Winning through M&A in uncertain economic times

The capital available for deals usually dries up during a downturn. This time may be different, with companies better able to explore inorganic growth.

pwc

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The outbreak of coronavirus (COVID-19) was an exogenous shock hitting economies and stock markets globally. Conventional wisdom holds that mergers, acquisitions and other deal activity will likely plummet with the economy, especially after record highs in M&A volume and a wave of stratospheric transaction values in recent years. Concerns of a steep drop-off are understandable. That is what happened in the global financial crisis, and the dot-com bust before that.

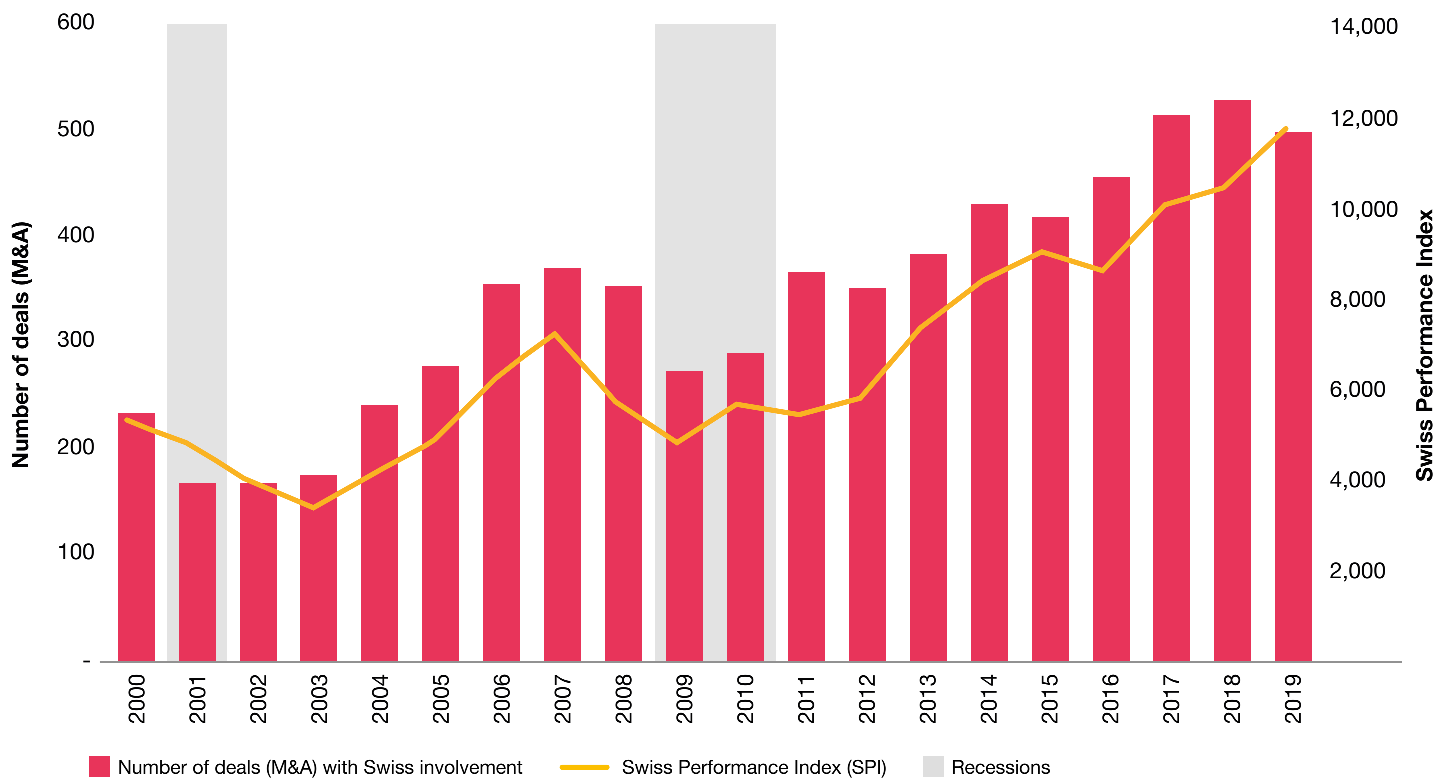
But the expectations of M&A's demise may be exaggerated. While annual deal volume in Switzerland has declined since 2017, fears of a full collapse similar to previous cycles may be premature. In short, a combination of factors has been driving a decoupling of deals from the broader economy. That decoupling is different from past cycles, providing a higher floor that should prevent deal activity from plunging.

With this anticipated resilience, prepared corporate and private investors should not retreat in the next downturn.
As our research shows, organisations that are opportunistic with deals in a recession actually could outperform their industry peers.

> Although M&A declined during the dot-com bust, a PwC analysis found that companies that made deals during the downturn ultimately saw higher shareholder returns than others in their industries.

Past M&A cycles and economic recessions

Deal volume declined substantially after the past two downturns, taking several years to recover



Source: PwC analysis of Mergermarket and SECA data

A structural shift in deals and capital

The big reason for this decoupling is capital—the funding that companies can call on for deals. From cash on corporate balance sheets to undeployed capital at private equity firms and low interest rates for borrowing, investors are in a solid position. The money available for M&A, whether it is already in a buyer's hands or within reach through a favourable lending environment, is real and substantial, PwC's analysis found.

Megadeals—transactions of at least USD 5 billion—illustrate how companies with ample resources are willing to make aggressive moves. This structural shift, compared to a cyclical trend, should not change significantly—even if the economy slows. But, for some decision-makers it may require a psychological shift and a degree of confidence that may seem counterintuitive in a downturn.

An eye on valuations

Declines in deal volumes in 2019 are largely due to high valuations, which have kept some buyers on the sidelines. Our analysis shows that transaction multiples tend to fall along with the economy, resulting in more attractive valuations. The pool of acquisition targets should swell as it typically does in a recession, with pieces of companies or entire organisations adding to the M&A supply.

But the ability to buy—a key part of demand for M&A—will be stronger than in past downturns, thanks to both the level and mix of capital. Theoretically, this would imply that valuations might stabilise rather than dip during a downturn. Critically, however, not all potential acquirers will be in the same position. An economic downturn tends to impact marginal players—those that have not taken action to realign their business, shore up their balance sheet and address other key areas—and turn them from prospective buyers into potential sellers.

What is driving capital that could be used for deals

Private equity: **USD 2.5 trillion**

of private equity dry powder—highest ever

Corporate cash: **USD 1.1 trillion**

in cash on European corporate balance sheets—highest ever

Interest rates: **-0.75%**

Swiss National Bank rate—negative rates since January 2015

Debt: **USD 2.8 trillion**

corporate bonds outstanding at European nonfinancial corporations

What you need to know to get ready

The view that acquirers should be aggressive in a recession is contrary to conventional wisdom. But it is shaped by an understanding of what propelled past M&A cycles—the historical relationship between M&A and various economic and financial drivers—and what is different today. In this series, PwC will share analysis and insight that explains this decoupling of M&A from the economy and outlines how investors can prepare to explore deals during periods of economic uncertainty.

