providing them with relative comfort that the deal is sensible and that any potential problems that may affect them in the future have been adequately identified (Mikesell & Wood 2016; Moeller 2009).

While traditional DD enables prospective buyers to find potential issues, the aim of an improved or strategic DD should ideally include realising any future prospect opportunities for the enlarged corporation (identification of synergistic benefits) and post-merger integration planning, among other things (Epstein 2005; Howson 2016; Moeller 2009; Steinberg 2002). Fitzgerald (2009) contends that industry players are aware that there are more opportunities for them to fail than there were prior to the global financial crisis. Similarly, Spizman (2008) asserts that investors today are able to be more selective, and are accordingly more vigilant and weary in their assessment of potential targets; thus, buyers have realised that DD is a different game in today's economy.

Due diligence is often mistaken as an 'audit'. However, most audit engagements essentially focus on compliance with an accounting framework. With this in mind, DD process differs from general auditing in the sense that it focuses on the liabilities that have been generated by current and previous projects which the buyer may 'inherit' on acquiring the target, but which might not be currently recognised and/or disclosed in their financial statements (Howson 2003). DD processes also differ in that they are often characterised by extremely tight deadlines which restrict the amount of time

available for data gathering and evaluation. Under certain circumstances, the availability of pertinent information may also be limited (Howson 2003). This lack of information may hinder and affect the outcome of the DD process.

Young (2005) maintains that traditional DD is commonly viewed as a mere box-ticking exercise. Accordingly, the scope of the DD process needs to be extended to provide decision-makers with information on opportunities as well as potential problems (Young 2005; Price, Harvey & Lusch 1998). Particularly, the probing of a wider variety of DD areas should counteract the short-termism of traditionally limited financial and legal DDs, assisting buyers to understand how markets and competitive environments will affect their purchases, and determining whether the opportunity is a prudent one to take on from a commercial and strategic point of view, particularly when considering cross-border deals (Chapman & Linlin 2011; Moeller 2009).

Factors that restrict due diligence processes

Time restrictions are of paramount importance in many deals (Wangerin 2016). A good DD process takes time and, depending on the size and complexity of the target company and the structure of the deal, the time necessary to perform a complete DD process can be quite substantial (Weiner 2010). In a competitive auction situation, for example, adequate time for intensive DD may simply be unavailable. In addition, very often DD is viewed as too expensive, especially if it entails bringing in experts to render an opinion in every functional area (Cumming & Zambelli 2016). That is, time and cost constraints are often present when conducting an effective examination of the target acquisition that extends beyond the major financial, legal, taxation and future sales projections (Cumming & Zambelli 2016). Consequently, choices and judgements need to be made about which issues are critical and need to be pursued as part of the DD process. In addition, both time and cost constraints need to be viewed in terms of using warranties and representations to remedy problems that are not uncovered during the DD process (Cumming & Zambelli 2016; Wangerin 2016).

Marks and Mirvis (2011) maintain that the type of information available for the traditional DD process 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 DD processes are conducted within an aggressive time frame. Hostile bids, aggressive time frames and remote site locations may restrict the DD team to a desktop review of available data, which can be particularly perilous when the project is located in an unfamiliar jurisdiction or when it involves technologies about which the potential buyer has no prior experience (Marks & Mirvis 2011; Reichardt 2006).

Effectiveness of due diligence processes

The financial crisis of 2008–2009 has placed additional pressure on the financing of transactions and has also added

to the general instability in the business world; it does not come as a surprise that DD processes have thus fallen under greater scrutiny over time (Dodgen 2011; Milton & Solomon 2009). The purpose of traditional DD is simply to confirm that the deal makes near-term financial sense. The purpose of an improved DD, 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. With this in mind, it also makes use of a wider array of information sources (Accenture/Economist Intelligence Unit Global M&A Survey 2006). In order to ensure that the target acquired will function well as an integrated business, this more detailed and tactical value assessment commonly known as 'strategic due diligence' needs to be followed (Gleich, Hasselbach & Kierans 2012; Perry & Herd 2004). Strategic DD is known to be more work than traditional DD; however, when deadlines are tight, strategic DD helps successful buyers to focus on the key ideas and assumptions (Gleich et al. 2012; Perry & Herd 2004).

