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Transaction heroes: How CFOs can position their companies for a possible M&A revival

Any discussion of the current M&A landscape might start with a simple observation: In stark contrast to recent years, very little dealmaking appears to be happening out there.

Following a record performance in 2021, global M&A activity stalled in 2022, which caused deal volume to slump.[1] It hasn't picked up since, a fact that's hardly surprising given that the economic factors that triggered the slump have not gone away. Indeed, any possible resurgence in the M&A market in the near term would have to come despite several drags on dealmaking. Borrowing costs remain well above rates from a few years back. A possible recession looms. Regulatory scrutiny of proposed M&A transactions—especially those involving large tech companies and other data-rich entities—has increased. Moreover, many nonfinancial services companies have been draining their cash reserves of late, mostly on share buybacks or dividend hikes.[2]

However, mergers and acquisitions could remain essential for growth in many industries. Despite the current headwinds, deals in those sectors will likely get done by buyers with plenty of dry powder or access to nondebt financing. And CXOs at some businesses may see silver linings in the current uncertain environment and could pounce on openings created by industry disruptions. The lull in the acquisition action also generally provides companies time to lay the groundwork for future deals.

In Deloitte's ninth annual 2023 M&A Trends Survey, more than 90% of corporate respondents and those representing private equity (PE) firms say they believe that M&A outcomes depend highly on effective transformation planning and execution, likely reflecting their awareness of the challenging environment.[3] The survey drew responses from 1,400 US-based senior corporate and private equity firm executives and found that innovation has a significant role in current and future transactions and transformations.[4]

In this edition of *CFO Insights*, we'll explore how CFOs can adapt to the current M&A environment—and prepare for the shape of the potential M&A market to come. Where could affordable financing come from? What geographies will likely be most appealing—and why? How might deal structure change? And what can companies do to better position themselves for success when dealmaking ramps up?

High interest, low interest

Global M&A value topped $5 trillion in 2021, when buyers with large cash reserves accumulated during the pandemic set a record. Average 2021 transaction sizes across all industries topped $90 million per deal, compared to an average of $73.9 million in the previous three years.[5] In 2022, global M&A deal value descended to its pre-COVID orbit of $3.3 trillion.[6]

The decline continued in the first half of this year, with global M&A deal value landing at $1.3 trillion.[7] North American M&A volume dropped 17.5% compared to the last half of 2022, capping off four straight quarters of declining activity.[8] Ongoing interest-rate increases, persistent inflation, and escalating geopolitical risks are among the top variables contributing to dwindling enthusiasm for doing deals.[9]

Even so, respondents to Deloitte's 2023 M&A Trends Survey appear to see prospects amid the uncertainty. Among respondents' top three offensive M&A tactics, corporate respondents listed "taking advantage of disruptive opportunities to secure future positioning."[10] Pouncing on these unexpected openings could help acquirers get a leg up on their competitors or open up new sources of revenue.

