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# The New Abnormal: COVID-19 Due Diligence


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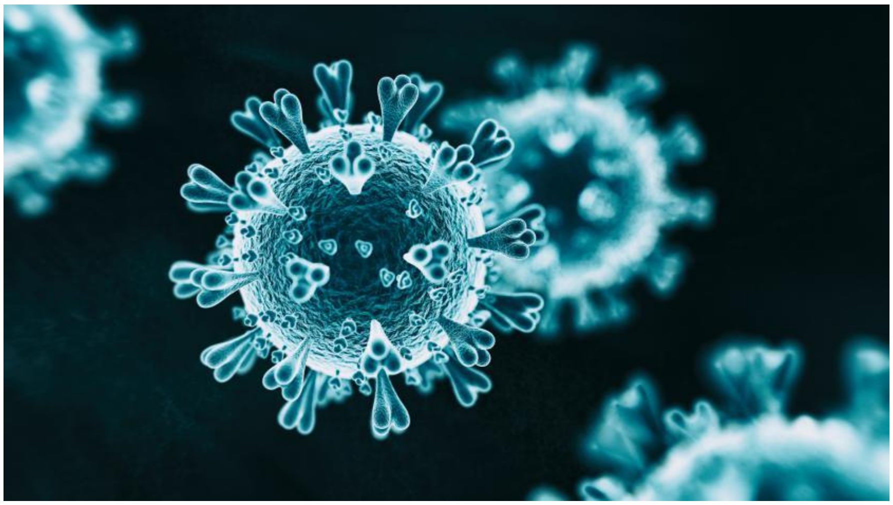

Figure 1: Depiction of coronavirus (COVID-19). Photo credit: southshorehealth.org.

We are in a "new abnormal" heading into a "new normal" driven by the ubiquitous Covid-19 crisis. Businesses will never be the same. Many white-collar workers have gone remote, performing their jobs from seconded living spaces at home. Daily work habits have changed with social distancing, fanatical hand washing, and heightened anxiety in general. And certain industries have collapsed, or are at the brink of collapse, due to the crisis including airlines, cruise travel, hospitality, live entertainment, and restaurants.

In mergers and acquisitions, rarely do we see companies buy dying firms. Exceptions would be purposeful asset buys and opportunistic purchases of severely distressed businesses to be flipped. However, in the COVID-19 environment, there is a heightened risk that both strategic and financial buyers acquire firms that will fail to thrive.

In normal times, during due diligence, buyer's discover market factors (projected demand for products and services), financial factors (quality of earnings), legal factors (open litigations), operational factors (excellence), innovation factors (product pipelines), organizational factors (culture), and a slurry of other traditional data. But we are not in normal times as of the writing of this article.

**Threat and Opportunity**

The Chinese character for "crisis" is actually the combination of two other characters: one for "threat", the other for "opportunity". Figure 2 shows how drastically market capitalizations have dropped in three examples concurrent with the rise of COVID-19 cases. The charts clearly show the threat and the opportunities in our abnormal period.

