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Done deal? Why many large transactions fail to cross the finish line

Our research shows that many large mergers and acquisitions are abandoned before closing because of value-creation, regulatory, and political issues. Here's how to improve the odds of success.

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Our research shows that in any given year, about 10 percent of all large mergers and acquisitions are canceled—a significant number when you consider that about 450 such deals are announced each year.

The consequences of deal abandonment can be severe, affecting both the reputation and share price of the parties involved. Besides companies incurring the obvious one-off costs like advisory and termination fees, senior managers in these businesses are often perceived as having wasted precious time and resources pursuing a strategic path that turned out to be a dead end.

Clearly, teams don't go into such transactions expecting or wanting them to fail—so what happens? What are the common characteristics of such terminations, and what can companies do to make such abrupt endings less likely to happen?

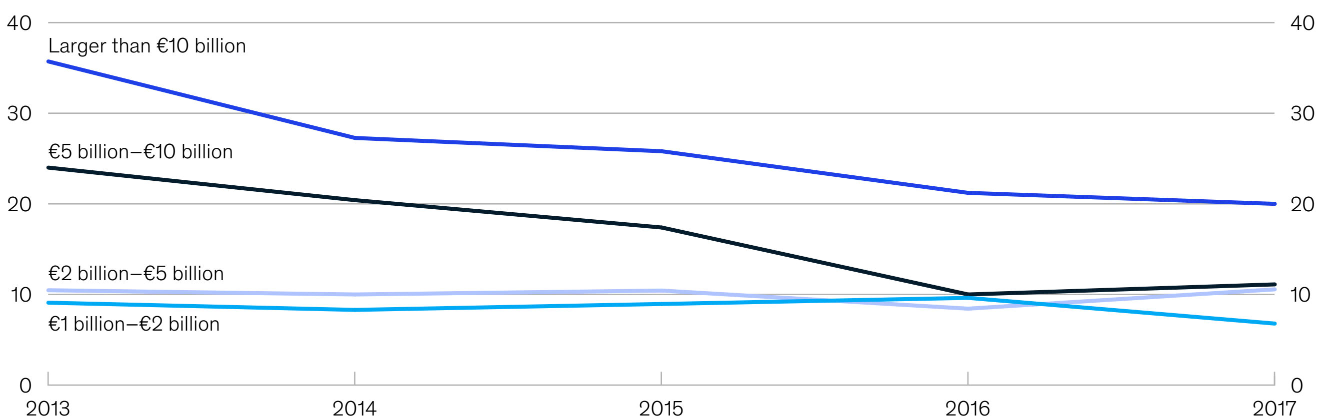
To help answer these questions, we reviewed more than 2,500 deals that were announced between 2013 and 2018 and valued at more than €1 billion, seeking to identify the types of deals that would be less likely to close once announced.[1] From that data set, we found 265 canceled deals of varying sizes, industries, and geographies.

Specific reasons for termination of these 265 deals were varied: there were instances of cold feet—shareholders backing out of what they perceived to be a problematic deal (about 6 percent of the deals)—or interference from activist investors (about 3 percent of the deals). But the obstacles cited most often were mismatched expectations around synergies and value creation (hence, other companies sometimes swooped in with better offers), regulatory concerns (such as too much market concentration), and political issues (such as the introduction of new laws that directly or indirectly affected the businesses involved).

Exhibit 1

The larger the transaction, the more likely it is to fail.

Large M&A deals[1] terminated/canceled, 2013–17,[2] %



[1] Deals larger than €1 billion.
[2] Data for 2018 have been collected but are not reflected here, as reviews are still pending and deals may still be canceled. Data for 2015 onward may also include transactions that are still pending.

Source: Capital IQ; McKinsey analysis

[1] We considered a deal "canceled" or "terminated" if it was announced (for example, after signing or the launch of a takeover offer) but did not reach closing. Our data set include deals in Asia–Pacific, Europe, Latin America, North America, and the Middle East.

In this article, we explore our findings and suggest ways executives can sidestep the three most common obstacles and improve the odds of getting large mergers and acquisitions over the finish line.

