DUE DILIGENCE: THE STRATEGIC FOUNDATION OF SUCCESSFUL MERGERS AND ACQUISITIONS (M&A) AND ITS CHALLENGES

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ABSTRACT

Due diligence serves as the indispensable cornerstone of any successful merger and acquisition (M&A) transaction, functioning not merely as a risk-mitigation exercise, but as an active value-creation mechanism. In high-stakes corporate restructurings, the strategic pursuit of synergies, market expansion, and technical capability often obscures deep-seated transactional hazards. A rigorous due diligence process systematically verifies a target entity's financial, legal, operational, technological, and cultural health before closing, safeguarding acquirers against unforeseen obligations, post-merger integration friction, and severe financial losses.

A multi-disciplinary diligence investigation scrutinizes multiple core workstreams, ranging from the quality of historical earnings and debt obligations to intellectual property integrity, cybersecurity resilience, and key-person retention. In the Indian corporate ecosystem, legal and regulatory diligence requires strict adherence to a web of primary statutory frameworks. These include court-sanctioned schemes and director duties under the Companies Act, 2013;[1] promoter disqualifications under Section 29A and debtor protections under Section 32A of the Insolvency and Bankruptcy Code, 2016;[2] market-integrity safeguards such as insider trading controls (Regulation 3, SEBI PIT Regulations)[3] and mandatory open offers under SEBI takeover code;[4] cross-border foreign direct investment (FDI) guidelines governed by FEMA;[5]and merger control thresholds evaluated by the Competition Commission of India (CCI).[6]

Despite its necessity, deal teams frequently navigate formidable procedural

[1] The Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India).

[2]2The Insolvency and Bankruptcy Code, 2016, §§ 29A, 32A, No. 31, Acts of Parliament, 2016 (India).

[33] Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015, reg. 3, Gazette of India, pt. III sec. 4 (Jan. 15, 2015).

[44]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Gazette of India, pt. III sec. 4 (Sept. 23, 2011).

[5] Foreign Exchange Management Act, 1999, No. 42, Acts of Parliament, 1999 (India).

[66]Competition Act, 2002, §§ 5, 6, No. 12, Acts of Parliament, 2003 (India).

hurdles. These include severe time constraints, selective disclosures by targets, cross-border regulatory divergence, fragmented inter-team communication, and inadequate collaborative infrastructure like Virtual Data Rooms (VDRs). Failing to address these challenges can lead to profound corporate miscalculations.

The practical significance of thorough due diligence is underscored by landmark corporate case studies. Verizon's 2017 acquisition of Yahoo demonstrates diligence as a deal-saver: uncovering major undisclosed cybersecurity breaches enabled Verizon to renegotiate a $350 million price reduction and mandate shared litigation liability.[7] Conversely, Hewlett-Packard's (HP) 2011 acquisition of Autonomy illustrates the catastrophic fallout of inadequate forensic scrutiny, where the failure to detect aggressive revenue mischaracterizations resulted in an $8.8 billion write-down and prolonged litigation.[8]

Ultimately, an exhaustive, cross-functional due diligence exercise bridges information asymmetry between transaction parties. By equipping decision-makers with verifiable operational and financial data, it empowers buyers to negotiate tailored representations, warranties, and specific indemnities, ensuring that the target's negotiated price reflects its true enterprise value and setting the stage for sustainable post-merger integration.

In this project, the researcher will take a holistic approach to have an in-depth study of the given topic.

Keywords: Due diligence, Mergers and Acquisitions (M&A), Corporate laws.

INTRODUCTION

In the high-stakes world of mergers and acquisitions (M&A) due diligence is essential to a transaction. Examining and confirming a target company's legal, financial and strategic concerns before closing a sale is a challenging procedure. The risks of due diligence cannot be overstated, even though expansion, synergy and competitive advantage often drive M&A activity.

A tempting purchase could become a mistake if a red flag is overlooked during due diligence. That mistake could lead to hidden obligations, monetary losses and integration difficulties after

[7] Cynthia J. Larose, *Data Breaches Will Cost Yahoo and Verizon Long After Sale*, Mintz: Viewpoints (Feb. 27, 2017), https://www.mintz.com/insights-center/viewpoints/2017-02-27-data-breaches-will-cost-yahoo-and-verizon-long-after-sale.

