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Deloitte M&A Views podcast:
Regulatory Realities Amid M&A Momentum

Rob: Welcome to Deloitte's M&A Views podcast where we tap into what Deloitte professionals know about making smart, strategic M&A decisions. I'm Rob Dietrich. Today, Regulatory Realities Amid M&A Momentum. I have with me Sriram Prakash, Global lead for M&A Insights, Global M&A Services, Deloitte LLP, and Larry Hitchcock, a principal with Mergers and Acquisitions Consultative Services practice with Deloitte Consulting LLP. Larry and Sriram, I appreciate your being here.

Sriram Prakash: Thank you.

Larry Hitchcock: Thank you.

Rob: You recently published a report that discusses the M&A market we have today and the more stringent regulatory agenda and the heightened scrutiny of trade, social, and environmental issues that we're seeing. So, let me start by asking: Why do we need to talk about regulatory realities right now? Why is there urgency for dealmakers to be thinking about regulatory risks? Larry, do you want to start that one.

Larry Hitchcock: Sure. First off, I'd say, regulation that's in place now is influencing deal activity, so it should be top of mind for anyone who's thinking about deals. Second, there have been some shots across the bow in some specific industries named by specific countries that'll face increasing regulatory scrutiny. So, to the extent you can move quickly and execute a deal before those are in place, it would be advantageous. Thirdly, anybody who's thinking about a deal and who has seen some of the regulations that have passed recently, some of the regulations allow regulators to look back and to question deals after they've been approved. So, you certainly, as a dealmaker, have to ask yourself, "If it's approved (laughs) now, can I be sure that it'll be approved in the future or reviewed?" and that would certainly play into your thinking about deals you're considering.

Rob: And to be clear, we're not just talking about regulatory issues or these issues coming up in the U.S. or even just the U.S. and the U.K. This is regulatory and political issues that are coming up all over the world right now, are they not? Sriram?

Sriram Prakash: Yeah. I mean, just to consider it. The last 12 months, we saw about $4.5 trillion worth of deals globally. That's the highest ever 12-month period in history. So, one can say M&A probably emerged from quarantine faster than most governments did. But what that also means is that the last 18-odd months, most governments, and they're focused on the pandemic response, but that also brought to front a lot of anxieties about globalization and national self-reliance.

And now, all that is coming to fore, which means that as the world enters into a new post-pandemic era, there's going to be a lot more government and regulatory scrutiny on not just the corporate affairs and competition but also on the M&A activities, absolutely. So, we are going to see a lot more scrutiny across all major M&A markets.

Rob: I hear you guys saying that there's been disruption in a lot of different areas and that that's playing out in all of this. Is that right?

Larry Hitchcock: It certainly is, and we're seeing it in these widespread patterns where M&A is under increasing scrutiny. I would also say the thing that I am very mindful of is if you look over long periods of time, there are probably four or five geographic markets where most M&A activity takes place, and it's striking that each of those markets—so, in this case, it's the U.S., U.K., France, China, very prevalent, markets for M&A activity—they've enacted new regulations that pose new challenges for M&A.

Rob: And I think one of the important things is to look in particular at China. There's been a real shift in how they view some aspects of deal making, it seems to me.

Larry Hitchcock: That is true, and it's important because they've historically been a really high volume M&A market, and also, in order to sort of enter and compete in China, it's predominantly a joint-venture model. And so, not only are conventional deals a part of the scrutiny that deals in the future, where it's even in China, but the new regulation that they passed encompasses joint ventures, which calls into question the very way that some non-Chinese companies have entered and expanded in the company and certainly has to have them thinking about how that impacts the joint ventures and alliances that are already operating in China.

Rob: Yeah, and we're talking about not just the kind of regulatory risks that may have been commonplace in the past, the things we're more used to managing. I think there are matters that are coming up that could affect the planned merger that range from regulatory intervention to political opposition to consumer activist involvement. There's a big change that's going on here, right?

Sriram Prakash: Absolutely, Rob. The regulators used to focus primarily on the impact of M&A on consumer pricing powers, the other market dynamics largely related to competition, but it is but inevitable, right? After one year of pandemic hardships, most governments in the world are embracing a lot of their protectionist instincts. There's a lot more economic patriotism going on. At the same time, the backlash against globalization has pretty much intensified the debates around social justice, environmental protection. All these point towards a fundamental change in terms of how deals are going to get scrutinized in the future.

Rob: Okay.

Larry Hitchcock: Just commenting on that to show the contrast, one of the situations that we described in the research is where France rejected a proposed merger on the grounds that it would jeopardize its nation's food supply. If you think about that for a minute, the entire (laughs) global food and beverage industry was built on acquisitions, and there was never a challenge on the grounds that it would jeopardize someone's food supply. But that was certainly not the case with the deal that got rejected in France.

