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Regulatory  
realities amid  
M&A momentum



# Introduction

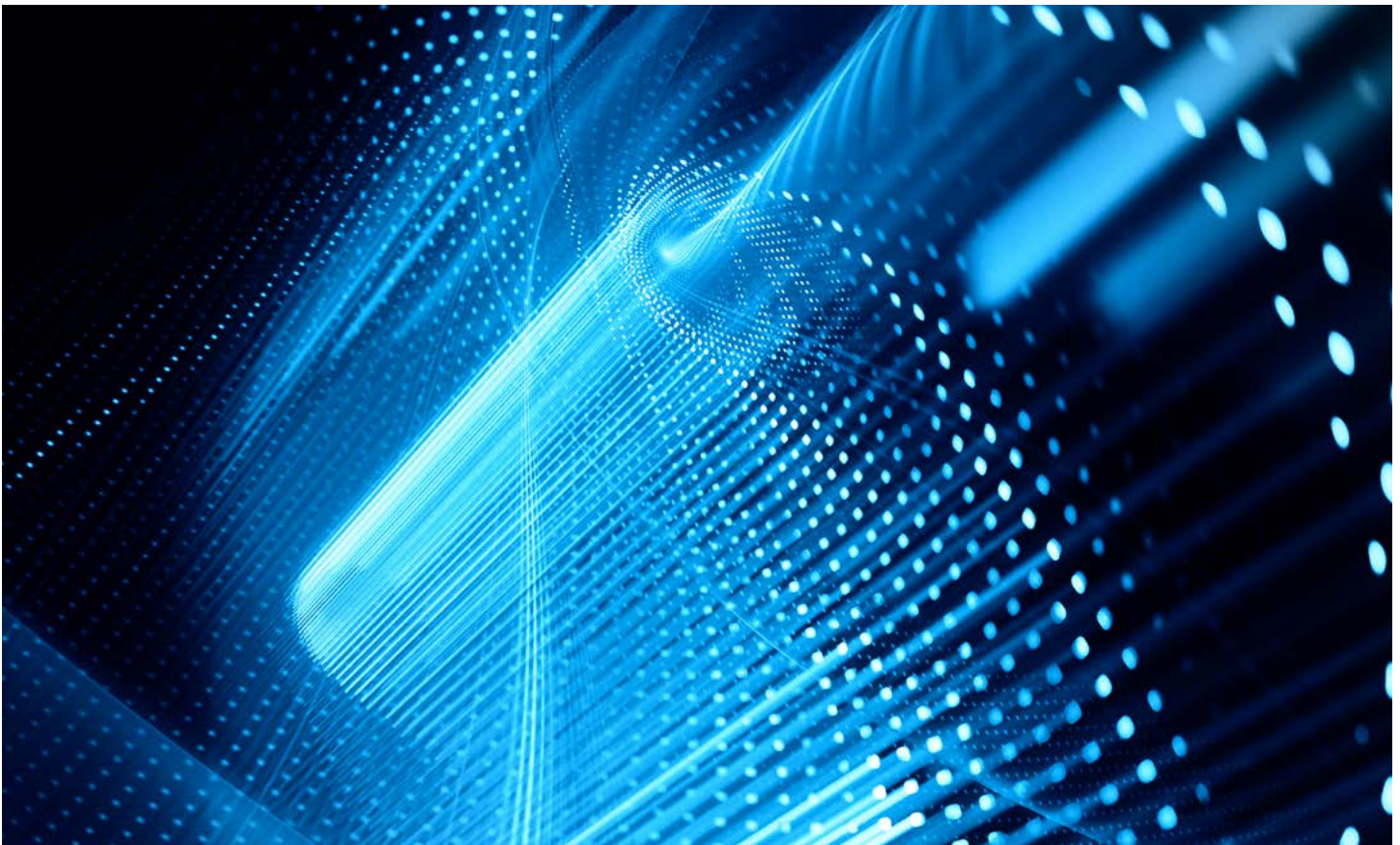
As the positive news of vaccination has started to emerge, resurgent global M&A activity has confounded expectations. Some \$2.1 trillion worth of deals were announced during this rebound in the second half of 2020, the highest ever recorded over a six-month period.<sup>1</sup>

In a period of brisk M&A activity, it is not unusual to experience regulatory obstacles and political pressure aimed at preserving competition and consumer interest. But in current circumstances, after more than a year of pandemic hardships and social justice movements, nationalist rhetoric and debate has intensified amid economic and societal disruption. These forces are prompting a more stringent regulatory agenda and a heightened sense of economic patriotism.