Terminations: By the numbers

The larger the transaction, the more likely it is to cancel before close—at least that's what our analysis showed. Deals of €10 billion or more were terminated more than twice as often as deals between €1 billion and €5 billion (Exhibit 1). What's more, the average value of the canceled deals was approximately twice as high as that of completed deals.

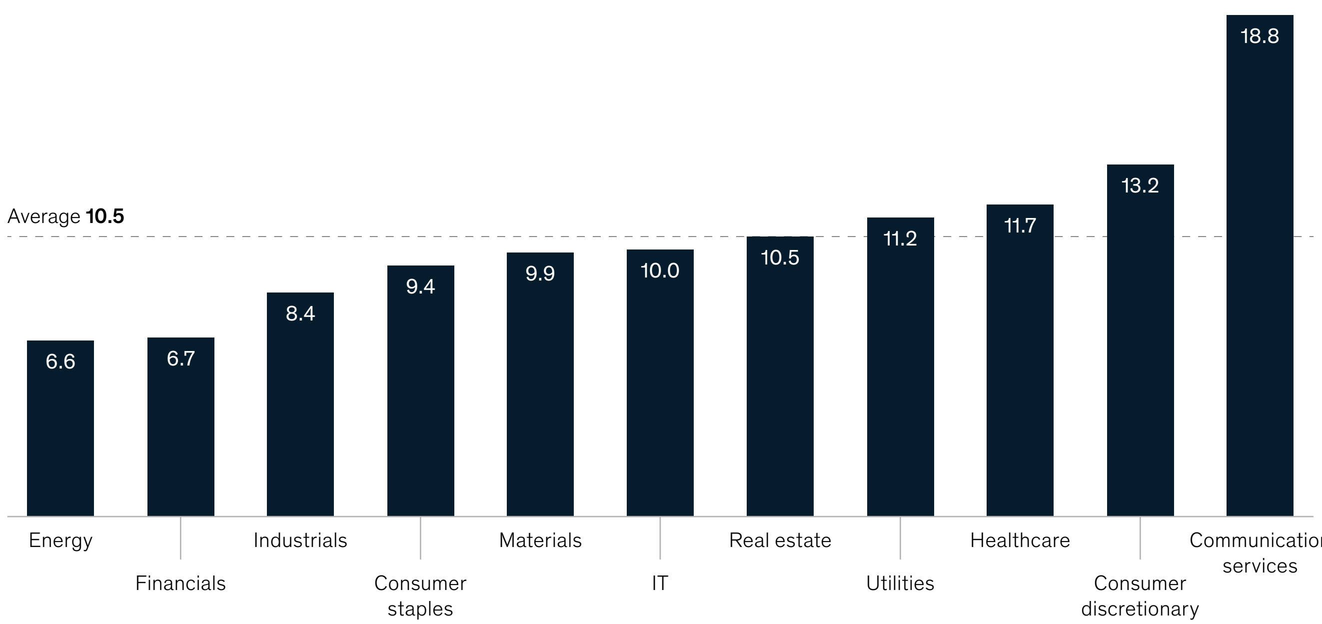
Our analysis also revealed that mixed-offer deals, consisting of both cash and stock, were more likely to get canceled than pure cash or pure stock transactions—specifically, 17 percent of all the deals in our database that offered mixed consideration did not close. (Cash-only deals had the lowest termination rate and stock-only transactions had only a slightly higher termination rate.) Clearly, simpler deal structures win the day as they mitigate shareholders' uncertainties about potential premiums, taxes, and other investment factors.

A closer look at sector-level data showed that the cancellation rate in most industries fluctuated from year to year. The communications-services sector proved to be the only outlier; in each of the five years we studied, more than 15 percent of all deals announced in this sector were canceled. Of course, the communication deals we analyzed were substantially larger than transactions in other industries, often coming in above the €10 billion threshold and often negotiated in a highly regulated sector. They were also twice as likely as deals in the other sectors we studied to face antitrust challenges (Exhibit 2).

Exhibit 2

Communication-services deals are more likely to be canceled than deals in other sectors.

