WHAT REALLY KILLS DEALS DURING DILIGENCE: THE RISKS THAT DON'T SHOW UP IN THE CIM

THE COMMERCIAL, OPERATIONAL, FINANCIAL, AND MANAGEMENT ISSUES THAT MOST OFTEN DERAIL TRANSACTIONS AFTER LOI

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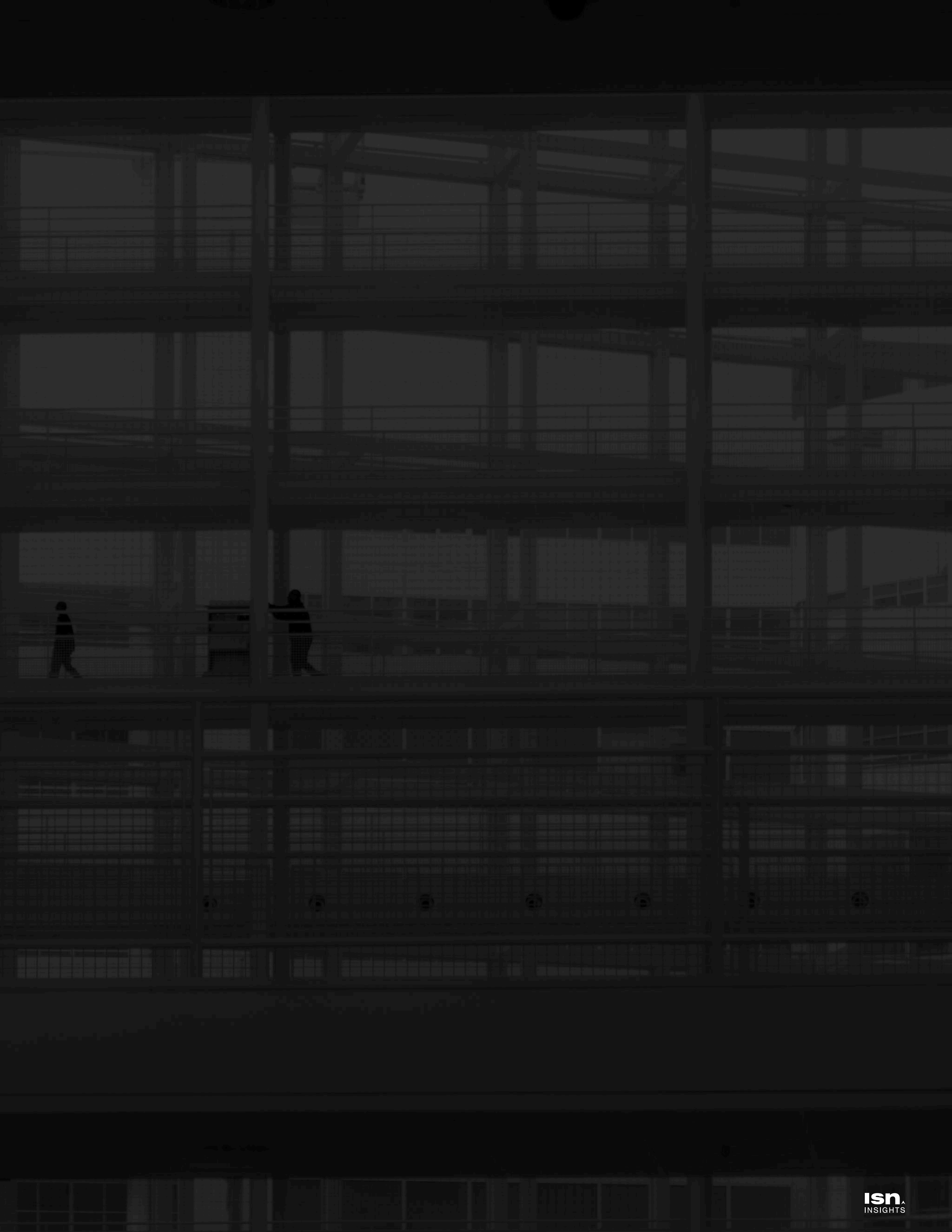
EXECUTIVE SUMMARY

The CIM tells a buyer what the seller wants them to know. Diligence tells them what is actually true, and the gap between those two things is where most deals die. Axial's Dead Deal Report, based on an analysis of 75 unsuccessful transactions across eight firm types and eight industries that broke down in 2025, found that diligence-related issues were the leading driver of broken LOIs, with non-QoE diligence findings accounting for 25.3% of failed transactions, the single most common reason deals fell apart after LOI. Quality of earnings discrepancies were close behind, accounting for 21.3% of broken deals, reflecting the continued impact of earnings normalization when reported performance diverged materially from buyer expectations.

Together those two categories explain why the post-LOI period, not the marketing process, is where most lower middle market transactions actually fail. Separate analysis of lower middle market deal data estimates that roughly 30% of signed letters of intent fail to close, with failure rates reaching 40% in smaller SBA-financed deals and dropping to roughly 15% in cash-rich strategic transactions. For Independent Sponsors, who operate with a ticking exclusivity clock and a capital raise still in progress when diligence begins, understanding which categories of risk actually kill deals, rather than simply slow them down, is the difference between protecting a deal and losing it to a preventable surprise.