[8] *ACL Netherlands B.V. v. Lynch* [2022] EWHC (Ch) 1178 (Eng.).

the merger. However thorough due diligence may open a path to success reveal unexplored opportunities and strengthen bargaining positions.

This blog explores the role that due diligence plays in a successful or failed transaction. It highlights factors to consider common issues that arise and recommended practices that could help companies navigate this challenging but essential process. No matter how experience you have in the M&A sector understanding due diligence is essential, for making informed and safe decisions.

I. How important is due diligence for mergers and acquisitions?

In the context of mergers and acquisitions (M&A), due diligence is the extensive investigation of various aspects of a target company that can enable the buyer (and sometimes seller) to understand the risks, determine value, and receive all relevant information.[9]

Typically, due diligence covers a number of areas:

- **Financial Due Diligence** is verification of the accuracy and consistency of cash flows, debts, tax liabilities, and financial statements.[10]
- **Legal Due Diligence**- Legal due diligence includes things such as checking contracts, intellectual property, legal disputes, and regulatory compliance.[11]
- **Operational Due Diligence-** evaluation of operational performance, internal processes, and superior networks.
- **Commercial Due Diligence:** Understanding of the market position, customers, competitors, and opportunities for growth is known as commercial due diligence.
- **HR and Cultural Due Diligence**- HR and cultural due diligence includes such things as evaluating employee agreements, organizational structure, and cultural fit.

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[9] 1 James C. Freund, *Anatomy of a Merger: Strategies and Techniques for Negotiating Corporate Acquisitions* 229–35 (1975).

[10] Tim Koller et al., McKinsey & Company, *Valuation: Measuring and Managing the Value of Companies* 541–55 (7th ed. 2020).

[11] Companies Act, 2013, § 166(3), No. 18, Acts of Parliament, 2013 (India) *(mandating that a director exercise due and reasonable care, skill, and diligence)*.

II. Why is due diligence important in mergers and acquisitions?

- **Helps discover risks and liabilities**- These include unresolved legal matters, poorly performing assets, and high debt levels that may affect the value and performance of the deal.[12]

- **Helps maintain an accurate appraisal**- By reviewing financials and projections to ensure that the deal's purchase price reflects the target's value, due diligence helps prevent overpayment or underpayment.

- **Helps verify strategic fit**- Due diligence helps confirm that the acquisition is consistent with the buyer's strategic goals, such as obtaining cutting-edge technology, entering new markets, or realizing synergies.

- **Helps provide for smooth post-** acquisition integration-By identifying issues that could derail the merge or acquisition, due diligence makes it possible to address and resolve them before the deal closes.

Overall, due diligence serves as a guide and a safeguard, helping buyers avoid expensive pitfalls and spot opportunities to maximize value. Due diligence is, therefore, an essential component of any merger and acquisition (M&A).[13]

III. KEY AREAS TO FOCUS ON DURING DUE DILIGENCE

Due diligence is an important step in any merger and acquisition (M&A). It requires a comprehensive analysis of the target to highlight any risks and problems that may arise during the deal.

The following are some of the key areas that should be reviewed during due diligence:

A. Financial due diligence

- **Revenue and profits** - By analyzing revenue and profits, one will be in a position to

[12] Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015, Reg. 3(3)–3(4) *(governing diligence access for assessing transaction viability)*.
[13] Companies Act, 2013, § 166(3) (India) *(statutory obligation on directors to exercise due and reasonable care, skill, and diligence in corporate decisions)*.

make accurate forecasts and understand the organization's performance. One should scrutinize the numbers closely and question each assumption. Activities such as evaluating cash flow, working capital, and other financial ratios are critical in this area.

- **Valuation -** By determining the fair market value of the target using valuation models, one will be able to come up with a reasonable purchase price. In this step, one should carry out a financial audit and analyze the company's market position and competitive advantage.