M&A cycles: Fundamental drivers and valuation impacts

Like the economy, M&A moves in cycles. The fundamental drivers and influences, and the related returns, are constant and include buyers motivated by growth strategy, capital enabling the transactions and economic conditions. But the specific features of each M&A wave can differ significantly—from the sectors involved to the typical deal structure and the players in the field. Private equity, corporate cash and other borrowing have contributed to a substantial shift in funding for deals in the current cycle. And an analysis of shareholder returns in between the waves shows how deals launched during a downturn may be an opportunity for growth.

The state of capital for M&A, and how it could change in a downturn

The amount of funding available for deals is larger and more diverse than ever. Volumes have been driven by the “global saving glut” and the mix has shifted from public to private. This capital is not spread evenly across industries, companies and private equity firms, and not all of it will likely hold up in an economic downturn. But even if some funding sources decline, many corporate and private acquirers will be able to call on capital for strategic investments.

How to prepare for successful M&A in a recession

They may have the capital for deals in a recession, but companies, private equity firms and other investors need to take decisive steps now to ensure they maximise their chances of having successful bids and realise the benefits of those transactions. From improving operations to reducing costs to updating growth strategies, how you position yourself today is critical for winning through M&A in uncertain economic times. That means having the right tools to assemble a deal that will deliver value after the downturn.

M&A cycles: Fundamental drivers and valuation impacts

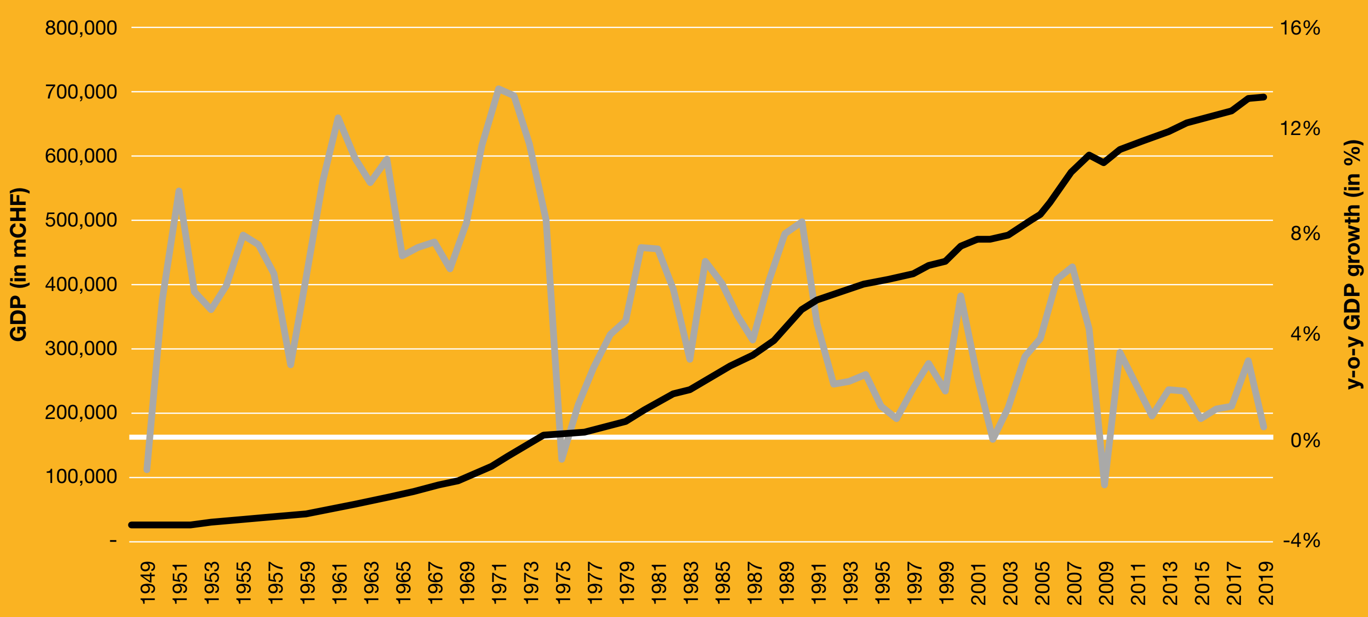
Just as the economy rises and falls in cycles, so have the volume and value of mergers and acquisitions in Switzerland. And as the economic expansion that began in mid-2009 has remained resilient, M&A has achieved new heights. The uptick in deals activity in recent years is the third such wave in the last three decades, and this wave has lasted longer than each of the previous two.

PwC analysed data on mergers, acquisitions, leveraged buyouts, minority stake purchases and other investments disclosed by Swiss acquirers from 2000 to 2019. This analysis is important for understanding how M&A volume and value have behaved historically, as some cyclical trends are likely to endure.

But M&A is also seeing significant structural changes. These include an unprecedented amount of capital and diversity of funding sources for deals. They also include deal strategies that have shifted more capital investment toward emerging technology as the Fourth Industrial Revolution (4IR) continues to unfold. These changes are key to our view that the next M&A cycle will be different, especially as the economy ebbs.

A historic period of growth

The economic expansion following the Second World War is now the longest since the Swiss government began keeping records in the 1860s.



