

# The road less taken: a case for alternative M&A

How to stay ahead of disruption

April 2021

# Rise of alternative M&A strategies amid persistent disruption

Business disruption comes in many forms.

Vast technological innovations surrounding automation, big data and artificial intelligence (AI) have transformed multiple facets of business and enabled novel products and business models. Special purpose acquisition companies (SPACs) and direct placements have changed the way companies enter the IPO market. Further, achieving scale and gaining market share may no longer be reliable strategies for value creation as traditional sectors, such as consumer products and retail, mature and face sluggish to stagnant organic growth. At the

same time, companies are under ever-increasing pressure from shareholders and activist investors to deliver strong, consistent financial performance.

The winners that have risen amid the disruption of the last half decade appear to be the acquirers that have responded by turning to alternative deal approaches as a means to maintain competitive advantage and upgrade their capabilities.

Alternative deal approaches can lead to greater value capture, can be effective hedges for companies in times of relentless disruption and may generate better outcomes compared to “classic” M&A.

Strategic approaches	Definition	Strategic levers	Deal rationale
Classic	This study defines a “classic” investment as one that requires significant capital investment (greater than 20% of the acquirer’s market capitalization) to scale the existing business.	<ul style="list-style-type: none"> <li>▶ Traditional M&amp;A</li> <li>▶ Merger of equals</li> <li>▶ Tuck-ins</li> </ul>	<ul style="list-style-type: none"> <li>▶ Consolidate market share</li> <li>▶ Build economies of scale</li> <li>▶ Enter new markets</li> <li>▶ Transform and simplify the business structure</li> </ul>
Alternative	An investment that is less than 20% of the acquirer’s market capitalization is defined as “alternative” for the purpose of this study.	<ul style="list-style-type: none"> <li>▶ “Surgical M&amp;A”</li> <li>▶ Joint ventures</li> <li>▶ Corporate venture capital</li> <li>▶ Minority investments</li> <li>▶ Strategic alliances and partnerships</li> </ul>	<ul style="list-style-type: none"> <li>▶ Disrupt or completely redefine markets</li> <li>▶ Eliminate competition</li> <li>▶ Acquire niche capabilities in disruptive fields of play with high growth potential</li> <li>▶ Address strategic portfolio gaps (e.g., technology, IP, market access)</li> </ul>



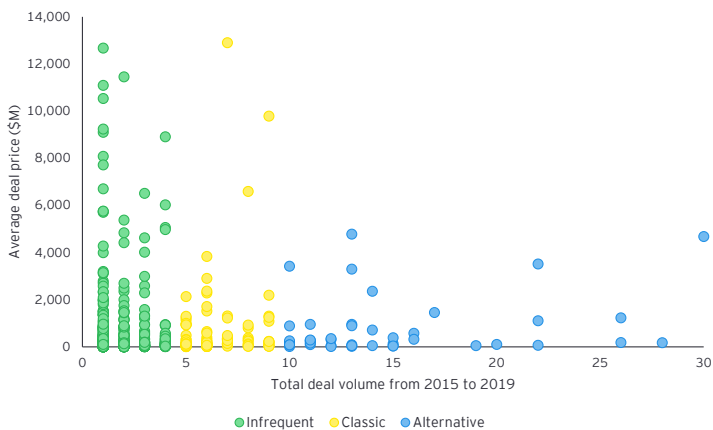
In this article, we investigate why alternative M&A approaches can be effective and recommend operational levers to help companies improve M&A results. The M&A market can be defined by two strategic approaches: classic and alternative. While nearly all acquirers pursue a mix of these two approaches, we segmented acquirers by their preferred approach based on dealmaking frequency for our analysis.

**Classic** A classic deal approach encourages selective dealmaking and is commonly defined by landmark deals.

**Alternative** An alternative deal approach is characterized by a prolific M&A program that executes multiple deals per year.

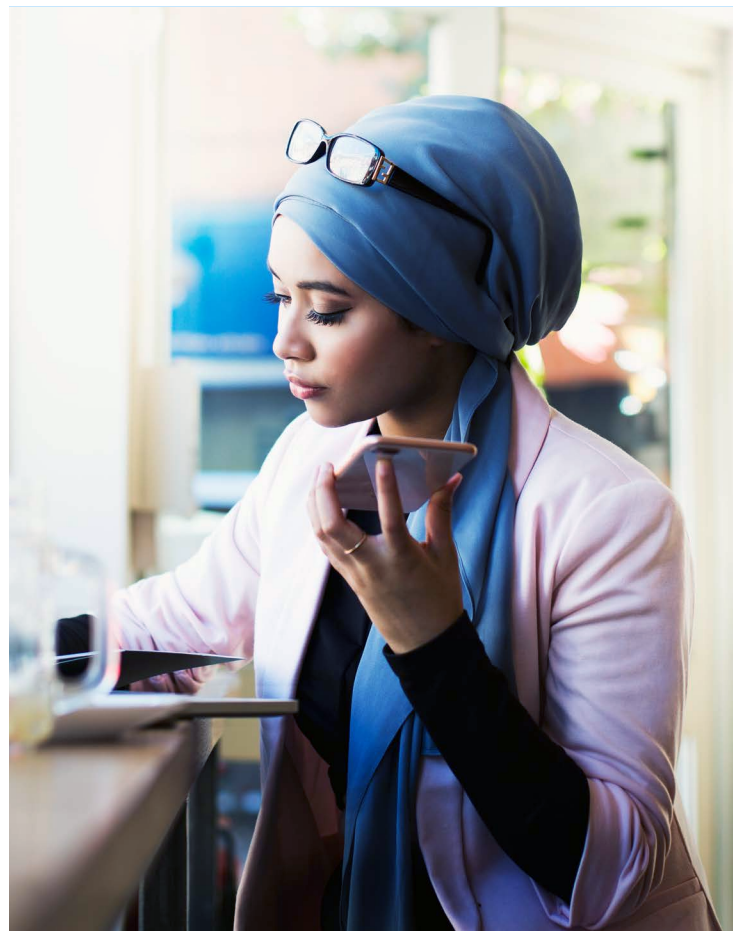
**Infrequent** An infrequent deal approach is not active in M&A and executes fewer than one deal per year. Acquirers that take this approach serve as the control group of the analysis.