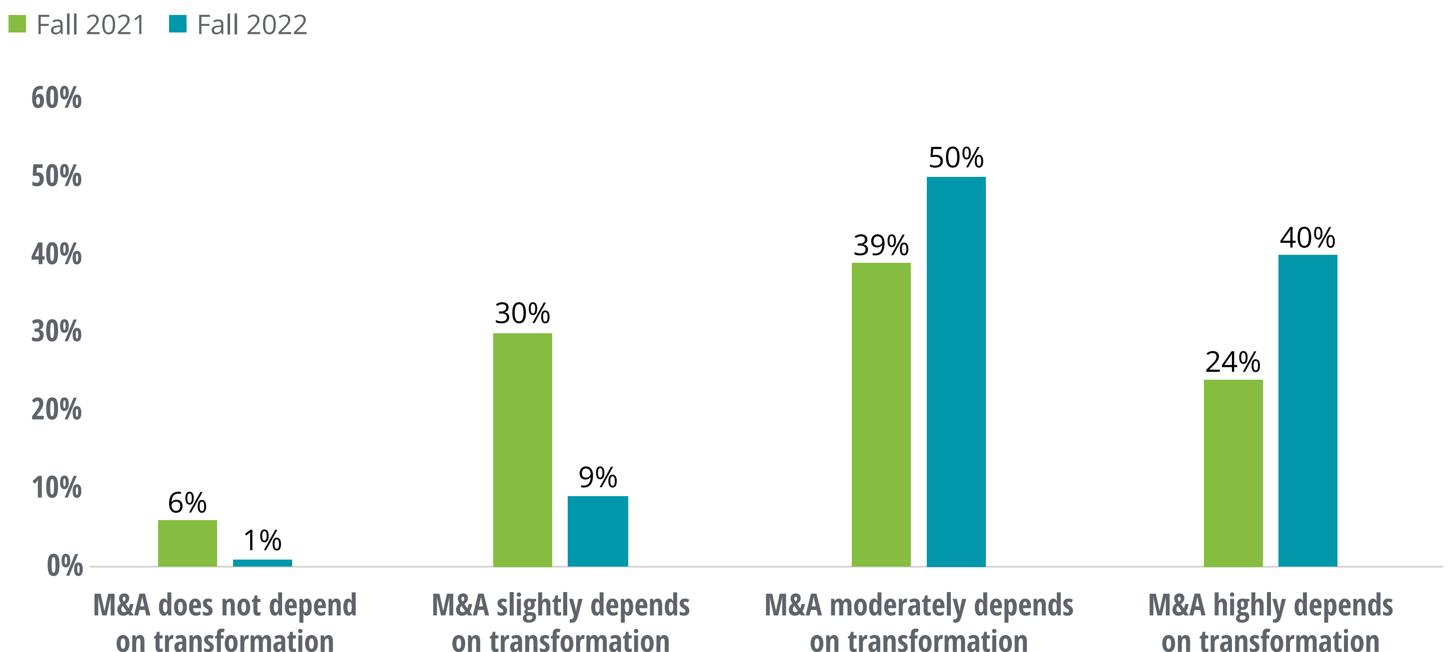
Post-pandemic, however, some CFOs may have focused more on internal transformation than on external dealmaking. In the long run, those internal transformations—adopting data-driven scenario planning or developing lean and agile operations, for example—could improve cash flow and increase the capacity for deals. Such improvements may also help smooth the integration of a target company's operations. Consider this: In the survey, about one-third (32%) of respondents say they are likely to conduct business transformation before dealmaking, a marked increase from the 2020 survey when less than one-quarter of respondents echoed those sentiments.[11] Since the pandemic, respondents across industries indicated that their companies have restructured working capital or reconfigured some core elements of their organizations.

Among PE firms from the same survey, an even higher proportion—almost four out of five surveyed—are pulling transformation activity ahead of transactions (see Figure 1).

Deal breakers

The uncertainty that now hovers over the M&A market is less mysterious than it may sound. CFOs of some buyers and sellers may be cautious, but with good reason. The higher cost of debt, for one, may make the prospect of a deal too rich for some companies and PE firms. Collectively, PE firms tend to have abundant reserves of dry powder. However, they may be waiting for valuations to come down or for more certainty on future interest rates before deploying their funds.

Figure 1. Transformation and transactions: Organizations increasingly recognize the link



Source: "2023 M&A Trends Survey: Navigating Uncertainty," Deloitte Development LLC, 2023.

Below are some macro indicators and market dynamics that dealmakers are likely watching closely to gain greater clarity.

- **Rising interest rates:** The Federal Reserve launched its 18-month-and-counting monetary-tightening policy in March 2022. And the central bank's announced pause in June lasted for just a month.[12] If the Fed hints at a timeline for tapering the inflation-fighting strategy, companies may return to the table.
- **Deepening geopolitical tensions:** The Russia-Ukraine war began in early 2022, disrupting supply chains, among other repercussions (see "Why the Russia-Ukraine war may drive CFOs to reconfigure battered supply chains," *CFO Insights*, July 14, 2022).[13]
- **Tightening credit availability:** Lending has contracted in response to inflation and the prospect of recession. Higher interest rates mean that financing a transaction through debt is costly, thus curtailing activity. And many US banks plan to tighten loan standards, covenants, and tenor through the end of the year, according to the Federal Reserve's quarterly survey of lending activity.[14]
- **Clashing valuation views:** Faced with uncertainty, buyers and sellers appear to have each retreated to their corners, likely waiting for a better view of how these factors might ultimately affect company performance and deal pricing. With the rising cost of capital driving valuations down, some sellers may prefer to wait and see.[15] Even prospective buyers who can hop financing hurdles tend to want more from their targets, particularly better visibility into the resilience of their businesses. Becoming more closely aligned may take time and creative thinking on both sides.

The emerging M&A market

The hyperactive financial markets of yesteryear may not be returning. But CFOs who recognize that can learn from understanding the implications. In short, they must adapt their M&A priorities and strategies to accommodate structural changes in the economy and in their operating environments.