Source: Swiss Federal Statistical Office

What happened in recent M&A waves

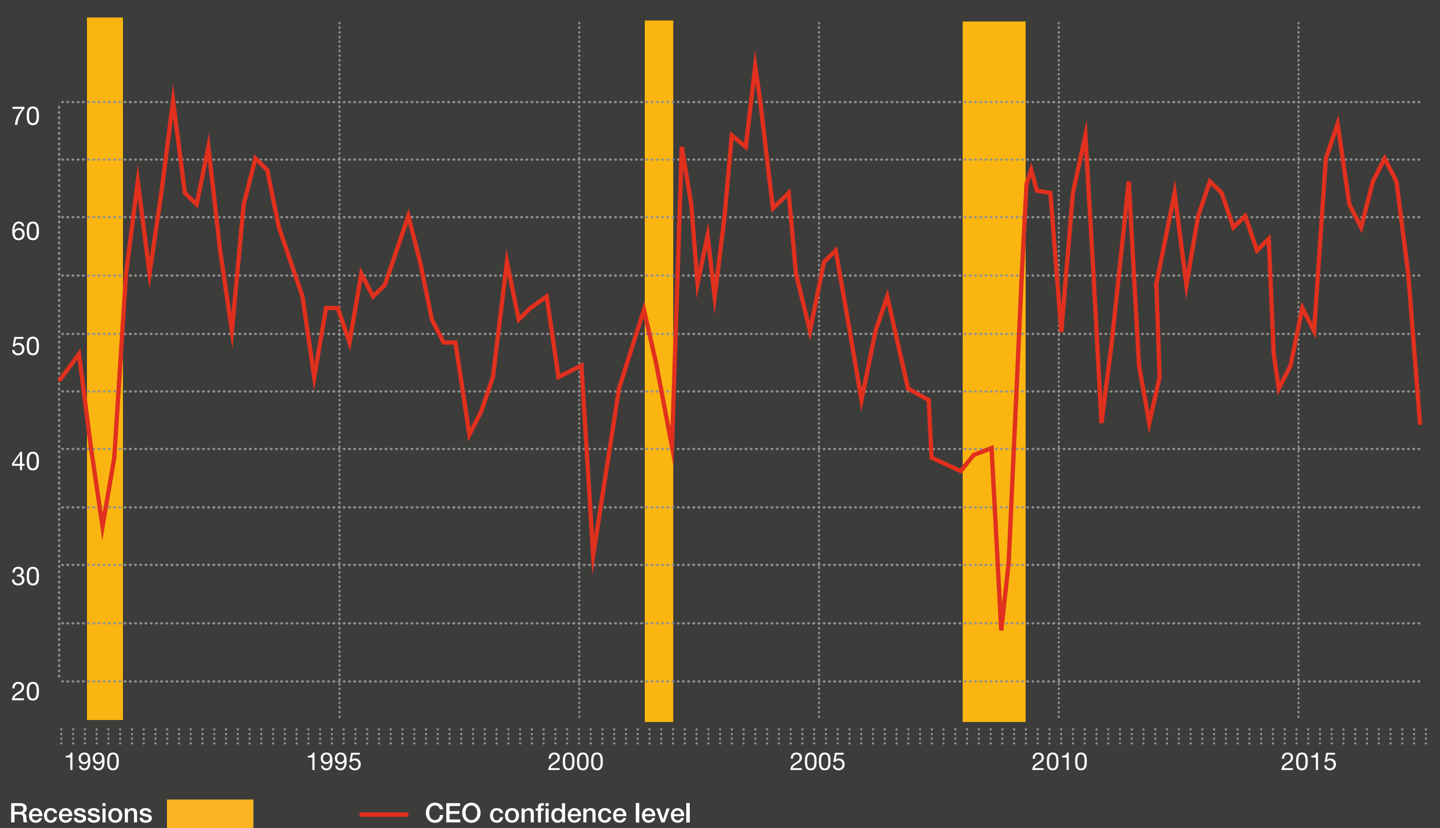
In a typical M&A cycle, deal volumes and values initially decline in line with an economic downturn, often prompted by an exogenous event, like the outbreak of coronavirus (COVID-19). Company management and boards of directors often hesitate on big investments, wary of extending their organisations in a weaker economy.

As companies, private equity (PE) firms and other investors reassess portfolios and strategies, opportunities to buy starts to grow as others decide to sell. Lower valuations for targets during the cycle improve the chances for acquirers to see higher returns. With a greater supply of targets, M&A activity accelerates. This momentum eventually slows as more companies regain confidence and economic footing and valuations again climb, reducing the number of acquisition targets and the prospects of strong returns.

As this trend played out in recent M&A waves, the sectors that have seen brisk deal activity have varied, and the funding for deals has shifted over time, especially as the combined wealth in the world has grown.

Less CEO confidence during a downturn

While there have been negative outlooks during economic expansions, recessions historically have taken a greater toll on CEO confidence.



Source: The Conference Board via IHS Markit

1992-2000: Tech deals during the dot-com boom

The rise of the internet follows the 1990-91 recession and the end of the Cold War. Technology, financial services and telecommunications see heavy interest from investors. With the equity market funding a big chunk of M&A, deals include the UBS-SBV merger, UBS' acquisition of Paine Webber and Credit Suisse's purchases of Swiss Volksbank, Winterthur Group and Bank Leu. Annual Swiss deal volume more than doubles during this wave, and deal value more than triples.

Booming stock market provides equity for deals

From the start of 1992 to the end of 2000, the Swiss Performance Index (SPI) more than quintupled.

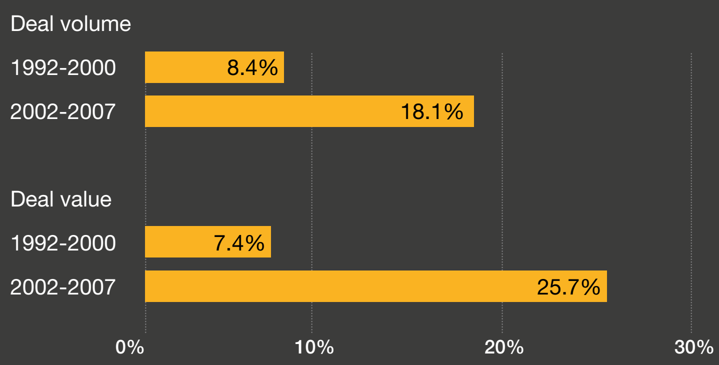
Source: SPI Swiss Performance Index

2002-2008: Financial deals rise

After the burst of the dot-com bubble and the 2001 recession, deal activity in the financial sector and pharma sector increases. Megadeals include the AXA Winterthur merger, Swiss Re's acquisition of GE's insurance practice (GEIS), and Merck's purchase of Serono. Private equity joins the public equity market as a growing source of funding. PE-related deal volume picks up speed, and deal value surges to an all-time high, paced by SIA's investment in UBS and QIA's investment in Credit Suisse. Annual Swiss deal value triples during a wave that is shorter than the previous one, while annual deal volume doubles.

Private equity takes a bigger share of acquisitions

The percentage of total deal volume that involved financial investors doubled in this M&A wave, and the private share of deal value more than tripled.



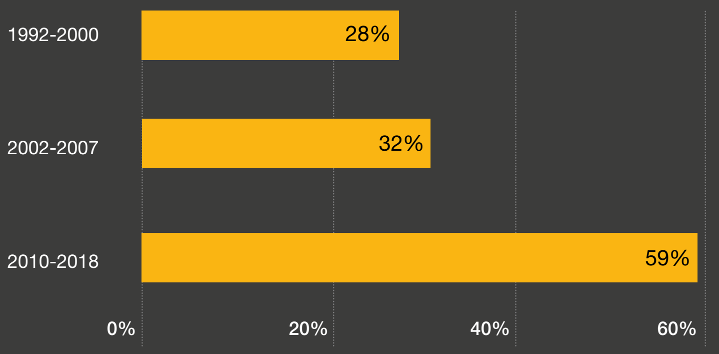
Source: PwC analysis of Refinitiv data

2010-2019: Long recovery from the global financial crisis

The global financial crisis and the worst economic recession since the Great Depression spur new regulations that contribute towards a shift in M&A funding. As the equity markets finance a smaller percentage of deals, more corporate cash and borrowing enter the picture. Deals include Glencore's acquisition of Xstrata, the merger of LafargeHolcim and Novartis' acquisition of Alcon. PE deal volume grows as investors scour the landscape for returns. Energy and healthcare draw more interest from dealmakers. The increase in Swiss M&A volume and value hits an all-time peak and remains high. More money in the market enables even larger deals.

Cash becomes a bigger player in deals

The percentage of total deal value for which cash was a funding source.



Source:PwC analysis of Refinitiv data

In short, the last three decades have brought fundamental changes in both the players involved in M&A and the money they have invested in deals. The mix of capital has evolved, with public financing and bank financing increasingly joined by more privately-funded transactions—all of which has created a historically large pool of capital overall.