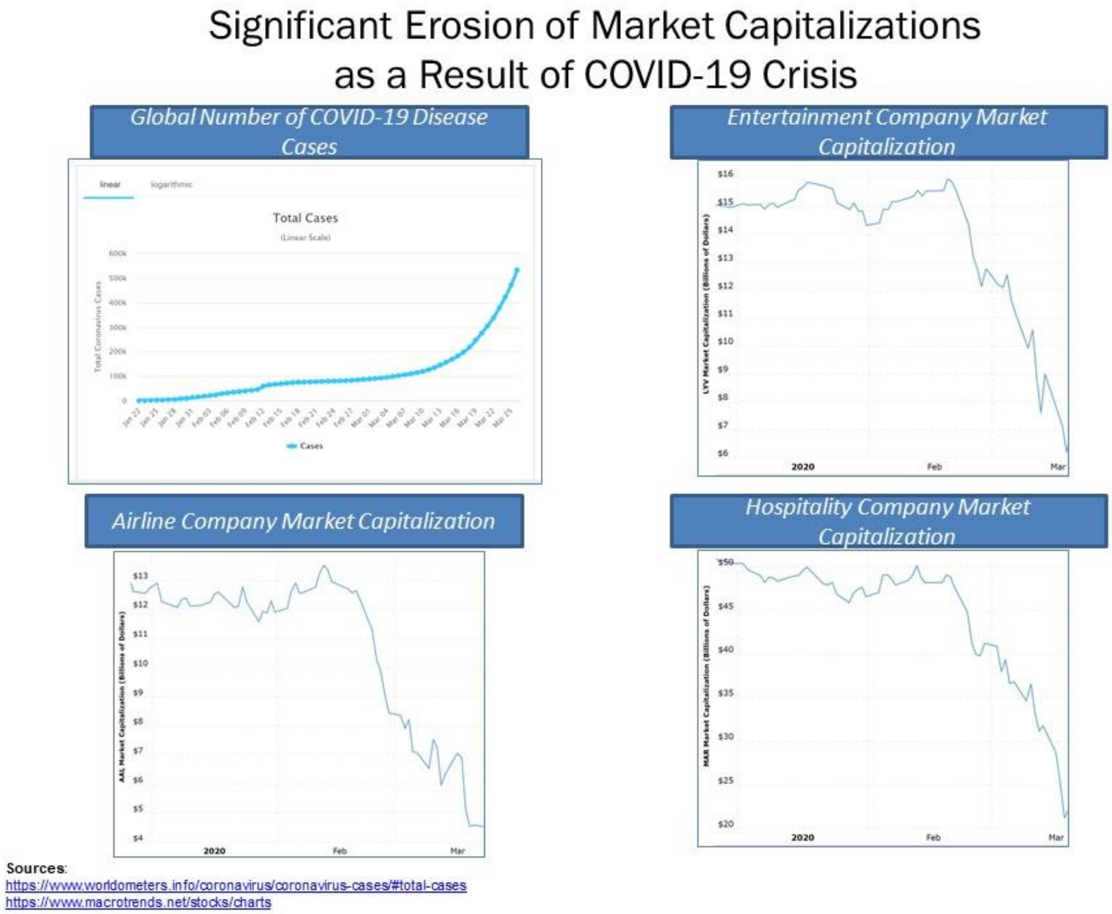


Figure 2: Threat and opportunity

In Q1 2020, total global transaction value was the least it has been at least as far back as 2013. I hypothesize that towards the tailing off of new COVID-19 cases, acquisition deals will re-emerge due to bargain basement market caps. I also project that during an inevitable recession, consolidations will occur across a myriad of industries. How many airlines will survive? Will the major hotel chains buy more brands? What will be the future role of private equity?

**Abnormal Actions**

Abnormal times call for abnormal actions. A savvy buyer will pay as much attention to a target company's response and resilience to the COVID-19 crisis as the buyer does to market, financial, and operational factors during the diligence period of an acquisition.

Why COVID-19 due diligence? COVID-19-specific diligence places focus on the one major business disruptor *all* companies face. No one is safe. Additionally, few, if any, M&A playbooks include COVID-19 in diligence. COVID-19 due diligence fills a gap. Financially, impacts to valuation of the target necessarily should include the cost of pandemic "revenue recovery and re-invention", (a term coined by Chesley Chen, CEO of g.root Biomedical Services in Boston). Post-transaction, the cost of a target's COVID-19 response and recovery will impact the cost, method, and timing of integration.

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**Risk Mitigation**

The risks of not conducting COVID-19 due diligence are similar to those of other diligence tasks: valuation of the target is too high, miscalculation of synergies in customer engagement, competitive position, revenue resilience, and cost elimination, and underestimated cost and duration of acquisition integration.

However, additional risks specific to the COVID-19 crisis include unknown consequences, intended or otherwise, of the target's pandemic response. Will the response be effective? The ultimate risk of not performing COVID-19 diligence is being left with a standalone business, or a combined business, that will fail to thrive in the post-pandemic environment.

**High Level Objectives**

A multitude of possible high-level objectives of COVID-19 due diligence exist. Several objectives, that can be prioritized based on specific deals, are to determine:

- A target's long-term chances to thrive not just survive
- COVID-19 responses and impacts to valuation
- Loss of key employees due to death or turnover (voluntary and involuntary)
- Loss of tribal knowledge and core competences
- Competitive position pre- and post-COVID-19
- Organization climate and employee morale
- Employees' adoption of remote work and enabling technologies
- Impact of work-from-home policies and practices on productivity and on the flip-side, burnout
- Gaps in COVID-19 recovery program
- State of the target's pandemic playbook for future crises, COVID-19 or other diseases

**COVID-19 Questions**

COVID-19 due diligence is accretive to other diligence activities, for example, financial diligence, legal diligence, etc. Some big questions in COVID-19 diligence include:

- "Will combined and integrated COVID-19 efforts drive deeper resilience and improve chances to thrive in the new normal?"
- "How secure are the target's post-COVID-19 revenue streams?"
- "Are the target's pandemic initiatives compatible with the buyer's?"
- "Are there any gaping holes in the target's COVID-19 initiatives?"
- "What extraordinary activities will need to occur on day 1, day 10, day 30, and day 90 of an integration?"

- “What, if any, obligations exist due to government bail-out funding?”
- “What steps will be required to integrate COVID-19 initiatives?”
- “Will COVID-19 initiatives increase or decrease the valuation of the buyer post-transaction?”

These are but a few of the questions buyers could (should?) ask during due diligence in our period of the new abnormal.

**Side Bar**

Interestingly, the objectives and questions in COVID-19 due diligence can be applied in non-M&A situations. Company executives can take these questions, for example, and perform a “COVID-19 audit” on their own firms. Is the company doing enough in response to the pandemic?