Rob: In the report that the two of you just completed, you chart a path forward for dealmakers, and you present five guidelines to help companies plan for and mitigate these kinds of regulatory and related risks that we've been talking about. And I want for you to touch on each of those briefly. I think several of them are things that companies have become pretty good at managing, so let's start there.

Larry Hitchcock: One would be in terms of managing market expectations, but here's what I would say about that. In conventional terms, I think companies are quite good at that. There's a well-established narrative where deals get described and rationalized on strategic and economic terms no matter the industry, no matter the point in time.

That's a narrative that's well-established, but now that narrative has to change because there's a new set of expectations around and including the political ramifications for the population and a lot of scrutiny on ESG, environmental, sustainability, and governance. And that's historically not been a part of the way dealmakers and company leaders describe and rationalize these transactions.

Sriram Prakash: So, just to build on what Larry said, I think it's really important to recognize that just because a deal is withdrawn doesn't mean that's the end of the story. In the paper, we did some really interesting analysis which shows that within one year of withdrawing a proposed transaction, 51% of the acquirers completed a deal with a different company, and 46% of the targets were, in fact, bought by a different buyer. So, it's absolutely crucial that leaders, CEOs, boards realize that the possibility of any failed transaction leaves the company vulnerable to predators. So, our advice to companies is that you must have a robust Plan B, and more importantly, also develop a robust communication strategy in order to describe these issues transparently and exhaustively.

Rob: This is all interesting, but what are the other guidelines you wanted to touch on that are in that paper for you? Larry?

Larry Hitchcock: Sure. There are five and we'll probably have time to touch on a subset today. One is the user scenario planning early in the deal process. Two would be making sure that you appreciate the really thicket of regulations that are inconsistent that apply when any target you're looking at has digital assets. The third would be looking at the way you express the benefits of a merger and the stakeholder groups that are now looking at these deals to modulate your message to those stakeholder groups. Four is managing marketing expectations about the deal, and the last is turning to alliances and joint ventures as an alternative to outright acquisitions.

Rob: That last one, alliances and joint ventures, there's been some big changes in how that presents itself as a possibility for companies now, hasn't there?

Sriram Prakash: Indeed. So, joint ventures and alliances are not new. But I think that right now, there is an added sense of urgency of how do you use those and how do you optimize that. And particularly in an era of convergence across sectors, company's should consider actively collaborating with both their peers in their industry but also peers from across other industries, as well as innovative start-ups. And building such a coalition of support that then spans across regulators, about government bodies, competitors, as well as the social and environmental activists, that allows a very different proposition on the table rather than just a straightforward alliance or a joint venture.

Rob: So, it's really about managing all of these things with a real eye towards how you might get over some of these hurdles in a very big picture way.

Larry Hitchcock: I think while alliances and joint ventures are familiar ground for dealmakers, they find themselves on shaky ground now, and I'll give you two examples. So, recently, in the U.S., an alliance between two airlines was rejected, which is a real stark contrast to the past where, particularly on domestic routes, the airlines configured themselves using these alliances as a means to have long-haul routes and then regional players. So, now, while that's a familiar ground, that's no longer ground that you can consider firm. And secondly, the Committee on Foreign Investment, CFIUS as it's called, the scope of that committee was recently expanded to include a scrutiny of joint ventures. So, while you may have struck joint ventures in the past, you would have largely done so without a CFIUS review. That will no longer be the case.

Rob: These are big changes. It seems like one of the takeaways here is that there are regulatory and political and societal pressures that can really affect your M&A plans, and as much as a company might be very skilled at managing traditional regulatory matters, there are new twists. Is that a fair summary of where we are today, new issues to consider?

Sriram Prakash: Absolutely. I think that the key message for us, for our clients, is that the so-called interplay between social activism, the company's own CSR responsibilities, as well as the regulatory scrutiny which is further heightened by the sense of economic patriotism, has rarely been more fluid or more important. So, it's absolutely important that companies consider their M&A plans, they revisit their M&A playbook, and adjust for these new normal factors and conditions.

Rob: Larry, do you have anything you want to add before we wrap up today on that same plot?

Larry Hitchcock: I think what might be interesting to think about here is there are specific industries in a lot of these regulations. There's 16 in the U.K. and a number in the U.S. that are being specifically called out for added scrutiny. And then, industries like technology, media, and telecommunications, this may be unfamiliar ground.

So, they may need to dust off that playbook that Sriram mentioned, but they also may need to make sure that who's calling the plays has experience during periods when there was increased regulatory scrutiny or add capability, hire from industries that may not have the direct industry experience but have a lot of experience doing deals under intense regulatory scrutiny.

Rob: That's fascinating, and I think that's a good place for us to stop for the day. Larry and Sriram, thank you very much for being with us.

Larry Hitchcock: Thank you.

Sriram Prakash: Thank you.

Rob: This has been Deloitte M&A Views. We have been talking today with Larry Hitchcock and Sriram Prakash with Deloitte's M&A Consultative Services. I'm Rob Dietrich. Thank you for listening.

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