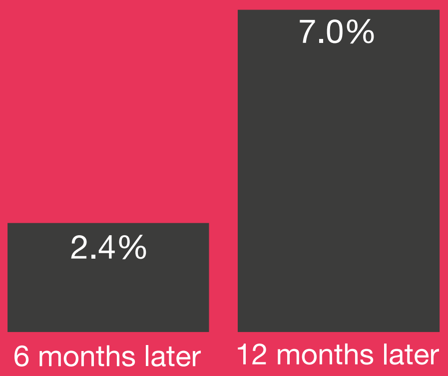
How companies that made deals during downturns have fared

Between M&A surges, companies still made deals, with many likely eyeing long-term growth. For deals with available data, PwC analysed public companies' shareholder returns following their transactions during the last two recessions—how their stock prices changed from the day before the transaction was announced. We then compared those changes to the percentage change in the relevant sector index for each acquirer's sector over the same periods. Deals are not the only factor in shareholder returns, but measuring an acquirer against its industry mitigates factors that affect the industry as a whole.

Our analysis found that investors who are opportunistic in a downturn can benefit. In the recession from March to November 2001, marked by the dot-com bust, the median shareholder returns for companies that made acquisitions outpaced their respective industries in the following months, rising as high as 7% one year after the transaction was announced. PwC analysed more than 900 companies that made 1,600-plus deals during that recession. In several sectors—including consumer durables, insurance, media and entertainment, and healthcare equipment—the median returns for those acquirers after a year were higher than the overall sector by double digits, our analysis found.

Better returns for buyers during a downturn

Companies that made acquisitions during the 2001 recession saw better shareholder returns than their industry peers in the months that followed.



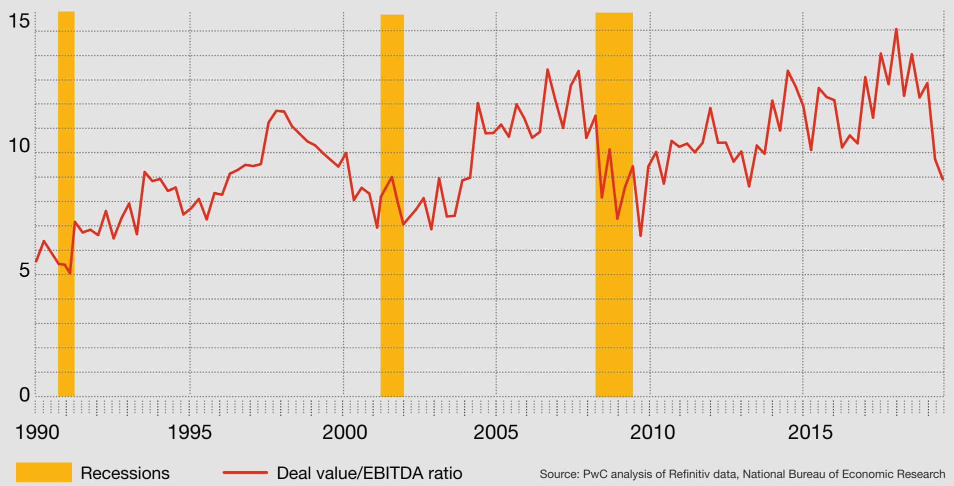
Note: Median returns for each deal vs. relevant sector index
Source: PwC analysis of Capital IQ data

Why deals could continue, with positive returns possible

The buying power for potential deals is not spread across all businesses and sectors. The largest companies generally control the most cash and are best positioned to maintain the pace of deal activity. Some firms will be more stable or even stronger in the downturn. Others will still struggle. The latter could boost the supply of targets, with divestitures occurring as companies recalibrate—similar to previous downturns. Historically, company valuations have been lower in recessions.

Deal multiples have generally increased

The median ratio of deal value to EBITDA is higher overall, but multiples were lower during downturns.



Source: PwC analysis of Refinitiv data, National Bureau of Economic Research

The difference from past cycles will be demand, thanks to the strong capital position that will keep the valuations of sturdier companies from tumbling. Some management teams still might hesitate; previous downturns saw weaker CEO confidence, and a recession after a historically long expansion naturally could bring pause. But the **next part** of *Winning through M&A in uncertain economic times* explains the unprecedented amount and mix of capital that has increased the ability to do deals in a downturn and set a path for M&A to remain active as the economy slows.

The state of capital for M&A, and how it could change in a downturn

The amount and diversity of capital available for business investment going into 2020 may have been unprecedented. It was and still is extraordinary. Corporate cash. Private equity dry powder. Bond issuances. Borrowing capacity, especially at historically low rates in Switzerland, the European Union and the US.

Structural changes in the economy and business behaviour have helped drive capital growth. Saving rates remain high a decade after the last recession—well past the point when they might be expected to fall, based on past cycles. The transition of the Swiss economy from manufacturing to services has resulted in less tangible investment. Companies that may be struggling with an "ideas deficit" are not confident in what they should pursue next, leaving cash largely untouched.

Private investors are also exerting more influence, shifting the capital mix. Private equity firms accounted for less than 10% of total Swiss deal volume in the 1990s. In 2019, that share surged to more than 35%. At the same time, more firms are considering longer holding periods that allow more time to create value and generate higher returns.

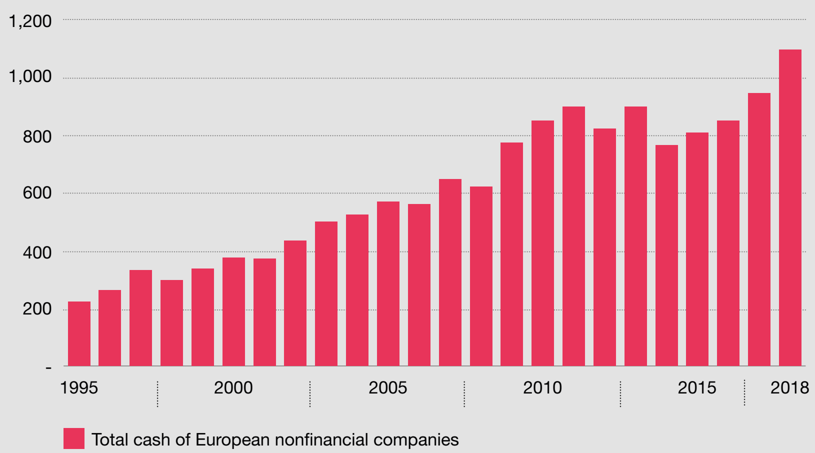
At some point, this abundance of capital likely will decline, influenced by short-term economic uncertainties but also longer-term forces. Some of the "savings glut," for instance, could dwindle as baby boomers who stashed away cash for decades start to spend more in retirement. Yet plenty of funding still could be available for deals by corporate and private investors in a downturn.

More corporate cash goes to M&A

European nonfinancial companies held about USD 1.1 trillion in cash and equivalents in 2018—about three times the amount in 2000. And that does not count cash that companies have invested in longer-term securities, which are not included as cash and equivalents on corporate balance sheets. Companies have generated more cash from operations over the last few years, PwC's analysis of cash flow statements found, and the cash they have spent on acquisitions has more than doubled during the latest M&A wave. As a result, cash has more closely tracked with deals than in previous cycles.