**Execution**

In most deals, due diligence must move quickly and must answer smart questions with a high probability of being correct. COVID-19 is an all-encompassing crisis and disruption affecting all aspects of a business. No single person or function will have all the answers. Therefore, I use a collaboration tool for executing COVID-19 due diligence. In many deals, an “agile board” approach is appropriate. Tasks can be picked up by a person, or better yet, a small team of people, for speedy execution. The agile board also serves as a high impact visual readout of the COVID-19 due diligence results.

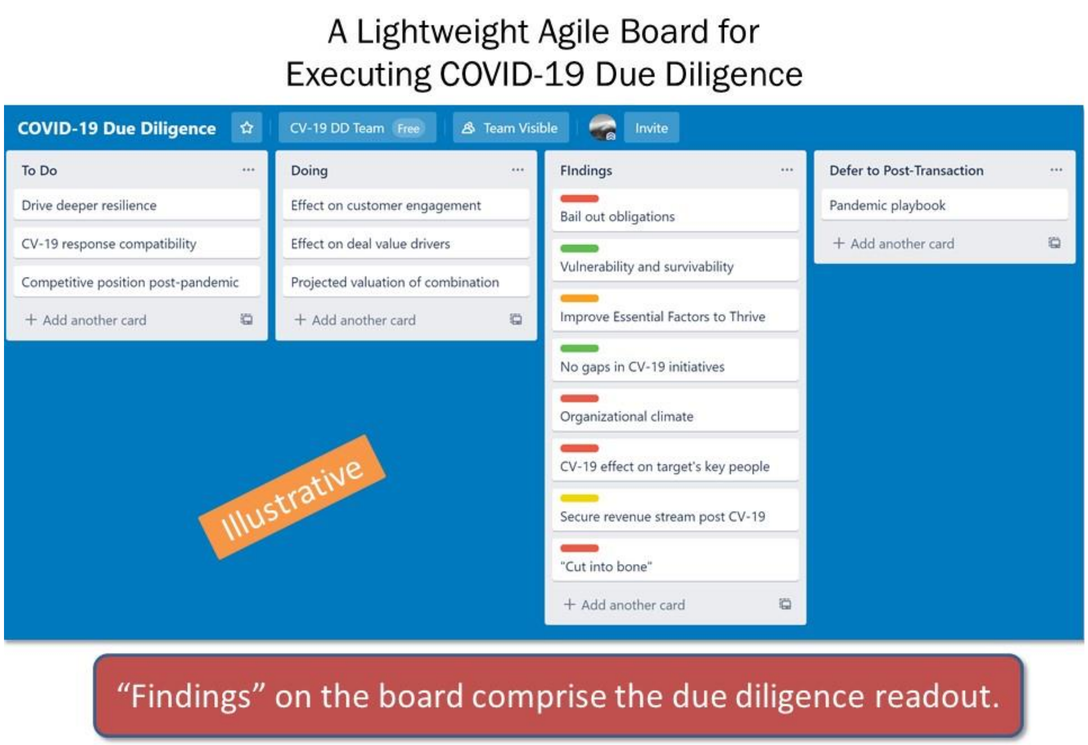


Figure 3: Agile board (Kanban method)

**Just the Beginning**

COVID-19 due diligence is the start of pandemic response integration post-transaction. The next major step is a rationalization of COVID-19 initiatives at both the target and the buyer. What initiatives should be combined? What initiatives should remain separate? Which initiatives should be deferred or halted?

Following rationalization comes execution of the remaining COVID-19 response initiatives. As with any post-transaction integrations, cross-functional, cross-geography, cross-business unit program management is a critical strategic capability. Effective program management will align, coordinate, and ensure timely implementation within cost-of-integration budgets.

As we emerge from the new abnormal into the new normal, all firms, not just acquisitive ones, need pandemic playbooks. In the special case of acquisitive firms, running the course of integrating COVID-19 responses presents an ideal time to develop a playbook for executing acquisitions during a pandemic. In the best-case scenario, this playbook will not be needed. The reality, however, is the possibility of a second wave of COVID-19 hitting the world during the winter of 2020-2021. Acquisitive firms must be prepared.

**Final Words of Advice**

- Incorporate COVID-19 due diligence in your review of an acquisition target.
- Leverage COVID-19 diligence findings in price negotiations (in both friendly and hostile purchases)
- Include COVID-19 initiatives in synergy estimates, price calculations, integration planning, cost-of-integration budgets, and the deliberate execution of forming a combined firm.
- Consider due diligence as only the first step in combining and integrating separate COVID-19 responses of you and the target.
- Execute integrated COVID-19 responses with speed, predictability, visibility, and control with flawless program management.
- Include pandemic due diligence and response in your acquisition playbook, and hope you will never need to use it.
- Conduct a COVID-19 audit on your own firm using the COVID-19 due diligence objectives and questions listed above.