A strategic DD also includes numerous non-financial aspects, including the evaluation of organisational fit, the ability to merge cultures, technological and human resource capabilities and fit, and a variety of other factors (Epstein 2005; Wangerin 2012). The lack of assessment in both financial as well as soft personnel and organisational issues, both of which are critical to organisational success, frequently result in M&A failure (Epstein 2005). Today, the traditional areas of a DD are still important, but they must be accompanied by other dynamics such as management and employees, commercial operations and corporate culture (Gleich et al. 2012; Nygaard 2002). In line with Moeller's (2009) findings, newer areas that require an extension on the scope of DD are developing rapidly. Holistic risk management considers both financial and non-financial risks and, if considered at a DD stage, a better chance exists that such areas of risk will be proactively managed throughout the project life (Mullins, Thornton & Adams 2007; Reichardt 2006).

Research conducted by Spedding (2009) showed that 55% – 77% of M&As fail to achieve their intended results because of the 'culture clash' that occurs as attempts are made to integrate the two organisations. In demonstrating this point, Chapman and Linlin (2011) recommended that thorough research should be conducted, especially when acquiring Chinese companies. The degree to which traditional DD is performed plays a significant role in determining the successful integration of two organisations from different cultures; 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 (Spedding 2009; Witzmann & Dörrenbächer 2015). Bearing in mind the failure rate and costs, DD processes that focus on cultural aspects of a merger are as vital and necessary as traditional legal and financial DD in providing an informed basis for executive decision-making and planning, and perhaps more so in

increasing the odds of success of the M&A (Spedding 2009; Witzmann & Dörrenbächer 2015).

Research methodology and design

Owing to the nature of the research topic, and the fact that little research has been conducted on DD practices in SA, an interpretive research approach was considered to be most suitable for this study (O'Dwyer, Owen & Unerman 2011). In addition, no attempts have been made to quantify the effects of DD failure on South African M&As. In light of this, an in-depth understanding of the interpretive approach, also referred to as qualitative research, was obtained (Creswell 2003; Leedy & Ormrod 2013; Willig 2008). Although there are weaknesses in a qualitative research approach, this approach was still considered the most appropriate method for this research topic as it allowed the researcher to understand the research topic in all its complexities (Harvard 2014; Leedy & Ormrod 2013; Maroun 2012).

Using information gleaned from the literature review, a data set of traditional DD processes was compiled, which formed the basis for an interview agenda (refer to Appendix 1). Using a qualitative approach, interviews were conducted with 12 senior managers at local corporate finance and audit firms which have been identified on the basis of the volume and value of the M&As that each firm was involved in. The interviews conducted with these various DD practitioners have been selected as constituents of the population as they are likely to have the most relevant knowledge for the study, as they facilitate DD proceedings in SA. These firms also covered the majority of the market's deal flow activity according to the Dealmakers Report (2016).

The interview agenda was designed to gather information about general DD processes rather than focussing on specific experiences. This study is qualitative and exploratory in nature as the findings are formulated based on the insights and experiences of DD practitioners. Because of the use of purposive sampling, interviews were the most appropriate method and were used to determine the views of DD practitioners with experience. All interviews were audio recorded and later transcribed, allowing interviewees to speak freely and share their experiences. Where responses were unclear or did not fully answer the question posed, further questions were asked. Through the use of a semi-structured interview agenda, closed- and open-ended questions were asked to gather insights and experiences of DD practitioners as a basis for meaningful dialogue into the practice of DD in SA. The insights and additions gained through this study are particularly significant as very little interpretive research has been performed on DD from a South African perspective. As a result, this study addresses the need for practical fieldwork studies on DD in M&As.

Where a particular group of participants had a specific response to a line of questioning, an attempt was made to highlight the variability (see the 'Findings' section).

However, because of the small sample size and the risk of bias, the interviewees were made aware of the fact that they may be requested to explain certain comments in different words to address 'script coherent expressions', misunderstandings and ambiguity (Leedy & Ormrod 2013; Maroun & Van Zijl 2015). Furthermore, the transcript of the interview was made available to the respective interviewees upon their request (Leedy & Ormrod 2013; Rowley 2012). The use of this standardised interview agenda (with follow-up questions where appropriate) allows for comparisons to be made between responses of different participants. Upon completion of the fieldwork and the required transcription, the data were processed using a systematic set of procedures to derive the grounded theory (O'Dwyer et al. 2011).