The climb of corporate cash

Even with a dip earlier in the 2010s, European nonfinancial companies now hold more than four times as much cash than they did 25 years ago.



Source: PwC analysis of company reports

This cash is not evenly distributed among companies. Novartis, Roche and Nestlé held approximately CHF 32 billion in cash by the end of 2019, which is more than all cash holdings combined of the remaining nonfinancial companies in the Swiss Market Index (SMI).

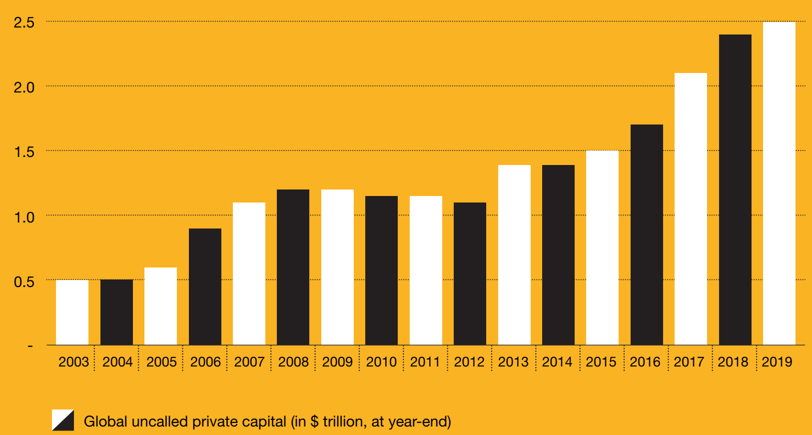
Private equity takes a bigger share

The capital held by private equity (PE) firms but not yet invested continues to grow, more than doubling in the last seven years, according to data from Preqin. Private investors, including pension funds, family offices, high net worth individuals and others, continue to seek higher returns not afforded in more traditional investment vehicles. They also see benefits to diversification in investments, and are willing to deploy capital to explore it.

As PE firms' share of total M&A has increased, so has the PE industry. The attraction of PE as an asset class, both in terms of the private nature of the capital and past success, has created momentum behind large PE firms, which are leveraging their scale and resources to capture an increasing share of fundraising.

Record levels of private equity dry powder

The uncalled capital that global PE firms have available for investment has never been higher.



Source: Preqin

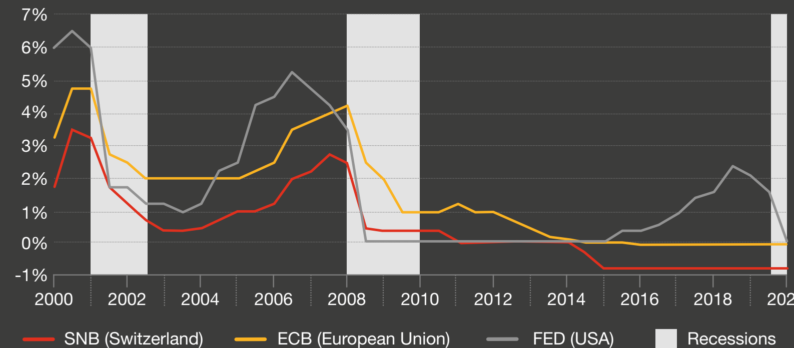
Some PE firms have attracted other investment partners, like sovereign wealth funds, that add to the capital supply. At the same time, they have diversified their tactics—inserting themselves into different parts of the capital structure—and the tools at their disposal to generate value have become more sophisticated.

Debt options evolve and expand

With historically low central bank rates since the last recession, debt has been plentiful for companies. Lower interest rates after a downturn, especially a historic one, are understandable. But those rates typically rebound in an improving economy. Instead, the slow recovery from the global financial crisis and other concerns, such as the recent trade tensions, have kept rates well below past levels, and it does not seem likely to change soon. Policy rates in Switzerland have been negative since 2015, and central bankers around the world are considering more rate cuts.

Lower rates keep credit flowing

Central bank policy rates that already had fallen since the early 2000s plunged further during the global financial crisis and have largely stayed low.



Source: CentralBankRates

The **2** largest Swiss banks hold about **45%** of the total assets of all the 248 banks in Switzerland.

Bank financing

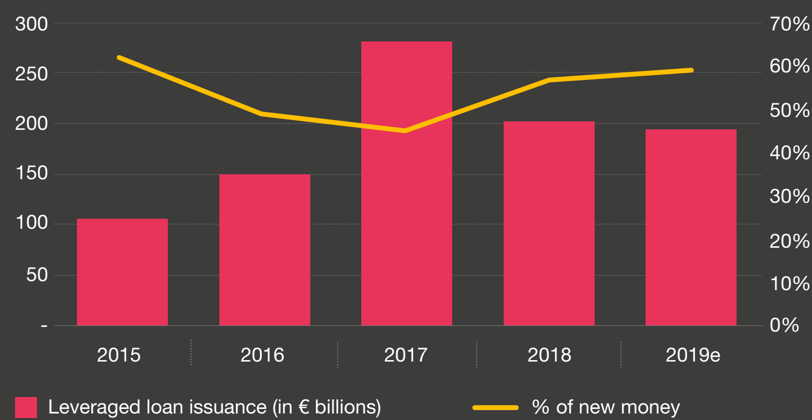
The overhaul of government regulations after the global financial crisis included tighter capital requirements for banks. Commercial and industrial loans have increased overall since the last recession, but the largest banks still have to undergo a stress test every year to understand how they would be impacted in a downturn. As bank financing has become tighter compared to previous cycles, the growth in nonfinancial corporate debt has provided alternative sources.

Leveraged loans

Often extended to companies that already have ample debt, leveraged loans typically have higher interest rates and can be more costly than other loans but usually are more flexible than bonds. Since 2015, the European leveraged loan market has doubled. The low rate environment and tighter bank requirements have led more borrowers to leveraged loans, which some companies may find more convenient than public debt markets. As a result, roughly EUR 200 billion in leveraged loans was issued in 2018, of which 59% was in new money compared to 41% in refinancing.

Leveraged loans gain popularity

Since 2015, the amount of European leveraged loans issued per year almost doubled.



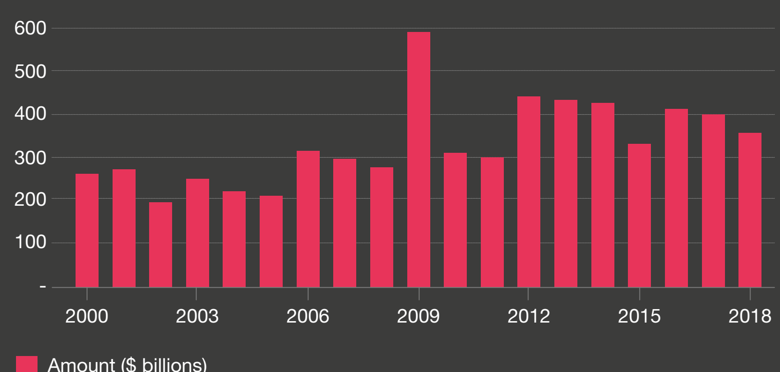
Source: Debtwire Par

Bonds

The amount of corporate bonds issued by European nonfinancial companies has, in comparison to the pre-crisis average of USD 250 billion average annual issuance, increased by 54% to USD 385 billion in the post-crisis years. And that bond universe has broadened to include more lower-quality bonds. From 2007 to early 2019, the amount of BB-rated bonds—the highest non-investment-grade bonds—grew by nearly 40%. Not all of this was newly-issued bonds; some came from past rating downgrades, often caused by country rating downgrades experienced by Greece, Portugal, Spain, Italy, Ireland, Belgium and France.