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THE FINANCIAL ISSUES ARE RARELY ABOUT FRAUD, USUALLY ABOUT NORMALIZATION

Most financial deal killers are not dramatic. They are a slow erosion of confidence in the numbers. Commentary from ACG's Middle Market Growth describes the most common pattern directly: once buyers start digging into owner compensation, one-time expenses, and customer churn patterns, the economics often do not support the original valuation, add-backs that seemed reasonable start looking aggressive, and revenue that looked recurring turns out not to be. The result is not always a dead deal. It is often a repriced one, which can be just as damaging to a sponsor who raised capital against a specific return target.

A separate breakdown of why deals lose value during diligence frames the mechanism plainly: the buyer is no longer evaluating a marketing story or a high-level LOI case, but re-underwriting the business in detail, with value eroding through adjusted EBITDA reductions, a reset multiple, a less favorable working capital peg, or larger than expected net debt. None of these show up clearly in a CIM, because a CIM is built to tell the most favorable version of the financial story.

OPERATIONAL AND COMMERCIAL RISK HIDES IN THE PARTS NO ONE PUTS IN A DECK

Beyond the numbers, the operational story is where sophisticated buyers spend real time. ACG's analysis identifies a second cluster of issues that are not financial at all but get priced as financial risk regardless: IP ownership disputes, employment classification problems, regulatory exposure, and key contracts without assignment provisions, which create real risk that sophisticated buyers price heavily.

Customer concentration sits squarely in this category and shows up repeatedly across deal post-mortems. One widely cited lower middle market example describes a profitable business where diligence surfaced personal expenses flowing through the business, inconsistent revenue recognition practices, and one customer representing more than one-third of total revenue, none of which alone would necessarily kill the deal, but together created enough uncertainty that buyers struggled to confidently project future performance. Contract assignability is its own recurring trap. Practitioner commentary on lower middle market deal failures lists contracts that require customer consent for assignment to a new owner, worker misclassification, and undisclosed litigation among the most common findings that surface only once a buyer is deep into diligence, not before.

MANAGEMENT AND OWNER TRANSITION ISSUES SURFACE LATE AND HIT HARD

Some of the most damaging issues are not about the business at all, but about the people running it and what happens to them after close. Legal analysis of post-closing risk in lower middle market deals describes how this gap forms structurally: most post-closing friction is not caused by something absent from the deal, but by negotiated documents, consulting agreements, employment agreements, and corporate governance terms, that were drafted separately and never reconciled into a single operating model by the time the deal closes. That same analysis notes a specific and common failure point, that buyers often assume a selling owner transitioning into an operating role will continue as expected, and the employment agreement is where that expectation either becomes a reality or breaks down.

Seller psychology compounds the risk. Axial's data shows that seller decisions accounted for 13.3% of failed deals in 2025, including sellers pulling transactions off the market or reconsidering strategic alternatives mid-process, a category that rarely appears in any financial model but can end a deal regardless of how clean the diligence otherwise is.

TIME IS THE MULTIPLIER ON EVERY OTHER RISK

None of these risk categories operate in isolation. The longer diligence runs, the more exposure a deal has to all of them at once. A blunt but accurate framing from deal advisory commentary: the longer a diligence process is allowed to run, the more it gradually erodes the prospects of closing, as new developments affect the parties' understanding of value, new buyers may enter the process, and diligence-related expenses continue to accumulate. ACG's commentary echoes the same point from the seller side, framing it as a near-universal rule of deal-making: time kills all deals, and the longer a transaction takes, the more chances it has to fall apart.

For Independent Sponsors, this is where the exclusivity clock becomes a real liability rather than a procedural formality. Every week spent chasing a financial, commercial, or management issue that should have surfaced earlier is a week the capital raise and the seller relationship are both put at risk.

WHAT ACTUALLY MATTERS NOW

01

Treat non-QoE diligence findings as the leading deal risk, not a secondary check. Axial's data shows these issues, not earnings problems, broke the most deals in 2025.

02

Pressure-test customer concentration and contract assignability before LOI, not during exclusivity. These are commercial risks that price like financial ones once buyers find them late.

03

Reconcile employment, consulting, and governance documents into a single operating model before signing. Misaligned post-close terms are a frequent source of disputes that were preventable at drafting.

04

Compress the diligence timeline wherever possible. Every category of deal risk compounds the longer a transaction sits open, and seller fatigue is itself a real cause of failed deals.

Axial, Dead Deal Report: Unpacking 2025's Broken LOIs, published January 27, 2026.
ACG Insights (Middle Market Growth), Why Middle-Market Deals Fail After the Term Sheet, published March 11, 2026.
Offit Kurman, Post-Closing Risk in Lower Middle Market M&A Transactions, published May 29, 2026.
Auxo Capital Advisors, Why M&A Deals Lose Value During Due Diligence, published May 16, 2026.
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CT Acquisitions, Why Business Sales Fall Through: 7 Deal Killers, published May 1, 2026

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