The transcripts of the interviews were analysed through a formal process of data reduction and data verification (O'Dwyer et al. 2011), and there was an iterative process of interview responses being considered in terms of the literature and each other's responses (Willig 2008). Open coding was conducted first, in which the data were manually segregated into categories and common themes, followed by axial coding, in which relationships between categories were identified (including an identification of the central phenomenon and surrounding conditions), and finally selective coding, in which the categories and their interconnections were considered together, with connections being drawn between different categories (Creswell 2003; Leedy & Ormrod 2013; O'Dwyer et al. 2011; Rowley 2012).

The above mentioned research method ensured a systematic analysis of each transcript necessary for generating more enhanced, reliable findings. In addition, the coding process allowed the researcher to identify the point at which theoretical saturation was achieved, confirming the appropriateness of the sample size, length of the interviews and the rigour of the open and axial coding (Maroun & Atkins 2014). At this point, the participants did not identify or raise any additional themes or issues. As participants were selected from firms representing over 95% of SA's due diligences, this provides a high level of assurance that additional interviews would provide little benefit. Once theoretical saturation occurred, findings were interpreted from the coded data. Interviewees were guaranteed complete anonymity in the interest of gaining complete and honest accounts (Maroun & Van Zijl 2015). As a result, quotes used in the 'Findings' section were thoroughly scrutinised for any information that could potentially be used to identify the interviewee and, if present, this was removed or the response was paraphrased (Maroun & Van Zijl 2015).

Interviewees had the authority to withdraw from the interview at any time and not to answer any questions with which they were not comfortable. All respondents received a copy of their own transcript to verify that their responses were captured correctly. External validity was also established through a peer review process wherein the classification and coding was assessed (Rowley 2012). Finally, purposeful

sampling of a defined group of experts does not constitute a threat to the validity and reliability of qualitative research (Maroun 2012; Rowley 2012; O'Dwyer et al. 2011). In other words, focussing on the views of a small but knowledgeable group of participants allows the researcher to identify emerging themes and other subtleties which are often overlooked by methods relying on remote inferential testing (Maroun 2012).

Findings

The information obtained from the interviews was condensed and is presented below. What is of interest is that according to the Dealmakers Report (2016), all the participants still dominate the M&A market in SA (more than 95% of M&A transactions have been managed through these interviewee firms). Therefore, even after the initial data collection, this sample is still reflective of the South African market in terms of deal value and the number of M&A activities in SA.

The objectives of due diligence processes

Of all the participants who were asked about the objectives of DD, only one participant produced an answer comparable to the literature review. The other participants gave answers which attempted to discuss the objective of DD vaguely. One participant, for example, stated that 'companies in SA see DD 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 DD to "cause any problems". It is within these cases that DD does not achieve its objectives [*sic*].'

This is particularly interesting as the literature reviewed describes DD as a process that should commence when a deal is initiated in an attempt to identify any issues relating to finance, employees, information technology (IT), legal matters, risk management systems, culture, innovation and ethics (Epstein 2005; Gleich et al. 2012; Wangerin 2012). Although it is seen as an investigatory exercise in theory, it would appear to be applied rather narrowly in practice. It is also worth noting that two other participants answered the question merely by defining financial DD. This would seem to support the idea that DD practitioners often mistake M&A DD in SA for merely financial DD (Howson 2016; Moeller 2009; Sherer et al. 2016).

When probed about whether the participants' clients ever confused DD with an audit, the majority of the participants averred that their clients do not see DD as an audit, which contradicts the findings of Howson (2003), who maintains that DD is too often seen as an audit by clients. In light of this, one participant stated that in SA, a client who saw DD as an audit would typically be an inexperienced deal maker or someone who was doing a transaction for the first time. The participant further added that their approach is to understand fully the client's proposed needs and then to explain the value of their approach towards DD to the client. Accordingly,

the interviewee came across a client who did not fully understand DD and possibly confused DD with an audit 'less than 5% of the time'.