B. Legal due diligence[14]

- **Contracts -** By thoroughly reviewing all the relevant agreements, including employment contracts, supply agreements, and customer contracts, one will be in a position to identify any legal obligations and risks. One should also go through all the legal proceedings to understand the liabilities that the target may be involved in.

- **Copyright and trademarks** - By evaluating the target's copyright and trademarks, one will be able to determine whether there are legal issues and weaknesses in the target's intellectual property.

C. Operational due diligence

- **Processes** - By carrying out a review of the target's processes, one will be in a position to identify weaknesses, opportunities for improvement, and threats to the target's operations. Activities such as analyzing the supply chains and carrying out a cost analysis are essential in this area.

- **Management and people** - By analyzing the target's management and people, one will be in a position to evaluate their skills, integrity, and suitability. In this step, one should also determine whether the target's management and staff can contribute to future strategic goals.

[14] Companies Act, 2013, § 166(3), No. 18, Acts of Parliament, 2013 (India) *(duty to exercise reasonable care, skill, and due diligence)*.

D. Technology due diligence

- **Infrastructure** - By evaluating the technical infrastructure, one will be in a position to determine the target's strengths and weaknesses and come up with ways of maximizing opportunities and minimizing threats. Activities such as examining networks and systems and carrying out a security audit are essential in this area.

- **Security and data privacy** - By reviewing the target's security and data privacy policies, one will be in a position to identify any vulnerabilities and threats. Activities such as carrying out a risk assessment and examining the data protection and regulatory compliance are essential in this area.

E. Culture and values due diligence

- Although it may be difficult to quantify, a firm's culture and values play a significant role in determining its performance and success and should, therefore, be taken into account during due diligence. The following are some of the activities that should be carried out to assess a company's culture and values:

  i. Looking through internal documents to gain an insight into the company's culture and values.

  ii. Reviewing communications, including emails and exit interviews, to understand how employees feel about the company.

  iii. Carrying out customer surveys to obtain customer feedback.

  iv. Conducting supplier and vendor interviews to understand how outsiders perceive the company.

  v. Talking to the owner, chief executive, and other members of the leadership to get a clear picture of the company's culture and values.

Note - By focusing on the five key areas, companies can carry out comprehensive due diligence and deal-scouting to uncover risks and opportunities and make the right M&A decisions.

IV. COMMON DIFFICULTIES IN PERFORMING DUE DILIGENCE

Although it is an essential step in M&A, due diligence comes with a number of challenges.

Some of the common difficulties in performing due diligence include:

A. **Limited time -** Due diligence may be limited by time constraints, especially since there are usually tight deadlines in mergers and acquisitions (M&A). In addition, due to the dynamic nature of most businesses, it may not be possible to stay on top of developments and gather the latest information about the target.

B. **Informational challenges -** Due diligence may encounter informational challenges, especially if the target is not forthcoming with the required information. Some targets may also fail to disclose certain liabilities, obligations, and commitments, which may turn out to be detrimental to the buyer.

C. **Cross-border complexities -** Due diligence may involve navigating regulatory and legal frameworks in different countries, especially in international M&A deals. Other difficulties include language barriers, cultural differences, and challenges with currency conversions.

D. **Not knowing what to ask -** It is essential to start preparing for due diligence long before the process begins so that one has ample time to come up with the right questions to ask. By asking the appropriate questions, one will be in a position to carry out a thorough investigation and make the right M&A decisions. What we mean by "right questions" is questioning the key areas that have been identified.

E. **Lack of the right technology -** Due diligence teams have become so reliant on spreadsheets and emails to carry out their duties, which has compromised the quality of the due diligence process. The only way to address this problem is to slow down the due diligence process and adopt more sophisticated technology to make the process safer and more efficient. By eliminating the time-consuming back-and-forth emails that are usually involved in due diligence, companies can overcome a lot of the challenges that are associated with due diligence. In addition, these technologies can help the due diligence team to avoid the difficulties that are mentioned above.