The resulting scrutiny of trade, social, and environmental issues may also affect the ability to effectively complete a deal; as a result, dealmakers may need to take these factors into account and plan their M&A strategy differently than they might have in past cycles.

In this paper, we first provide an overview of momentum in M&A markets and, against that backdrop, describe the unique regulatory risks and political pressures that color the current boom in M&A activity.

The report then explores the path forward for dealmakers and presents five practical guidelines companies can consider to effectively acknowledge and manage the political and regulatory risks that prevail in the markets.



# The rebound in M&A markets

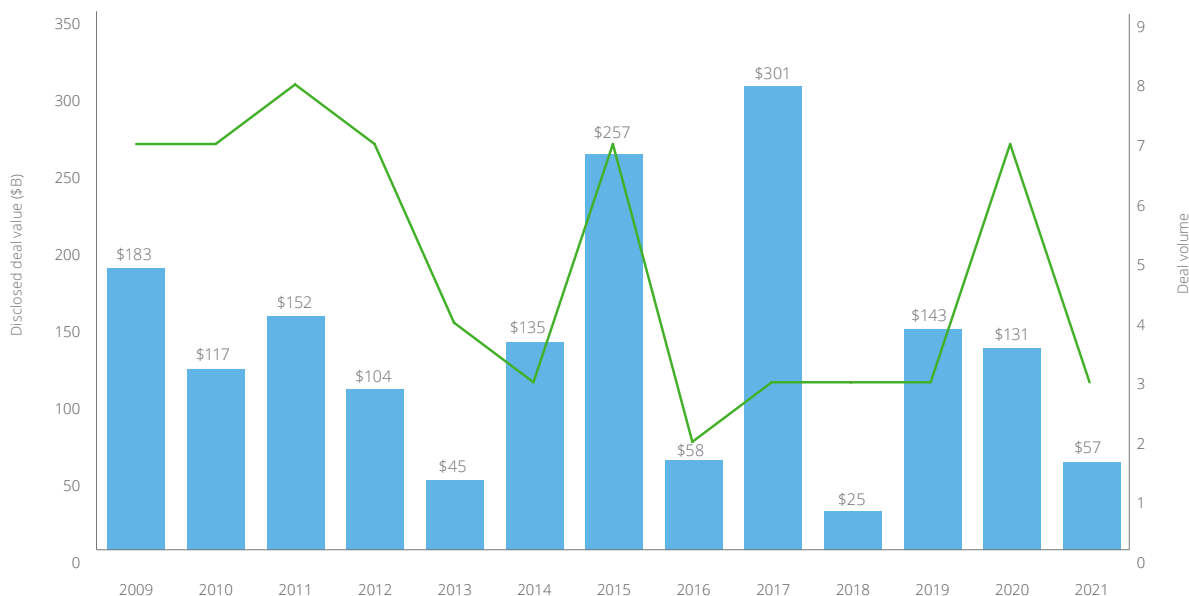
The rebound in M&A markets has been nothing short of dramatic. Nearly \$2.1 trillion in transactions were announced worldwide in the second half of 2020, and this accounted for two-thirds of the \$3.1 trillion in deals announced throughout the year.<sup>2</sup> As vaccines have begun to be distributed and the economic outlook has brightened, this rally is expected to continue throughout 2021.<sup>3</sup>

Many factors have led to this historic rally. Market conditions have remained highly favorable for M&A activity, companies were able to raise significant amounts of debt at historically low rates, and many were sitting on record levels of cash reserves. As a result, many pursued defensive transactions, seeking to safeguard core markets, while others played offense with deals meant to accelerate a transformation. At the same time, private equity investors have remained active in M&A, regularly deploying “dry powder” estimated at \$1.9 trillion globally.<sup>4</sup> Certainly, in the United States, there is the added motivation to complete deals before potential changes to tax law come to prevail.

