Special Report

Variety of Forces Affecting Sector Distribution of Global M&A

By Lisa Singh

Global merger-and-acquisition activity continues to trail last year’s, as various geopolitical and economic developments slow the pace of growth. Industry figures reflect the need for heightened awareness by deal advisers of evolving sector trends and regulations, experts say.

“Global volume does not appear to be on track to meet the level of 2018, which was a high M&A volume year,” said Bloomberg Law M&A analyst Grace Maral Burnett. In parallel, a more subdued tenor now prevails.

“A sense of uneasiness has crept into the M&A market this year,” said Stephen Arcano, a partner with Skadden specializing in mergers. He cites concerns over high-asset prices and perceived risks to the economy on various fronts.

Volume has fallen as economic worries build.

Reflecting this unease, global M&A volume dipped 17% and 13%, respectively, in the first two quarters, Tony Balloon and Erik Nielsen of Alston & Bird noted in Bloomberg Law. European deals fell 54% and Asian deals 49% compared with the second quarter of 2018. In a contracting environment, foreign acquisitions of American companies also declined.

“No doubt in part due to concerns over supply chain problems should trade tensions escalate,” said Charles Korsmo, professor of corporate law at Case Western Reserve. Similarly, trade tensions have tarnished China’s appeal as a base of global operations, Balloon and Nielsen wrote.

Among M&A headwinds, experts also cite inevitable downward economic forces.

“The state of the global economy will be the driving force behind M&A activity,” Balloon said in follow-up discussion. Citing developments in China, he said, “While U.S.-led trade disruptions have had an impact on M&A activity, the overall decline in health of the economy, particularly with access to cash and credit to engage in M&A activity, is a critical driver.”

This year, China’s economic growth slowed to roughly 6%, its lowest rate since 1992, based on government figures. For the first six months, the volume of Chinese outbound M&A stood at $35 billion, the lowest tally for any similar period since 2013, a Bloomberg data analysis found. By midyear, Chinese acquisitions in the U.S. dropped 17% over last year, Balloon and Nielsen noted.

Stateside, regulatory crackdowns on politically sensitive deals have contributed to the inbound M&A decline, as the Committee on Foreign Investment in the U.S. increases scrutiny of non-U.S. entities seeking entry to industries relevant to national security.

This year alone, CFIUS has flagged Chinese ownership and investment in a dating app and health tech startup. In this environment, deal advisers must stay apprised of potential obstacles to mergers before and after implementation. “In the United States, that means getting familiar with CFIUS and the potential for trade war flareups,” Korsmo said.

Yet even if cleared by CFIUS, as was a major U.S. wire carrier’s proposed merger with a telecommunications company last year, antitrust review is another growing concern.

Responding to uncertainty elsewhere, cross-border M&A in Europe has declined, as Brexit fallout fears deepen. Based on financial market data, the first quarter of the year saw a 62% decline in transactions by Britain, Europe’s biggest M&A market.

Consumer noncyclical remains the most popular target industry this year among global and U.S. M&A participants, Burnett said, “This can be seen as driven by all the current macroeconomic concerns causing investors to seek relatively safer M&A investments with recurring revenue,” she said.

Eyeing safer targets, Chinese outbound deals increasingly focus on the One Belt, One Road regions, Balloon said. Stateside, service-oriented markets have also fared better than sectors such as manufacturing.
“To the extent one industry stands out, it would be financial services,” Korsmo said, citing a wave of large mergers. Similarly, health care has proven a boon among transactions valued at $10 billion or higher. As global M&A volume declines elsewhere, mega deals have been a lifeboat in the U.S.

This year, U.S. M&A volume dropped just 3%, buoyed by several mega deals. These transactions are, Burnett said, “a key M&A trend this year and an example of inorganic growth reshaping entire industries.”

In this environment, the second- and third-largest U.S.-target deals announced in the first half of the year were in pharmaceuticals, according to Bloomberg Law. Within the U.S., technology has also proven an active sector. Like last year, the majority of acquisitions by two big tech giants involved U.S. targets, Burnett noted.

Yet a tougher regulatory climate makes it harder to negotiate and close deals. “Successfully completing an M&A transaction seems to be more difficult and takes longer than it once did,” Arcano said. Navigating this environment requires a broader focus.

“General counsel of companies engaged in, or considering engagement in, M&A activity need to be cognizant of deal trends, regulatory developments, shareholder governance, and activism trends, and a host of other factors, all while performing their day jobs,” Arcano said.

Among these considerations, activist investors have become a significant driver of M&A activity, experts said. “Deal advisers need to be prepared to advise boards on how to deal with an activist campaign while fulfilling their fiduciary duties to all shareholders,” Korsmo said.

“Defensive thinking” is also imperative, Balloon said, along with an eye on the European economy and banking sector. “While the Chinese government and banking system has enough reserves and market control to manage an economic downturn toward a soft landing, their European counterparts do not. If recession or bank failures hit Europe, it could be a real mess.”

Yet analysts remain optimistic.

“The imperatives to grow corporate earnings and to strategically position competitive platforms to succeed in a rapidly evolving landscape are not disappearing,” Arcano said. “M&A is likely to remain an effective way to achieve these ends.”

Lisa Singh is a writer specializing in business and technology matters.