F. **Communication barriers -** During due diligence, the various functions, including operations, financial, and legal due diligence, may work independently without sharing their findings openly and transparently. Although this observation may be an exaggeration, it illustrates the communication challenges that are usually associated with due diligence. Apart from the communication barriers between the various due diligence functions, there is also the challenge of communicating with the other party to the transaction. How can one effectively communicate with the other party to the M&A deal and ensure that everyone is on the same page? How can the team carry out effective communication with other stakeholders, such as vendors and customers?

   To address the communication challenges and ensure that everyone has access to the latest information regarding the M&A deal, it is advisable to encourage all the stakeholders to collaborate in a virtual deal room.

G. **Lack of expertise -** Some of the key challenges associated with due diligence include the lack of the right expertise and knowledge to carry out the due diligence process effectively. For instance, an average accountant may not have the expertise to carry out a comprehensive financial due diligence to support a merger or acquisition. Obviously, the CFO will be in a better position to carry out financial due diligence, but it is important to understand one's limitations since failing to fully comprehend any of the aspects of due diligence can be extremely detrimental to the M&A process.

H. **Legal hurdles -** Sometimes, due diligence may uncover legal issues and concerns that need to be addressed, including liabilities and obligations that should be taken into account when finalizing the deal. When it comes to legal hurdles, legal counsel's assistance may be required to help navigate the challenges and finalize the deal.

V. Statutory Provisions

Due diligence in India consists of scanning compliance with various primary statutes, such as the following:

A. **Companies Act, 2013:**

- **Sections 230-240[15] read with Section 166:[16]** This provides regulations concerning

[15] Companies Act, 2013, §§ 230–240, No. 18, Acts of Parliament, 2013 (India).
[16] Companies Act, 2013, § 166(3), No. 18, Acts of Parliament, 2013 (India).

compromises, arrangements, amalgamation, and merger and requires the approval of the National Company Law Tribunal (NCLT) by the concerned creditors and shareholders.

- **Section 186:** This Section governs loans, investments, and guarantees by a company, including those made during amalgamation or arrangement of assets.[17]

B. Insolvency and Bankruptcy Code, 2016 (IBC):

- **Section 29A:** This Section necessitates stringent eligibility criteria for resolution applicants to ensure that promoters do not return to power via any M&A process in the corporate insolvency resolution process.[18]

  In the case of ArcelorMittal India Pvt. Ltd. v. Satish Kumar Gupta, (2019) 2 SCC 1 (India) (establishing the purposive interpretation of Section 29A to bar errant promoters).[19]

- **Section 32A:** This provision protects corporate debtors and acquired assets from legal action by any person for criminal offenses committed prior to the initiation of the Corporate Insolvency Resolution Process (CIRP).[20]

  Manish Kumar v. Union of India, (2021) 5 SCC 1 (India) (upholding the constitutional validity of Section 32A and the immunity of the successful resolution applicant).[21]

C. Income-tax Act, 1961:

- Governs capital gains tax, carry forward of business losses (sections 72A and 79), and general anti-avoidance rules (GAAR) in relation to reorganization of business.[22]

D. Foreign Exchange Management Act, 1999 (FEMA):

- Governance of cross-border acquisitions, downstream investment, and foreign direct

[17] Companies Act, 2013, § 186, No. 18, Acts of Parliament, 2013 (India).
[18] Insolvency and Bankruptcy Code, 2016, § 29A, No. 31, Acts of Parliament, 2016 (India).
[19] *ArcelorMittal India Pvt. Ltd. v. Satish Kumar Gupta*, (2019) 2 SCC 1 (India) *(establishing the purposive interpretation of Section 29A to bar errant promoters)*.
[20] Insolvency and Bankruptcy Code, 2016, § 32A, No. 31, Acts of Parliament, 2016 (India).
[21] *Manish Kumar v. Union of India*, (2021) 5 SCC 1 (India) *(upholding the constitutional validity of Section 32A and the immunity of the successful resolution applicant)*.
[22] Income-tax Act, 1961, §§ 72A, 79, No. 43, Acts of Parliament, 1961 (India).

investment (FDI) in India, as well as overseas direct investment (ODI) and foreign exchange management.[23,24,25]

VI. Rules and Regulations

Further, several rules and regulations comprise the due diligence process for transactional purposes in India. They are as follows:

A. **SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR)**[26]**:** This requires listed entities while considering schemes of arrangement to comply with stringent corporate governance norms and make disclosures to the shareholders regarding any significant events (refer to Regulation 30)[27].