At the same time, the pandemic has also exposed the frailties of global trade links and continues to deepen public skepticism about global interconnectedness. A survey by the Global Business Alliance of US subsidiaries of large multinationals found that more than three-quarters (77%) of respondents expected that, postpandemic, there may likely be greater protectionism on matters of trade, government procurement, and cross-border M&A.<sup>5</sup>

Megadeals (>\$5B) have normally been closely scrutinized, and between 2009 and 2020, global companies abandoned \$1.6 trillion in megadeals across industries as varied as technology, telecommunications, fintech, pharmaceuticals, and stock exchanges. However, in the past 12 months, around 10 megadeals worth a combined \$188 billion have been withdrawn due to political and regulatory intervention, the highest such 12-month figure since 2011.<sup>6</sup>

**Figure 1. Megadeals (>\$5B) affected due to political and regulatory intervention by announced year**



Source: Deloitte analysis based on data from Thomson One as of September 2, 2021.

# New regulatory and political hurdles

The ongoing pandemic has increased concerns around national self-reliance, food security, and supply chain dependencies, in addition to shifting attitudes toward the impact of climate change, the environment, and sustainable growth.<sup>7</sup> These issues have started to manifest themselves in regulatory concerns around M&A activity, and circumstances that might challenge a deal are becoming more prevalent.

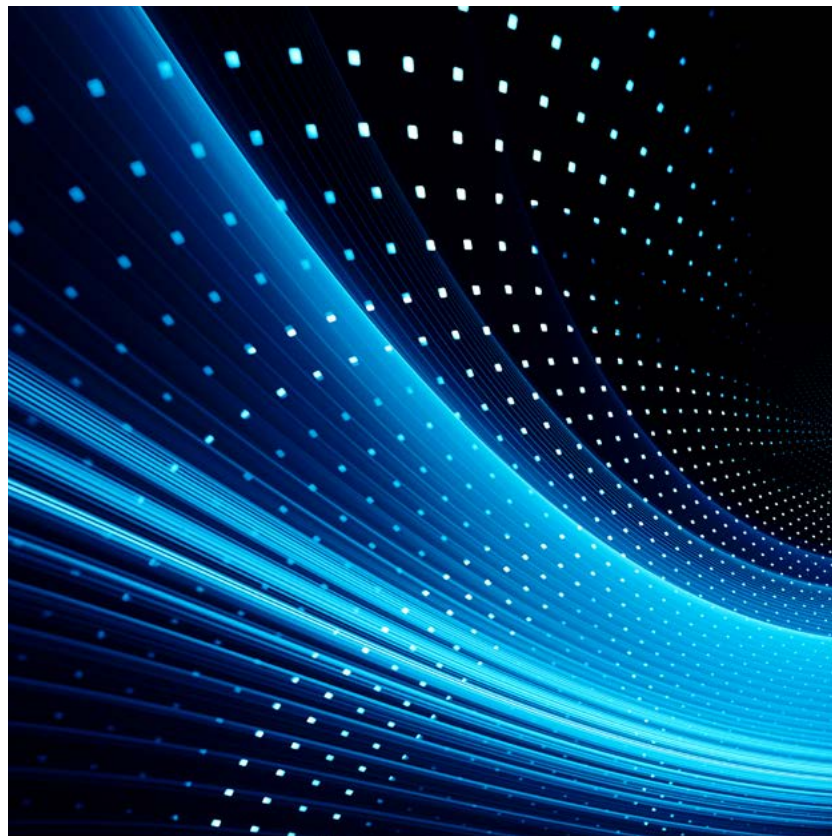
In the United States, the Committee on Foreign Investment in the United States (CFIUS), which is tasked with addressing the national security implications of M&A activity involving US companies, was further empowered last year when the authority of CFIUS was expanded to include a broader range of activities, including joint ventures. Investors should expect greater scrutiny for a variety of investment activities.