The participants were also asked whether their clients considered DD to be a mere box-ticking exercise, as contended by Young (2005). The participants answered unanimously in the negative, all agreeing that as a result of the evolution of the world of commerce and the increasing number of corporate failures, DD is no longer seen in this way and that their clients understand that failure to carry out proper DD can be damaging to the company involved. This was despite the fact that some participants did not provide satisfactory answers to the objectives of DD, and still think of it as a financial verification exercise. In line with the findings of Young (2005), although DD may sometimes be seen as a mere box-ticking exercise, the DD process needs to be expanded to include an investigation, both prior and after the M&A. According to the participants in this study, SA clients understand the need to conduct a more thorough DD.

What is of interest to note is that one participant mentioned that:

'Some clients, particularly some private equity houses/consortiums, see traditional DD as a mere box-ticking exercise as they [private equity houses/consortiums] would have done extensive research into and analyses on the business already. They only require the DD for the purposes of presenting this [DD findings] to a local bank in order to obtain funding for the deal from the bank.'

This denotes that DD practitioners are at times contractually required to conduct their DD efforts in limited and narrowed measures, as this is what is demanded of them by their clients' financiers. However, to the avail of DD, the participant further continued, 'even though the private equity house itself might see it as box-ticking, the DD is still essential to the bank which has to provide the funding'. It is thus clear, in line with Spedding (2009), that DD processes are applicable to varying extents or degrees depending on various circumstances, and the detail, scope and intensity of the process is clearly adapted according to the value and significance of the transaction.

Factors that restrict due diligence processes

Time and cost constraints

The majority of the participants responded in the negative when asked if there are any restrictions to DD prior to it being conducted. In particular, one participant noted that although at times the process of DD is tedious, time-consuming and costly, the majority of their clients understood that failure to conduct proper and thorough DD could result in greater negative consequences. The other participants further asserted that, in their experience, only a minority of their clients are so focused on getting the deal done, and that they cut corners because of these types of perception.

Conversely, another participant noted that the days of long and tedious DD are ending, and only a few of their clients expressed concern about the cost and time constraints. This is contrary to the findings of Spedding (2009) who asserts that it is a widespread practice for DD practitioners to look no further into a prospective M&A beyond the mere basics because of cost and time limitations. Accordingly:

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 DD, traditional or otherwise, takes place. (p. 4)

It would seem that cost of DD (as analysed by Cumming & Zambelli 2016) may not be within the reach of all clientele. However, this is not a reflection of DD itself, but rather the economic factors that play a role in conducting DD.

When the participants were asked if their planned DD processes were curtailed by their client because of the cost implications, 83% 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*]'. One participant who replied that DD is not limited by its cost implications stated that they would typically plan the DD only *after* obtaining a proper understanding of the M&A. The extent of work to be done would typically determine the fee and, therefore, their client would see the value in the DD process. Therefore, cost is seldom a determining factor for them. Based on the theory examined in the literature review, as well as in the opinion of the participants, it is evident that the devoting of time and resources to performing an effective DD should be one that should not be compromised.

Other constraints

Several shortcomings, constraints and limitations were cited by the participants when conducting DD processes, which include information simply not being available (because of confidentiality considerations or other reasons), incomplete or irrelevant information being supplied, the transaction being concluded in a short time period and the undeveloped markets in which many of the target businesses operate (e.g. African markets which are possibly more difficult to fully understand). In addition, the participants noted that the DD process is influenced by the deal negotiations. Accordingly, a reluctant seller may impose constraints on the DD such as a lack of access to key personnel or a lack of cooperation by target management, a short time period and limited access to certain information.

When questioned about whether the participants had experienced any other barriers to DD, some participants identified buyer-seller dynamics as a potential barrier. This occurs when the seller or target company has nothing to gain by giving the buyer time to probe and question into their affairs, whilst the buyer is under pressure to gather and digest much information of the seller in a very short time (Marks & Mirvis 2011; Moeller 2009). One participant

commented that this was combated by maintaining clear and effective communication and by gaining a comprehensive understanding of the client's needs, understanding the macro and micro reasons as to why their client was doing the deal, the expected synergies and so on. Another participant, however, stated that they did not see buyer-seller dynamics as being particularly troublesome in their South African practice. Accordingly, if both the buyer and the seller want the deal to work, they would find a way to compromise on timing of or access to the deal so that both parties *get comfortable in the end*. The participant admitted, however, that while there is an incentive for the seller to try and hide things, this was the reason for an experienced DD team being employed and a broader and more thorough DD scope being espoused to ensure that these *hidden things* are identified.