We focused our analysis on the financial performance of approximately 800 publicly traded acquirers executing approximately 2,500 transactions, spending US\$1.3t over the five-year period from 2015 to 2019.<sup>1</sup>



<sup>1</sup> Acquirers were sampled from the technology, media and telecom (TMT) and consumer sectors due to the high levels of innovation and disruption in those sectors, as well as availability of transaction data.

Our research shows that the last five years have seen valuation multiples and growth potential shift to acquirers leveraging alternative deal approaches that have the risk appetite and agility to sustain innovation. These acquirers are finding that frequent acquisitions can be more effective in capturing incremental value than occasional, capital-intensive or “big-bang” deals. This strategy also may allow the acquirer to maintain a flexible resource and capital position, which can be favorable when weathering external headwinds, such as geopolitical instability, government intervention and macroeconomic disruption.





# Why alternative M&A may be effective

Alternative deal approaches appear to deliver better financial results across the board compared with classic deal approaches, as EY analysis shows in the chart below.<sup>2</sup> Most notably, acquirers using alternative deal approaches appear to significantly outperform other companies on total shareholder return (TSR).

		Five-year historical averages <sup>3</sup>				
Category		Return on assets	Return on invested capital	Revenue CAGR	Market cap CAGR	Total shareholder return
Types of acquirers	Infrequent n = 683	-4.5%	-6.1%	7.8%	8.0%	55.0%
	Classic n = 108	4.6%	3.0%	8.4%	8.4%	72.5%
	Alternative n = 47	5.6%	5.3%	10.5%	10.5%	104.2%

**We find that acquirers leveraging alternative deal approaches achieve nearly 1.5x the TSR of acquirers focused on classic approaches.** Alternative dealmakers use an arsenal of tools, including “surgical M&A,” corporate venture capital, joint ventures and minority investments to make deals aimed at achieving key strategic goals, most prominently to fill portfolio gaps and acquire niche capabilities.

<sup>2</sup>EY analysis based on S&P Capital IQ data.

<sup>3</sup>For the period from 2015 to 2019.

In our research, we found seven common themes that help explain why acquirers that pursue alternative strategies have driven financial performance relative to classic acquirers

### 01 Innovating business models continuously

Acquirers using alternative deal strategies appear to be more willing to disrupt their current business models by paying significant premiums to secure business-model-altering deals in new adjacencies or markets. This comes as a creative response to pressure and competition from players outside of their core industries. For example, some subsectors, such as brick-and-mortar retail, are under existential threat from new technologies. In contrast, acquirers using classic strategies tend to play it safe and focus on classic M&A within their own sectors.

### 02 Investing in early-stage, growth targets

High-potential, riskier, venture capital (VC)-funded startups are more likely to be considered in an alternative deal approach, while a classic approach tends to prefer mature and lower-risk, private equity (PE)-backed or publicly listed companies. The average age of targets in alternative deal approaches focused on niche plays was 12 years, whereas the average target age in classic deal approaches is nearly double, at 23 years. The risk-taking culture and innovative plays of younger companies or startups may be uncomfortable to traditional approaches but appealing to alternative strategies. Additionally, many alternative strategies include coordination with corporate venture capital (CVC) arms to build a portfolio of partnerships, minority investments and bolt-on acquisitions to test the waters of emerging technology.<sup>4</sup>

### 03 Creating valuable moats with startups

Internet companies that acquired targets less than a decade old achieved a TSR of 157%. These acquirers exhibited a particular focus on acquiring niche capabilities, which helped them realize tremendous gains by establishing strong competitive moats and providing these innovative companies the resources to scale their product aggressively.

### 04 Applying a catch-and-compete approach

Alternative deal approaches see talent and intellectual property (IP) as primary sources of value and competitive advantage. They opt for smaller targets or carve-outs that present a niche field of play or help address critical portfolio gaps. Generally, we found that acquirers focused on alternative strategies completed very few classic deals (47, or approximately 6.6% of total deal volume), preferring “acqui-hires,” minority investments and IP-focused deals. At scale, this catch-and-compete approach appears to resonate – the top 10 most productive alternative acquirers in our data set exclusively made alternative deals and achieved a five-year market cap CAGR of 24%. This represents more than triple that of the other 37 companies focused on alternative deal approaches that achieved average market cap growth of 6.9%.