In July, the Biden administration issued an executive order to promote competition in the American economy.<sup>8</sup> This executive order covers 72 initiatives across more than a dozen federal agencies and reaches broadly across agricultural markets, banking, health care (prescription drugs, hospitals, and insurance), meat processing, and the tech sector. It also creates a White House Competition Council to “coordinate the federal government’s response to the rising power of large corporations.”

Other countries are also setting higher regulatory hurdles and intervening to question potential deals. In April 2021, the UK government enacted a new law that enhances its ability to review, alter, or block M&A activity on national security grounds. This marks the biggest overhaul of takeover rules in the UK in more than two decades and creates a new agency to implement the regulation. Prospective foreign acquirers will be required to notify UK regulators for proposed transactions in 17 sensitive industries.<sup>9</sup> It is worthwhile to note that China, France, the UK, and the US historically account for a significant amount of global deal activity; in fact, these four countries who tightened their regulatory scrutiny of deals generated 66% of global M&A deal values in the first half of 2021.<sup>10</sup>

In Europe, the French government intervened to reject the takeover of grocery retailer Carrefour by Canada’s Alimentation Couche-Tard, citing food security grounds.<sup>11</sup> In December 2020, Germany blocked on national security grounds the acquisition of IMST, a small satellite and communications technology company, by a subsidiary of the state-controlled China Aerospace and Industry Group.<sup>12</sup>

Securing approval for global deals involve regulators from multiple countries, making it not only a complex undertaking, but, in the current febrile environment, one where geopolitical tensions could come into play. The proposed deal by US chipmaker Nvidia to acquire UK-based chip designer Arm from Japan’s Softbank provides an elaborate example of competing regulatory forces that can overlap.<sup>13</sup> This deal is subject to approval by regulators in the United States, the United Kingdom, Europe, and China.



# The path forward

Companies that expect to pursue M&A activity need to be alert to the implications of potential regulatory intervention, political opposition, and even consumer or activist involvement.

Deloitte suggests the following five guidelines that companies can consider when planning for and mitigating the associated risks.

## 1. Risk and regulatory monitoring and scenario planning

In today's fast-changing global environment, companies need to develop the capability to monitor intelligence signals that point toward shifts in risk and regulatory events as they occur in order to mitigate the impact of a crisis. Recent advances in artificial intelligence and analytics can help companies detect early warning signs, including where regulation is likely to emerge or develop in the future. This can allow senior executives and corporate development groups to maintain a "one-world" view of related risks and regulations that could affect ongoing deals and future M&A strategies.

While standard planning processes tend to focus on addressing likely outcomes, scenario planning aims to weigh future scenarios that are possible (and potentially impactful), better preparing the company to respond to unexpected outcomes. Incorporating horizon-scanning and scenario-planning features into the dealmaking process can help companies identify risk events that may emerge, giving them the runway they need to respond to risks and capitalize on opportunities.

Quite often, leadership may not fully address the possibility that regulatory or political opposition could scuttle a deal, preferring to believe that concessions like a divestiture will allow a deal to proceed. Leaders need to anticipate that, in the current environment, popular opposition to a deal can snowball and lead to surprising political or regulatory obstacles that may not get resolved through typical concessions. Therefore, it is critical for

companies to develop robust contingency planning for all scenarios and eventualities—and advisable to confer with independent board directors to gain insight from their diverse experiences.

## 2. Managing for new digital realities

The pandemic has accelerated the trend of digitalization, and data is becoming a new battleground. This presents new challenges for the intersection of traditional, sector-specific regulatory mandates with those of privacy, security, and competition agencies. In addition, there are significant inconsistencies in data regimes across sectors and jurisdictions, which requires dealmakers to navigate a complex web of regulations when demonstrating the purpose and benefits of a proposed deal.

Regulators are catching up to digital realities and drafting regulations in sync with the fast-evolving digital landscape.<sup>14</sup> Companies need to be alert to such upcoming changes and drive proactive dialogues with regulators so that they remain well informed of specific use cases and burning issues.