Each of the participants also agreed that the nature of the M&A influences the DD conducted, in line with the literature observed, which could serve as a barrier to the DD process. The participants added that a deal or a transaction involving companies operating in the same industry would typically have stricter confidentiality arrangements and, therefore, sensitive information (e.g. customer revenue and profitability information) may be withheld. The participants further added that hostile transactions often rely on publicly available information only. This agrees with the findings of Reichardt (2006), who maintains that obtaining high-quality internal information is simplified if an M&A is friendly, but in unfriendly deals, DD processes sometimes never develop further than publicly accessible data. The common theme identified in the participants' responses was in accordance with Weiner's (2010) findings, which affirm that a good DD process 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 DD process can be quite substantial.

Effectiveness of due diligence processes

Changes in due diligence processes

A common theme raised by participants when asked about whether their execution of DD has ever changed within their respective practices was that their processes and DD methodology were continuously being updated and improved to ensure that they delivered on their clients' expectations and, ironically, to keep ahead of their competition. Generally, all the participants found that the DD process has changed in SA over the years and that it is constantly evolving based on what the market requires and what their international counterparts were doing. Overall, the responses of the participants were generally in line with the literature as all participants seemed to recognise that newer areas of DD are developing rapidly. Such areas include risk management, innovation and ethics (including corporate social responsibility) DD (Gleich et al. 2012; Moeller 2009).

Incorporating of non-financial aspects in due diligence processes

The participants were then questioned on whether they incorporated non-financial aspects when conducting DD to

which majority of them responded in the affirmative. This is in line with the findings of Reichardt (2006), who emphasises in this regard the importance of considering aspects of non-financial performance as part of the DD process. This inquiry explored the inherent dangers of not factoring such risks into the overall project and provided some insights on the structuring of DD processes and teams to ensure that the full risk profile of a project can be identified. One participant identified the non-financial aspects of the DD that they include as part of their processes (such as human resources and IT among others) and maintained that these aspects all fall within the ambit of a commercial DD. This is in line with research conducted by Wangerin (2012), who found that DD should include numerous non-financial aspects, including the evaluation of organisational fit, the ability to merge cultures, the technological and human resource capabilities and fit, and a variety of other factors (Epstein 2005; Wangerin 2012).

In contrast, some participants stressed that they generally did not incorporate any non-financial aspects in their DD processes. The participants maintained that it depended on the type of DD (whether financial, legal, cultural, etc.) and the scope requested by the client. Another participant (representing an accounting firm) stated that they focused mainly on financial, taxation and commercial DD and did not usually stray outside their areas of expertise. This is in contrast to the literature reviewed, which states that accountants are generally known to be well-trained business professionals who spend considerable 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). Moreover, this was not in line with the majority of the participants, with another participant stating that they find that DD differs from deal to deal and depends on the level of knowledge of the parties about the industry, the target company, the prospects of the entity being acquired and suchlike.

Merger and acquisition activities

Participants were then asked to rank nine activities of an M&A in order of importance, with one being the most important and nine being the least (see Table 1).

Interestingly, each of the participants ranked 'Identifying the M&A strategy early on' as their most critical activity, followed by 'Skilfully identifying, screening and prioritising targets', which 83% of the participants selected as their second most important activity. There was no other pattern or sequence identifiable in the choice of the remaining activities, and each participant varied in the way they prioritised them. The results in a similar survey on M&A activity performed by a KPMG global survey on a global level showed that DD was the most crucial of the pre-deal activities; however, this differs from the findings of this study. According to the KPMG global survey, companies that prioritised DD improved their chances of a successful deal. The participants in this study, however, ranked DD the fourth most important

TABLE 1: Activities of a mergers and acquisitions to be ranked by participants.