For CFOs, deciding when to seize M&A opportunities isn't simply a matter of prospects presenting themselves. Finance chiefs first should have clear strategies and strong processes to pursue deals that address strategic priorities and plug capability gaps. When M&A activity shows signs of life, CFOs will need the tools to act fast, supported by technology that can help boost dealmaking speed and efficiency (see the accompanying story, "What's the deal with technology in M&A?").

With the appropriate infrastructure, CFOs can think carefully—and creatively—about how their approach to dealmaking may need to change. Finance chiefs may want to consider taking the actions below.[16]

- **Re-examine financing options.** While rising interest rates may stifle bank activity, private credit markets have grown.[17] To continue to increase assets under management, many PE firms have diversified, offering private credit funds. Borrowers may find advantages such as speed and flexibility. Generally, roadshows are not required to secure private funding. In addition, the debtholders could add value as advisers.
- **Rethink cross-border transactions.** Global instability is generally driving buyers to look for safe harbors. In the 2023 M&A Trends Survey, leaders of companies and PE firms revealed a preference for expanding into developed economies and staying close to home.[18]
- **Re-evaluate the need for a divestiture.** The economic slowdown has likely enabled CFOs to take stock of their portfolio of assets. In some cases, they may have identified operations that are either underperforming or noncore—or both. Such units may make good candidates for spin-offs or sales.

These deals may hone strategic focus and raise cash which can then be invested in growth, inorganic or otherwise.[19]

- **Reset regulatory expectations.** With antitrust issues appearing to be a growing concern, large transactions can expect more government scrutiny.[20] This should be a consideration in the due diligence process and in any purchase agreement, meaning the dealmakers should begin considering, early on, how to mitigate the risks of undergoing such intense—and potentially long-lasting—scrutiny.

Point of return

A reinvigorated M&A market will likely result from a combination of factors: an abundance of liquidity in the system, confidence in flattening or decreasing interest rates, pressure from activist investors, or perhaps all of the above. Rising equity markets and falling inflation may be harbingers of a resurgence in deal activity.

A Deloitte analysis of nearly 40 years of historical M&A data found that adverse market conditions are a short-term hindrance, and M&A volumes tend to recover rapidly once uncertainty subsides.[21] Perhaps valuations will drop enough to convince PE firms to deploy some of the estimated $2.49 trillion in dry powder they've piled up on the sidelines.[22]

Eventually, confidence in the financial outlook seems likely to return. The front-runners may well be CFOs who have been acting as if it already has.

What's the deal with technology in M&A?

One common outcome of the pandemic appears to be the accelerated use of technology in M&A across a broad spectrum of businesses. Dealmakers were no exception, according to the results of the Deloitte 2023 M&A Trends Survey.

In fact, the M&A survey found that most global dealmakers expect to double down on using technology to conduct and execute transactions in the next year or so.[23] Their ultimate goal is to seal deals more quickly, efficiently, and—presumably—at a lower cost. Cognitive technologies such as AI could become invaluable in reviewing the many dense and complex documents involved in due diligence. These deep learning tools can review novella-length deal documents more quickly and accurately than manual assessments.[24]

Beyond investing in advanced tools, dealmakers may also need to procure a centralized platform that all parties can access.

Take, for example, the critical process of identifying and prioritizing risks, which can be especially stressful if deal communications live on multiple platforms and use different file formats. Virtual data room applications can make it easier to distill critical findings to all members of the extended deal team. The software can also keep a running, consolidated list of key issues that arise during due diligence, speeding up the process.

Checklists can also be embedded within a data room. This generally removes the need to email spreadsheets back and forth to see which documents have been added to the virtual room. The functionality automatically triggers updates when anyone uploads a file, providing a single source of truth for all users involved in deal negotiations.

Businesses on the block can also take advantage of tools that fully automate outreach to, and tracking of, potential buyers. This can enable a better understanding of buyer or creditor habits and greater visibility into essential business metrics. Another potential plus: it can provide project status reviews in a single place. AI and machine learning capabilities can now automatically categorize thousands of documents in minutes and allocate and index them into appropriate folders. The algorithms can also bulk redact sensitive information and data in seconds to help with regulatory compliance.

Sound futuristic? The world is evolving quickly. Keeping up and adopting the right technology to manage the entire M&A process efficiently and effectively will be critical for companies competing to be first movers in a resurgent M&A market.

End notes

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20. "Biden's Antitrust Team Signals a Big Swing at Corporate Titans," *New York Times*, Oct. 28, 2021.
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