Companies also need to plan for the interoperability of data regimes to reduce friction and facilitate the regulated flow of data across borders. They need to demonstrate commitment to data transparency and appropriate cross-border data transfer policies.

## 3. Rethinking your approach to regulations and merger benefits

Since the pandemic, customer loyalty to businesses has been increasingly upended, and customers are more likely to prefer businesses that demonstrate a greater purpose and show how they can address issues ranging from economic inequality to environmental stewardship.<sup>15</sup>

The interplay among social activism, corporate social responsibility, and regulatory activity has rarely been more fluid (or more important), and regulators and

politicians are paying attention. We expect more mergers to be scrutinized not just for their impact on competition and consumers, but also for their benefit to broader society and stakeholder groups.

These trends also play out through the economic underpinnings of deals. Investors expect, and management teams normally build, financial projections and estimate capital outlays as part of their efforts to establish the justification for an acquisition, divestiture, or joint venture. As an example, the UK Takeover Code requires a Quantified Financial Benefits Statement that is verified by an independent party. Now, management will need to scrutinize these benefits more closely to anticipate changes in regulation and to consider benefits beyond strategy and shareholder value. Another business consideration is the concentration of market power within certain sectors. In certain high-visibility industries such as technology, media, health care, and financial services, antitrust regulators are more likely to scrutinize proposed deals that occur in industries where market share or customer data is already concentrated in a few hands or where the transaction will significantly increase concentration.

In order to demonstrate the wider benefit of a deal, corporate and PE buyers alike need to build the economic, social, and environmental gains from a proposed merger into their strategy and synergy case from the onset. They also need to develop a robust communication strategy in order to describe these transparently and exhaustively. Doing so can help dealmakers stay one step ahead of regulatory and political intervention.

#### 4. Managing market expectations

Leaders need to consider the possibility that a failed transaction may leave the company vulnerable from the perspective of shareholders as well. Having explained the benefits of a proposed deal, you may have radically changed the story of your company. Once a company is in play, investors will expect leaders to continue to follow the M&A path outlined, and they will likely be disappointed if the price you get is less favorable or the deal is withdrawn owing to insufficient planning.

Deloitte analysis shows that within one year of withdrawal of a proposed transaction, slightly more than half (51%) of acquirers completed a deal for another company, while 46% of targets were bought by a different buyer.<sup>16</sup> If a company attempts a merger that is stalled or scuttled and is not going to hunt around for a new deal, leadership must quickly and clearly articulate a compelling alternative path forward.

The role of the board is particularly crucial for managing investor expectations. They need to support management by asking big-picture questions about how a proposed transaction (or failure to complete a deal) will be received by markets, regulators, and politicians, as well as by other stakeholders, including consumers, employees, and affected community members. This makes composition of the board important, as having a diverse board can allow for more well-rounded debate on these crucial matters.

#### 5. Consider collaboration using alliances and joint ventures

In periods of market or operational uncertainty, collaborative structures such as alliances and joint ventures can be used effectively as an alternative to M&A or even organic growth.

Companies should consider collaborating with both peers from other industries and innovative startups to shape new market offerings; address economic security concerns, technology constraints, and business model challenges; and mitigate regulatory scrutiny. For instance, Chevron and Toyota recently announced an alliance to commercialize hydrogen as an environmentally friendly transportation option and jointly advocate policy measures that support development of hydrogen infrastructure.<sup>17</sup>

Alliances and joint ventures can be used to demonstrate the viability of the business proposition and leave regulators more comfortable with the arrangement. In order to make alliances work, companies need to build a coalition of support that may span regulators, governments, competitors, and even social or environmental activists.

# Endnotes

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# Contact us

## Larry Hitchcock

Principal  
Deloitte Consulting LLP  
[lhitchcock@deloitte.com](mailto:lhitchcock@deloitte.com)

## Sriram Prakash

Director  
Deloitte UK  
[sprakash@deloitte.co.uk](mailto:sprakash@deloitte.co.uk)





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