Number	Activities of an M&A (random order)
1	Identifying the M&A strategy early on
2	Arranging finance
3	Skilfully identifying, screening and prioritising targets
4	Synergy evaluation
5	Integration project planning, orchestrating and executing
6	Pricing the deal and negotiation
7	Picking management team and energising the organisation
8	Understanding and resolving cultural issues
9	Conducting due diligence

Source: Accenture/Economist Intelligence Unit Global M&A Survey 2006
M&A, mergers and acquisitions.

out of the possible nine activities in terms of cumulative significance. The KPMG global survey also demonstrated that companies focusing their attention on arranging financial or legal issues to the detriment of other areas were unlikely to have a successful deal. In terms of this study, the participants all thought of arranging finance as the sixth most significant factor, before *integration planning, orchestrating and executing* and the soft DD aspects.

What is also interesting to note is how the participants ranked the 'soft' DD aspects (i.e. 'understanding and resolving cultural issues' and 'picking the management team and energising the organisation'). Of the participants, 83% ranked these soft activities in the 'least important' region. This is contrary to the research conducted by Witzmann and Dörrenbächer (2015), who found that M&A failures are overwhelmingly attributable to culture clash issues that occur when two organisations are merged. In this regard, it is important for South African practitioners to understand how to avoid such a culture clash and what to do post-merger when expected results do not occur. These reflect interesting notes on South African practice of DD versus global standards.

Strategic due diligence

The participants were asked whether their DD efforts ever picked up a potential cause of M&A failure for their clients before it happened. Remarkably, only 50% of the participants confirmed this was the case. One participant stated that only an adequately planned and resourced DD could have prevented failure and that, in their view, DD is a process of evaluating the history of a company to be of a certain nature. Another participant told, only a DD process which has a 'proper mandate' may prevent such a failure or highlight the risks that might ultimately lead to failure. Accordingly, DD should focus on value and valuation issues (including synergy benefits, valuation drivers, etc.) and that a DD that is not properly focused on the aspects of a transaction is unlikely to prevent an unsuccessful transaction. The participants all agreed in this regard, maintaining that DD process can only be successful in its aims if it has sufficient resources and scope – a perception that was confirmed by the literature observed.

One participant asserted that an M&A transaction also often fails as a result of poor implementation *post-deal*. Such failures

may be ascribed to management differences, cultural differences between organisations, poor communication leading to staff morale issues and/or management or staff losses, IT failures, synergy benefits not being realised as envisaged by the original deal and so forth. Another participant 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 DD' on certain effective date balances.'

This reveals that DD cannot be said to be the cause of M&A failure when it is initiated with a restrictive scope. Accordingly, DD cannot detect all M&A catastrophes before they occur, especially when equally important aspects such as inappropriate purchase intentions, lack of strategy, inadequate integration and so on are often neglected. DD efforts should ideally be continued through to the very end of an M&A deal as well as for a period post-deal, as suggested by Price et al. (1998).

The participants were also asked whether they thought their DD efforts were as effective as they could or should be, and what they could do to improve them if they were not. Unsurprisingly, all the participants unanimously agreed that their DD processes were strategic and effective, adding value to their clients, and were continuously being improved. Although the participants unanimously agreed that their DD processes were effective, according to the literature reviewed, effective DD is only achieved when an entity does the appropriate planning, identifying, prioritising, collecting and analysing of the suitable and relevant data. Only then will an efficient and methodical approach be established that can support fundamental purchase decisions (Dodgen 2011). It was unclear whether this was truly the case for the participants. What was evident, however, was that the participants' conclusions disagreed with the research findings of Spedding (2009), who stated that DD practitioners:

never question whether the foundations of traditional DD are sound, but it is a widespread practice [*for them*] to look no further into a prospective M&A beyond the mere basics. (p. 5)

Seemingly, the participants' inferences contradict this comment, as they acknowledged the need of continuously improving their efforts to meet the ever-changing needs of the marketplace.

Conclusion

The objective of this study was to understand the status quo of traditional DD procedures in SA by reviewing DD practitioners' views regarding its objectives, restricting factors and effectiveness. In this regard, the study showed that the DD process has been drastically redefined in practice over time, and will continue to change going forward. Furthermore, it showed that in spite of the centrality of financial, legal, cultural and other focus areas of DD, there are still far too many examples of transactions which have

been completed without effective DD being done, resulting in devastating losses of stockholder value.