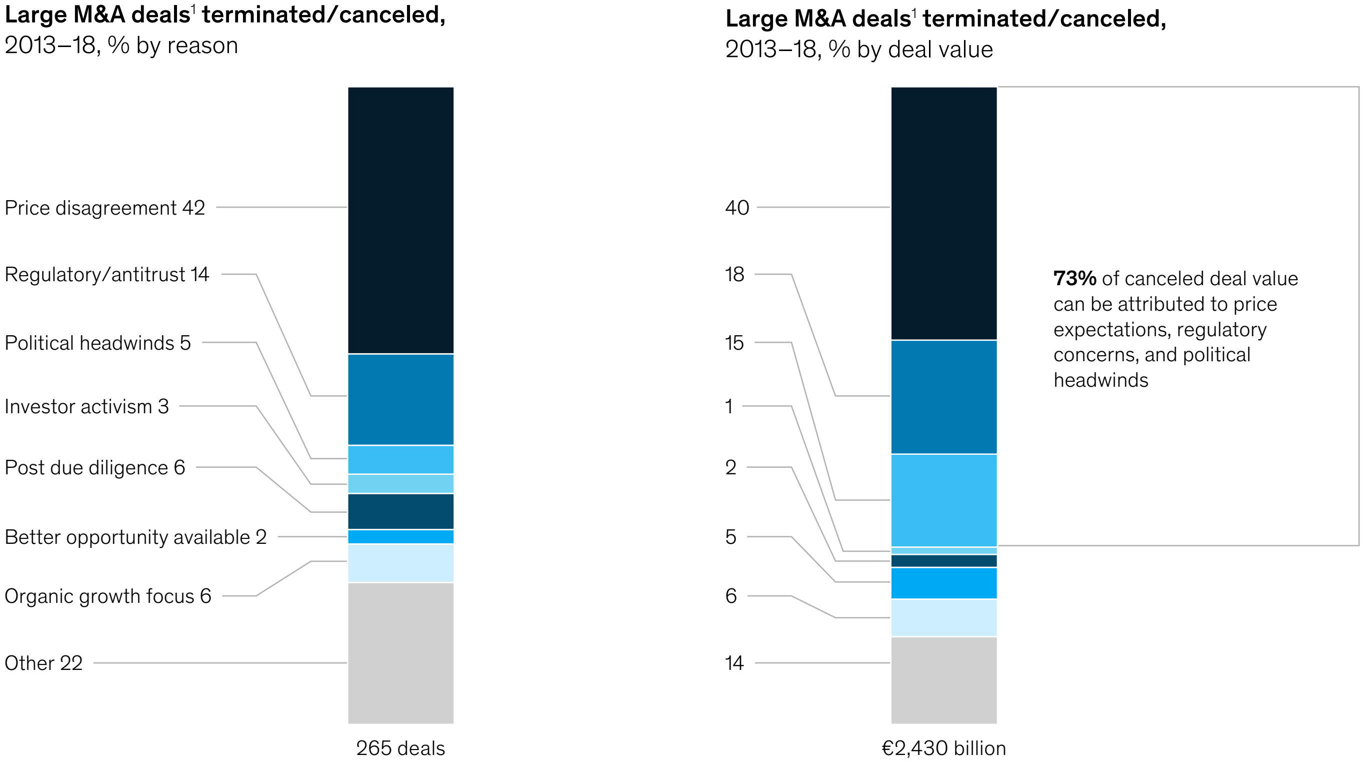
Large M&A deals[1] cancellation rate by sector, 2013–18, %



[1] Deals larger than €1 billion.
Source: Capital IQ; McKinsey analysis

Exhibit 3

Deals are canceled for a range of reasons.



Note: Figures may not sum to 100%, because of rounding.
[1] Deals larger than €1 billion.
Source: Capital IQ; McKinsey analysis

Perhaps most telling, of the deals over €1 billion that were canceled between 2013 and 2018, we found that about 73 percent (by deal value) were abandoned because of companies' disagreements over valuation, regulatory concerns, or political headwinds (Exhibit 3). A good example of the latter is the change in tax rules issued in 2016 by the US Department of Treasury and the US Internal Revenue Service to end so-called tax inversions. The announcement was one of the factors prompting two pharmaceutical giants to abandon their deal even as they were in final negotiations; they had intended to combine their businesses and move corporate headquarters to Ireland to effectively lower their tax rate—a move that would have put them in the crosshairs of this rule change.