Growth in corporate bond issuance

The European corporate bond market has increased its prominence in corporate finance, also relative to bank lending.



Source: OECD Capital Market Series

The capital mix for deals going forward

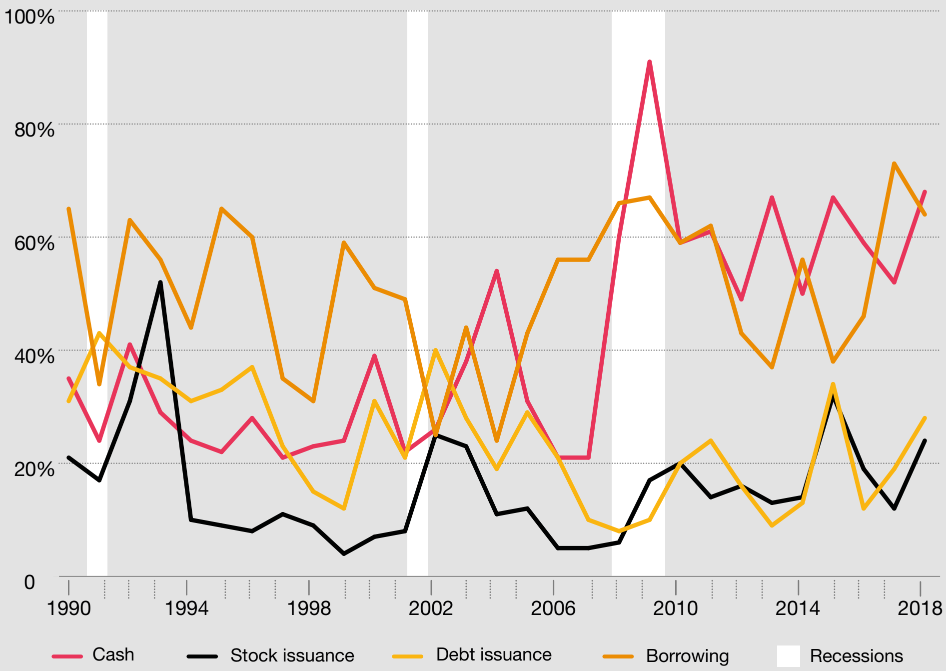
As in past M&A cycles, the various sources of capital available for deals probably will shift as new circumstances unfold.

- **Public equity** already has become less dominant in acquisitions, and it is likely to become a smaller percentage of overall deals funding, especially if the stock market declines; sellers may be less inclined to accept shares at lower values. Such a decline also could result in fewer IPOs and even longer holding periods for private investments.

- **Bond issuances** also could be weaker, as the lower–quality bonds that have thrived in the latest M&A wave would see less demand in a worse economy. But some large companies in a more solid financial position still should be able to offer reliable investment-grade bonds.

M&A financing has shifted in recent years

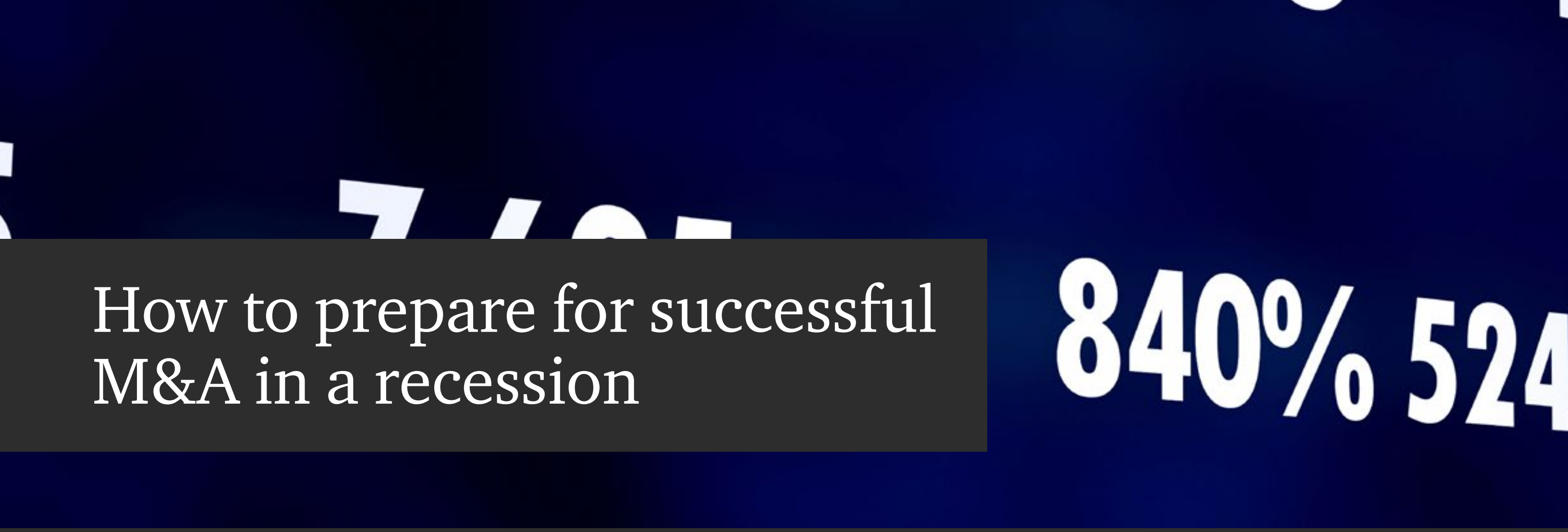
Compared to stock and debt issuance, cash and a wider range of borrowing options are a more common funding source in the latest wave of acquisitions.



Note: Many transactions include more than one source of funding; combined percentages for each year exceed 100%.
Source: PwC analysis of Refinitiv data

- **Cash** will further strengthen those companies' positions. Joined with the ample private equity dry powder, the capital mix will feature substantial liquidity. And similar to past downturns, we would expect interest rates to remain low to help stimulate the economy. That could make other debt beyond bonds a viable option for many companies.

If businesses have the appetite for M&A, the above sources of capital will provide the means. Before the economy softens, however, corporate and private acquirers need to make sure they are not simply relying on a big bankroll to execute deals. The next part of *Winning through M&A in uncertain economic times* outlines what businesses should do now and be prepared to do later to capitalise on M&A opportunities.



How to prepare for successful M&A in a recession

During any period of uncertainty, public companies, private equity firms and other potential acquirers are weighing adjustments to investment strategies. Compared with previous economic cycles, the amount and diversity of capital available for M&A is greater than ever. Companies that can use that capital and make deals early in a downturn could see better returns than others in their industry, a PwC analysis found. But for that growth to be realised, those companies have to be prepared. As we approach times of greater uncertainty, it is important to revisit M&A best practices and how they have changed over this past economic cycle.