B. **SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (Takeover Code)**[28]**:** This prescribes mandatory open offer norms for acquiring shares from public shareholders to prevent hostile takeovers and facilitate transparency in the process.

C. **SEBI (Prohibition of Insider Trading) Regulations, 2015 (PIT):**[29] This governs the use of Unpublished Price Sensitive Information (UPSI) during due diligence and requires adherence to norms such as non-disclosure agreements, legitimate purpose, and Structured Digital Databases (SDD) (refer to Regulation 3(1)).[30]

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[23] Foreign Exchange Management Act, 1999, §§ 6, 46, 47, No. 42, Acts of Parliament, 1999 (India).

[24] Foreign Exchange Management (Overseas Investment) Rules, 2022, Ministry of Finance Notification No. G.S.R. 646(E) (Aug. 22, 2022) (India).

[25] Foreign Exchange Management (Non-debt Instruments) Rules, 2019, Ministry of Finance Notification No. S.O. 3732(E) (Oct. 17, 2019) (India).

[26] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III sec. 4, Notification No. SEBI/LAD-NRO/GN/2015-16/013 (Sept. 2, 2015).

[27] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, reg. 30.

[28] Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Gazette of India, pt. III sec. 4, Notification No. LAD-NRO/GN/2011-12/19/26274 (Sept. 23, 2011).

[29] Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015, Gazette of India, pt. III sec. 4, Notification No. LAD-NRO/GN/2014-15/21/85 (Jan. 15, 2015).

[30] Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015, reg. 3(3)–(5).
(Note: While your text mentions Regulation 3(1) for the general bar on communication, the specific statutory exceptions permitting UPSI disclosure for due diligence alongside the Structured Digital Database requirement are located in Regulations 3(3), 3(4), and 3(5)).

D. **FDI Non-Debt Instruments (NDI) Rules, 2019:**[31] This provides sector-wise cap exemptions, pricing guidelines[32], and prescribes norms for government-approved and automatic routes as per FEMA.

E. **Competition Commission of India (Combinations) Regulations**[33]**:** This provides combinations filing forms (Form I, II), timeline for filing, and guidelines for Combination Clearances.[34]

VII. What are the key risks associated with due diligence?

Most risks that are not apparent during initial negotiations and reviews are revealed during due diligence. These risks have an impact on the transaction at the closing, post-closing, post-announcement, and during valuation and deal structuring. Some of the key risks associated with due diligence include the following:

A. **Hidden liabilities:** These include tax disputes, litigation exposures, legal liabilities and contractual obligations, and employee disputes and claims that are not apparent at first glance.

B. **Customer concentration:** Due diligence helps expose whether a company's revenues are overly dependent on a small number of clients or partners. Although this may seem like a minor issue, it can prove to be devastating if the major clients decide to terminate the business relationship.

C. **Regulatory non-compliances:** Due diligence helps reveal whether the target is lacking in licenses or filings or whether it has violated any regulations.

D. **Overriding expectations:** Due diligence helps assess whether revenue projections, customer acquisition rates, and retention projections are realistic or not.

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[31] Foreign Exchange Management (Non-debt Instruments) Rules, 2019, Gazette of India, pt. II sec. 3(ii), Notification No. S.O. 3732(E) (Oct. 17, 2019).

[32] Foreign Exchange Management (Non-debt Instruments) Rules, 2019, rr. 16, 21

[33] Competition Commission of India (Combinations) Regulations, 2024, Gazette of India, pt. III sec. 4, Notification No. CCI/CD/Comb.Reg./2024 (Sept. 9, 2024) *(superseding the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011)*.

[34] Competition Act, 2002, §§ 5, 6, No. 12, Acts of Parliament, 2003 (India).