Getting deals over the finish line

The fact that these three forces played a big part in quashing deals is perhaps not so surprising, and the truth is that executives can control only so many of the variables we've identified as being associated with abandonment of large mergers and acquisitions. There's no way they can pursue deals *only* under the €10 billion threshold, for instance, and political headwinds aren't always driven by business interests, nor are they always driven by numbers.

But our data on the most common pitfalls are instructive; they can help executives plan and pursue transactions more systematically, with three core principles in mind: be more transparent in deal communications, anticipate trade-offs coming out of regulators' concerns, and actively monitor the political landscape. Our data and work with companies pursuing large deals suggest that too many executives neglect even these basics.

Be transparent. The misunderstandings and miscommunications that can sink the completion of large transactions most often appear just before or during the due diligence stage, when buyers and sellers are still setting price expectations and everyone else in the market is watching intently to see how it will all shake out. Transparent and frequent cross-company dialogue is the only way to get all parties aligned and all motivations accounted for. And, as our data suggest, whenever possible, simpler structures for transactions should be favored over more complex ones—either all cash, or all shares.

Transparency was critical to the success of a takeover offer made in 2015 by a large European oil-and-gas company to acquire another large industry peer. Its offer, at a premium of about 50 percent, was considered high given turbulent times in the industry. The offer was attractive to the target company, but leaders in the acquiring company understood that their own shareholders could have perceived it differently and could have disagreed with the transaction. They took care to share with both sets of stakeholders detailed calculations of the potential synergies among the two organizations and the strategic rationale for the move. They offered real-time updates on the closing process, which took ten months from the time of announcement. During that period, the company frequently published on its website updates on all major antitrust clearances and shareholder approvals—about 15 media releases between announcement and close. Because every step of the process had been handled straightforwardly, and was clearly explained and presented, the offer was quickly approved by important shareholders of both companies, with acceptance rates of well over 80 percent.

Anticipate trade-offs coming out of regulatory concerns. Transactions involving companies that have substantial market shares and that own important industry-standard-setting licenses, permits, processes, and technologies will inevitably attract close attention from regulatory agencies. Indeed, according to our research about one-third of deals announced between 2015 and 2017, and valued at greater than €10 billion, ended up being challenged by the European Commission, or cleared with conditions.

Companies, of course, have legal teams and lobbyists at the ready when pursuing large deals, and most do their homework ahead of time,

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analyzing market scenarios and looking at how regulators have treated similar industry deals in the past. What's often missing from deal discussions, however, is an explicit consideration of trade-offs that might need to be made given regulators' suggested remedies and interventions. A drug company identified opportunities it could seize only if it started the integration process sooner rather than later, so it agreed to divest according to regulators' requests rather than negotiate with the regulator for an additional six to 12 months and the opportunity to divest fewer assets. How was it able to anticipate this trade-off? By engaging marketing, sales, and other functional leaders in due diligence processes, alongside representatives from legal and finance. In the trade-off between speed and cost, speed won out.

Actively monitor the political landscape. Big deals often involve blue-chip companies that are firmly plugged into local and national economies. Think of a company like Amazon or General Motors that is a central source of employment in a large city, for example, or that leads the industry in terms of technology innovation and market share. Governments may use their powers to block transactions involving such companies for any number of reasons—among them, national security issues (particularly in sensitive industries such as defense) and financial concerns (for instance, keeping a large employer in a structurally weak region).

For these reasons, it pays for acquirers to undertake a formal "market intelligence scan" early in the life cycle of the deal to get a sense of key issues relating to jobs, taxes, and investment trends in relevant regions or countries. This process should be jointly managed by the M&A organization and external-communications and investor-relations professionals in the company. In a Chinese manufacturer's takeover of a German company, for instance, the bidder stated publicly that no plant closures or layoffs would occur within five years of closing. The company made this explicit statement because it wanted to proactively address the concern that it was raiding the target for technology. By committing to long-term job preservation and keeping production and headquarters in Germany, it was able to steer clear of political intervention and complete the deal.

Obviously, the faster that deals get approved, the faster companies can move into the integration process, and the more likely it is that they will meet their acquisition objectives (greater production efficiencies, cost reductions, and so on). But, as our data suggest, unless executives tackle pricing, regulatory, and political challenges with greater forethought and confidence, abandonment will be the more likely outcome.

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