Specifically, from a South African viewpoint, the research has shown that there are still a few DD practitioners who only apply limited traditional DD processes despite years of scholarly research that has shown the disastrous effects of using such limited DD by itself. Another key issue identified in local DD processes is the consequence of a DD process that does not have an appropriate scope. The research has shown that these processes cannot achieve their aims and are beyond the South African DD practitioners' control as financiers place severe restrictions on the DD costs and, therefore, the effectiveness of the DD process. This ineffectiveness continues to exist despite research showing that most South African businesses requiring such services understand that failure to carry out proper DD could be damaging to the companies involved (Price et al. 1998; Wangerin 2016). This is a key area of concern that needs to be addressed in the South African arena, and is an area for further investigation.

In addition to the above findings, this study did not consider the other factors for M&A failure in SA, as identified by Wangerin (2012) and Epstein (2005), such as the lack of compelling strategic rationale, unrealistic expectations of possible synergies, overpaying, conflicting corporate cultures and failure to integrate the two companies. Perhaps, to ensure the success of M&As in the future in South African markets, more research needs to be performed on these aspects to determine their status and value in practice, and the role they play in local M&As. Similarly, further research should be conducted on other types of DD processes, besides what this research endeavoured to investigate. The aim of this research was limited to observing traditional DD procedures only. There exist far more DD processes such as cultural, management, taxation, pension, environmental, IT, technical and operational DD, for which further studies are needed in order to determine whether they are indeed successful in their aims and can be better improved in some manner or form. Although mistakes and failures are not a pleasant topic for DD practitioners, opening this black box and providing key insights would significantly inform scholarly research and DD practitioners into making their processes more effective and strategic.

Overall, the findings presented in this study concurred with the literature detailed on the traditional DD process. It is apparent from this that the traditional DD process as it stands lacks extensively in execution, both in SA and globally. The majority of the participants concluded that an effort to project the future of a target company based on its history is not enough, and that an improved DD is required to give insight into the target company. This was concluded as the way forward for DD endeavours in SA, and should ideally be observed by all DD practitioners when conducting DD to ensure a fighting chance for local M&A success.

An obvious question then arises: if there is a logical, disciplined DD process that gauges whether a transaction is

being properly valued – looking at issues such as industry impact, customer reaction and competitor response – why aren't more organisations following this? Essentially a DD process will entail getting to know the target entity's industry, clients, customers, habits and processes, and policies and procedures – its past, present and expected future. Ultimately, this process will result in the key information required to make a fundamental business decision and is enormously responsible for future M&A success.

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Appendix starts on the next page →

Appendix 1

Interview agenda

- What do you think the objectives of due diligence are in terms of mergers and acquisitions (M&A), and do you think due diligence achieves this objective? Please substantiate.
- Do you think your clients consider due diligence as just a confirmation of facts, a mere box-ticking exercise?
- Do you feel that your clients have a pre-conceived notion or stigma attached to due diligence before it is carried out? (Tedious, lengthy, costly, etc.)
- Are due diligence processes often seen as an 'audit' by your clients?
- Do you ever incorporate non-financial aspects in your due diligence engagements?
- Do your clients often restrict or limit the due diligence because of its cost implications?
- In your experience, is the acquiring of quality data impeded if the M&A deal is hostile? That is, does the type of M&A affect the type and/or nature of the due diligence conducted?
- In your experience, when an M&A has failed, was there a possibility that due diligence could have prevented that failure?
- 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
- What do you think are the negative aspects of conducting due diligence?
- Have due diligence processes performed by your firm ever identify potential causes of merger failure? Elaborate.
- 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?
- Are there any shortcomings, constraints or restrictions of the due diligence process in your experience? If any, how do you counterbalance them?
- Do you feel that the typical types of due diligence are sufficient and provide adequate coverage? Typical types include financial, legal and commercial due diligence.
- Do you feel that your due diligence efforts are as effective as they could/should be? If not, what could you do to make them more strategic/effective?