E. **Key person risk:** Due diligence helps determine whether the target company relies too heavily on a small number of individuals. If these people abandon the business after the acquisition, it may cause significant disruptions to the target's operations.

VIII. CASE STUDIES: WHEN DUE DILIGENCE SAVED OR SANK THE DEAL

The due diligence process determines the success or failure of most mergers and acquisitions (M&A). The following are two case studies of mergers and acquisitions where due diligence saved the deal and destroyed the deal, respectively.

A. Case study 1: When due diligence saved the deal

Verizon's acquisition of Yahoo (2017)[35]

In 2016, Verizon announced its intention to buy Yahoo's core internet business for $4.83 billion. The main reason for the acquisition was to expand Verizon's digital media and advertising footprint. During the due diligence process, Verizon uncovered two significant security breaches at Yahoo, which had affected more than a billion user accounts. Prior to the initiation of the acquisition process, this information had been kept from Verizon. At the time of the deal, Yahoo's security practices and liabilities were brought to Verizon's attention. Based on the findings that were revealed during the due diligence process, Verizon decided to renegotiate the contract. Verizon sold the life sciences business for $350 million reduction; the acquisition price fell to $4.48 billion.

Verizon agreed to share responsibility for litigation and any other liabilities that arose as a result of the attack, in an effort to reduce the risks associated with the acquisition.

The case illustrates how Verizon was able to leverage the due diligence process to renegotiate the contract and minimize the costs and risks associated with the acquisition after discovering Yahoo's security flaws.

[35] Cynthia J. Larose, *Data Breaches Will Cost Yahoo and Verizon Long After Sale*, Mintz: Viewpoints (Feb. 27, 2017), https://www.mintz.com/insights-center/viewpoints/2017-02-27-data-breaches-will-cost-yahoo-and-verizon-long-after-sale.

B. Case study 2: When due diligence failed and sank the deal

HP's acquisition of Autonomy (2011)[36]

In 2011, Hewlett-Packard (HP) spent $11.1 billion to acquire an English software company called Autonomy. The purpose of the acquisition was to position HP as a major player in the field of big data analytics and enterprise software. At the time, the acquisition of Autonomy was hailed as a masterstroke by many. However, when it came to analyzing Autonomy's finances, HP failed to identify a single problem. In reality, Autonomy had been artificially inflating its revenue and profits by classifying hardware sales as software sales. Instead of conducting extensive forensic due diligence, HP relied on assurances based on weak financial statements. Ultimately, $8.8 billion in the value of Autonomy's acquisition was written off by HP, and the company was forced to deal with a slew of legal issues. The case serves as a warning about the dangers of failing to conduct adequate due diligence before pursuing an acquisition.

IX. CONCLUSION

Due diligence is critical to a prosperous merger and acquisition (M&A). In the M&A, due diligence is an extremely important procedure that facilitates the identification of potential risks and opportunities and helps ensure that the buyer and seller are on the same page in terms of the value of the target. Due diligence, in other words, goes beyond just uncovering the truth.

A thorough due diligence process enables the buyer to:

1. Identify and respond to a variety of risks, ranging from financial to cultural, before they become expensive post-acquisition surprises.

2. Ensure that the projected operational, financial, and strategic benefits are realized by the transaction.

3. Use the findings to drive negotiations in order to obtain the most favourable conditions possible.

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[36] *ACL Netherlands B.V. v. Lynch* [2022] EWHC (Ch) 1178 (Eng.) *(finding former Autonomy executives civilly liable for fraudulent misrepresentation, accounting inflation, and breach of fiduciary duty)*

4. Neglecting or rushing through the due diligence process, on the other hand, might result in lost opportunities, decreased value, and even reputational damage, as the examples above demonstrate.

Due diligence, in conclusion, safeguards the buyer by giving them the information they need to make the correct decision. Due diligence is the cornerstone of a successful acquisition because it enables businesses to realize the most significant number of value and risk-reduction advantages. In other words, extensive due diligence is required in M&A, not just because it is desirable, but also because it is essential.

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