How do you position yourself to make acquisitions that could drive long-term growth? A thorough diagnosis can reveal specific actions to navigate challenges and exploit opportunities. Getting ready now allows buyers to act decisively during a period of uncertainty. It also can limit the anxiety that often comes with making aggressive bets in a contracting economy.

Buyers who act fast in a slower economy could see higher returns

Companies that made acquisitions during the 2001 recession saw higher shareholder returns than industry peers one year later. **7%**

And returns were even better at companies that announced deals in the first half of that downturn. **10%**

Note: Median returns for each deal vs. relevant sector index
Source: PwC analysis of Capital IQ data

Issues to address include deal strategy and leadership, capital, customer experience, operations and workforce. Actions and tools include scenario planning, cost optimisation, data analytics, reskilling and automation. In these critical areas, companies need to consider three key things:

- **What we know from before:** lessons and best practices from past recessions
- **What is happening now:** the characteristics of the current cycle and differences from past cycles
- **What you need to do:** the levers companies can pull to be better prepared to do deals

Agree on growth opportunities and act with confidence

What we know from before

The psychological effect of downturns: A struggling economy understandably tests the risk tolerance for company boards, management teams and investment committees, often causing hesitation in deploying large amounts of capital. At the same time, a declining stock market can make shareholders more anxious. Previous downturns have seen increased shareholder activism, as some investors pushed for action to cut losses and inject capital, such as divesting certain businesses.

New business models will emerge: As established companies, entrepreneurs and consumers adjusted to shifting conditions, new business models have emerged during past recessions, disrupting the M&A environment. The rise of ride-sharing firms after the global financial crisis is one example.

What is happening now

More stakeholders are watching: Greater connectivity means greater visibility of businesses, and a downturn would likely bring more scrutiny not only from investors but also the public in general. Reporting and criticism of companies has expanded beyond newspapers and television to social media. The consequences of actions during a slowdown—from short-term employee layoffs to acquisitions aimed at long-term growth—would be judged not simply as dollars-and-cents decisions but for how they reflect on a company's contributions to society as a whole.

4IR investing opportunities: Artificial intelligence (AI), the Internet of Things (IoT), 3D printing and other emerging technologies continue to mature, and companies in many industries are exploring how the Fourth Industrial Revolution (4IR) could upend processes, operations, products and services. Unlike traditional bids to grow scale, investments in 4IR technologies do not necessarily have to be substantial to help a company start down a path of transformation.

Looking forward

- **Consider strategic divestitures:** Investors should proactively assess their portfolios and determine if a near-term divestiture aligns with their business strategy and could boost their capital position even more. Connecting the growth strategy to portfolio management creates a feedback loop that allows the company to adjust for various scenarios—including the severity of the next economic cycle. This is a contrast to reactionary moves that too often result in strategic misalignment and value leakage.

- **Update the deal funnel:** The above actions can put a company in a better position to reassess the corporate development deal funnel and determine which prospects are clear priorities and which assets may come to market in a tighter economy. Recent history is less relevant than scenario analysis, which will be critical for target assessment.

- **Keep communication front of mind:** Proactive dialogue between management and corporate development teams and the board of directors and investment committees can build confidence that the company is current on the competitive landscape, monitoring warning signs and prepared for a range of scenarios.

Robust due diligence is critical when navigating through financial reporting complexities as a result of COVID-19

Businesses are experiencing unprecedent changes across all sectors. Stabilisation following the initial COVID-19 impact and the resulting economic crisis means something distinct to each sector and every company, with some benefiting and others going through a significant disruption. More than ever, robust diligence is required to establish and understand the financials of a company.

During diligence it is important to consider how the timeline of events has impacted and will impact the target's business model and the industry it operates in. Companies should then consider COVID-19-related lost revenue, incremental costs and savings as well as any cash-flow and balance sheet implications in a robust manner that is consistent, verifiable, and subject to scrutiny by a range of stakeholders including investors, lenders and insurers.

Analysing the business with a multi-stage approach is critical

FY19 and pre-COVID last twelve months	Year-to-date period	Full year outturn	FY21 projections	Outlook – Recession and "new normal"
Represents the last pure period for historical analysis, and a possible comparative for future periods.	Bifurcate pre-COVID trading from the impacted period, assessing KPIs throughout (i.e. before, during, after).	Understand as much detail as is available, including KPIs (financial and nonfinancial) to give an indication of the future short-term financial performance of the company.	The company needs to adapt its operations to the many possible outcomes that may be ahead. The ability to create plausible, structured and transparent scenarios will be key.	What will the "new normal" be? Focused consideration should be given to mid- and longer-term projections, built around different recession and recovery scenarios.

Key areas to consider when assessing potential financial impacts of COVID-19 across phases and scenarios

- **Value drivers:** To what extent was the company impacted by COVID-19 and have the key drivers that caused destruction in value now abated to the point where the business can be considered stable? On the contrary, if there was a pickup in activity, is the benefit also going to last during a recession?
- **Data for decision-making**: Is the company able to generate the right level of information in a timely fashion in order to make informed decisions? Have scenarios been considered?
- **Changing market conditions:** How have the competitive landscape and relevant consumer behaviours changed as a result of COVID-19 and with the beginning of the recession? What are the political, economic, social, technological, environmental and legal changes? Are the changes temporary or will they be sustained?
- **Acceleration of trends:** Which industry and societal trends have been accelerated and will persist as a result of COVID-19 (e.g. working remotely, social distancing, digital strategy, shifts in consumer preferences)?
- **Will government support measures last:** What level of government and industry assistance is made available and used (e.g. short-term work and government-backed loans)? Will this continue going forward, or will there likely be a secondary impact when this assistance stops?
- **Health considerations:** How will the long-term impacts of social distancing and health considerations change the industry? How will the company adapt to these?
- **Extent of impact:** How will the company return to pre-COVID-19 levels (unlikely in many cases), or is there a "new normal"? How is the business equipped for a second/returning COVID-19 situation? What are the possible recovery scenarios?
- **Positioned for growth:** How is the company planning to seize opportunities that will allow it to grow and create value after COVID-19, during a recession and also thereafter? A comprehensive understanding of the business model and resilience along the value chain is required (covering sourcing, operations, HR, R&D, Capex, financing and working capital).

Preserve access to and efficiency of capital

What we know from before

M&A capital declines in a downturn: Public equity, private capital and borrowing have all played a role in helping companies acquire others. The 1990s saw public equity play a larger part, as private equity firms had yet to assert themselves and interest rates—while falling—still were not as competitive. But declining stock markets reduce the value of shares, limiting their attractiveness in trying to assemble deal funding.

Debt can be more difficult to manage: Borrowing also became harder for companies in previous downturns. Rates typically fall, but so do companies' values and performance trajectories, which can affect the risk conversation. Companies also may face more pressure to meet loan terms and covenants that may have seemed favourable in an expansion but do not hold up as well amid declining revenues. Working capital also becomes a more critical focus, as financial and operational inefficiencies can jeopardise stability in a downturn.

What is happening now

Private capital flourishes: Compared to the last recession in 2007-2009, capital available for investment is not as closely linked to economic trends. While bank lending into deals has declined as a part of overall M&A capital, the rise of private debt funds, venture capital and private equity has greatly expanded the amount and mix of capital.

Companies hold more cash: Corporate cash has grown substantially over the past decade. Profits are generally up, while spending on tangible assets has tapered off, as a greater percentage of investments has shifted to intangible assets. Low corporate tax rates have helped balance sheets swell further, giving companies that see limited paths for organic expansion more liquidity to pursue deals.

More debt options, but with potential risks: While abundant and diverse, the capital mix is not bulletproof. Debt markets have expanded significantly, and loans issued by some institutions typically have fewer covenants and more flexibility than those from banks. But some of that capital could cost more in a contracting economy. In the bond market, the lower investment-grade bonds that have become more common could put some companies at greater risk of downgrades and default as economic conditions worsen.

Looking forward

- **Explore where to restructure debt:** On the borrowing side, companies should review their current plans and determine where they could restructure or refinance. They also should review how covenants could change in a downturn, as some alternative lenders may seek more protections, even if not at the level of those required by banks.

- **Right-size working capital:** Focus on improvements in the relevant operating levers to ensure working capital is tuned to a declining cycle. Reductions in inventory (which could be affected by decreased demand) and receivables (declining revenue growth) and improvements in payables are reasonable aspirations during periods of reduced top-line growth—or actual declines. These can increase operational efficiency overall and result in a stronger capital position going into a downturn. Benchmarking, data analytics and other tools can reveal both quick wins and long-term opportunities.

- **Take advantage of capital mobility:** Private equity firms should determine where they could move capital among their various pools to maintain adequate returns as some portfolio companies feel the impact of a slowdown. Firms engaged in alternative investments and private debt as well as equity should leverage that flexibility to avoid capital being trapped in non-productive situations.

Plan for customer experience challenges and opportunities

What we know from before

Customers feel the pressure: The rules of customer engagement change with the economy. Companies that fail to understand financial pressures on their customers and do not anticipate changes in buying patterns can find themselves facing sudden, unexpected revenue declines. And when management focuses primarily on cutting costs to offset declines, a company can lose sight of the impact on clients and customer experience.

Internal issues can affect external perceptions: There is also the potential impact of internal communications on customer experience. Employee anxiety in a recession can spill over into customer engagement, damaging relationships at a critical time. Customers who sense a company is vulnerable and has neither a plan for short-term survival nor a long-term vision are more likely to consider alternatives that could better serve them going forward.

What is happening now

Data delivers deeper ties with customers: Whether it is B2B or B2C, customers are open to deeper relationships with companies through technology. They recognise the benefits of connectivity and customisation, and the proliferation of e-commerce business models and social media platforms has made for a richer customer experience in many industries. Social listening and sentiment analysis provide more insight on consumer preferences and behaviours that can be used to strengthen ties.

Relationships can change quickly: But customer loyalty is also more complex in a digital world. Products and services tailored to specific needs have appeal, but customisation does not displace traditional demands, such as competitive pricing and fast service. Customers are more mobile than before and can quickly end relationships if they experience gaps in key areas.

Looking forward

- **Prioritise customer needs:** Companies should determine what aspects of their particular customer experience are most important and what they need to do to preserve them. This could vary by industry, and concrete resources should be identified to safeguard the quality of engagement and maintain a company's customer base so it can consider building on it through M&A.

- **Capture sentiment directly:** In executing on an acquisition in the downturn, understand sentiment and develop a process to conduct that analysis early in the deal. Learning from customers of a target business can be a valuable complement to dialogue with management. Listen to the themes. In addition to customer opinions and expectations, sentiment can provide greater insight into the workforce—a key part of the customer experience.

- **Analyse to retain and expand:** Use analytics to determine what customer retention incentives are more important in a slower economy. Being able to deploy those quickly in response to customer anxiety will ensure a company remains stable and better able to acquire in a downturn. Analytics can also identify areas of potential customer expansion in acquisition targets, which can increase deal value as the economy eventually improves.

Ensure consistency while adjusting operations

What we know from before

Strategic and focused cost-cutting: Companies that move earlier on strategic reductions to offset revenue declines can outperform others that wait and sometimes overcompensate, often with indiscriminate, ineffective slashing. Focused cuts should be calibrated to lower volume expectations.

Opportunities to simplify: Prudent reductions can do more than compensate for less revenue. They have allowed companies in past downturns to invest in simplifying processes and improve productivity, putting them in a stronger position to potentially acquire other assets later.

What is happening now

Shifting supply chains: The extension of supply chains to countries around the world over the past two decades has made the companies that rely on them more vulnerable than in previous recessions. The outbreak of coronavirus (COVID-19) is the most prominent example, but also other events—such as the trade war between the US and China as well as Brexit—pose threats to long-standing supply chains and processes. Swiss companies must now consider the financial impacts of such events and a more protectionist world.

Digital tools expand: Increasingly sophisticated digital tools and data analytics have improved visibility and information across operations as physical locations have become far flung in many industries.

AI and other techs emerge: The person vs. machine dynamic continues to shift. Worker productivity has declined over the last few years, requiring acquirers to consider what they would need to do to improve efficiency in potential targets. Further adoption of 4IR technologies ultimately could have a significant impact on how business models evolve in several industries.

Looking forward

- **Revisit pricing and incentives:** Adjustments to revenue paths cannot wait until the recession fully hits. Companies should revisit pricing strategies, as well as sales force incentives, and plan for various degrees of decline.
- **Position supply chains for the long term:** Supply chain agility will be more important going forward. Along with adapting their own chains, companies should secure capabilities to evaluate how tariffs—existing or possible—could affect the supply chains of acquisitions.
- **Find efficiencies in shared services and PMO:** Corporate and private buyers should have clear plans for shared services—locations, automation or otherwise—that can then be used for potential acquisitions to generate immediate savings. Procurement, demand planning, accounts payable and performance reporting are a few areas where a buyer could quickly fold in a new asset. Project management office (PMO) practices and discipline can also pay significant dividends in times of turmoil, whether for integration readiness of an acquisition or effective execution of organic transformation initiatives.

Next steps for successful deals in a recession

The prospect of making a deal in a slower economy can be daunting. But the idea of acquisitions being off-limits in a downturn is living in the past. Companies that leverage historical best practices, informed by the recent changes to the business environment over the past decade, can have significant success in creating value.

- **Deal strategy and leadership confidence:** Consider strategic divestitures and adjust metrics and benchmarks. Update the deal funnel for various scenarios and keep communication front of mind.
- **Capital availability:** Explore where to restructure debt, right-size working capital and take advantage of capital mobility.
- **Customer experience:** Prioritise customer needs, capture sentiment directly, and analyse to retain and expand the customer base.
- **Operations:** Revisit pricing, position supply chains for the long term, and find efficiencies in shared services and the project management office.
- **Workforce:** Assess the people in place before acquiring more, keep growth in mind during cuts and provide skills that help in the long run.

How PwC can help

To have a deeper discussion about how this topic might impact your business, please contact your engagement partner or a member of PwC's Deals practice.

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