### 05 Balancing opportunity with timing

Acquirers leveraging alternative deal approaches are likely to be flexible dealmakers and appear to be willing to hold off for long stretches without making a deal. In any given year, they can execute zero to five deals<sup>5</sup> and spend 19.7% of annual revenue on M&A. On the other hand, acquirers taking a classic approach tend to pursue fewer<sup>6</sup> but larger deals, spending approximately 15.3% of revenue. Alternative dealmakers will likely leverage minority investments to get a toehold in promising companies and perhaps use their stake as a stepping-stone to an eventual full acquisition.

### 06 Demonstrating greater flexibility

Acquirers that leveraged alternative deal approaches and averaged five or more deals a year had a standard deviation of three deals, whereas acquirers averaging fewer than five deals a year had a standard deviation of 1.4 deals. This suggests that more prolific acquirers may have operational enablers that allow them to take a highly programmatic and varied approach to dealmaking, while achieving roughly equivalent levels of financial returns.

### 07 Anchoring an ecosystem build-out

Acquirers leverage alternative deals to build a comprehensive suite of products and services for customers and to drive cross-selling and revenue synergies along the entire customer experience journey. Dealmakers with a classic approach instead tend to pursue competitors with overlapping products or markets and focus on cost synergies.

#### A successful trend among Software as a Service (SaaS) acquirers

Top SaaS companies routinely acquire complementary platforms to integrate into their portfolios. One made back-to-back acquisitions in property insurance processing and real estate marketing platforms to bolt onto its property management platform, creating an ecosystem of real estate management solutions.

<sup>4</sup>EY Corporate Development Leadership Network: Perspectives, March 2020.

<sup>5</sup>On average, acquirers that pursue alternative approaches pursue approximately 2.53 deals per year with a standard deviation of 0.70.

<sup>6</sup>A 2020 [EY study](#) found that the most active tech divestors achieved 78% higher TSR than the overall tech sector.

# How alternative M&A may help companies generate strong results

Realizing value from alternative M&A strategies may not be easy. Being successful across a diverse set of deals can require acquirers to commit to innovation, holistic value creation and robust infrastructure.

Top-performing acquirers pursuing alternative strategies generally employ the following six operational levers to execute alternative strategies effectively.

## 01 Reshape portfolio frequently around core assets

Acquirers leveraging alternative deal strategies divest assets frequently in order to prune their portfolios, prioritize operational focus and capital allocation and maintain strong day-to-day business performance. While divestment may feel somewhat antithetical, we found that, on average, these acquirers executed twice<sup>7</sup> as many divestitures as their classic counterparts—0.53 vs. 0.31 divestitures per year. This trend is especially prominent in TMT, where acquirers use divestment in tandem with acquisition to create a portfolio that can withstand waves of disruption.<sup>8</sup>

## 02 Establish a robust corporate development function

Our experience indicates that alternative deal approaches tend to be supported by more extensive and specialized corporate development teams to turbocharge their robust M&A programs. Usually, teams follow a specific mandate and play an active role across all aspects of the deal life cycle, from origination to functional integration to synergy management. Corporate development teams are often augmented by, or collaborate with, CVC teams to enable a flexible dealmaking apparatus.

## 03 Adopt a holistic value-driven lens

The deal rationale should likely stem from a realistic awareness of value gaps, which may allow the acquirer to scan the horizon for specific complementary assets that present the best sources of value and revenue. A focus on customer need and product offering can precede shareholder-oriented financial targets, such as increasing EPS and reducing costs. Acquirers using alternative deal approaches can extend their runway for growth when they apply this holistic view of value to their M&A strategy. Our analysis shows that this approach can be accretive for customers and shareholders alike.

## 04 Prepare playbooks for all types of deal structures

Companies need to have playbooks ready for all types of transactions. These include “surgical M&A,” joint ventures, corporate venture capital, minority investments, strategic alliances and partnerships. M&A playbooks covering topics such as deal planning, execution and integration should be developed for each deal structure.

### Industrializing the alternative M&A apparatus

Alternative deal approaches evaluate a larger number of deals. Top consumer wholesale distributors review over 1,000 deals each year and tend to execute integrations with greater agility than their direct competitors. In addition, our analysis shows that acquirers leveraging alternative deal strategies took 10 fewer days on average than classic dealmakers to move from deal announcement to close.

<sup>7</sup>Ibid.

<sup>8</sup>Ibid.



## 05 Determine the right premium during diligence

Alternative deal approaches may utilize a sophisticated and systematic diligence process that allows the acquirer to determine the value and appropriate deal premium of a target. Diligence can preserve value by identifying red flags or confirming that a bad deal never gets made. Since alternative M&A deals can pose risks, diligence is critical to determine the right multiples and premium. Operational deficiencies, product or talent gaps, or suboptimal contracts are just a few potentially value-destroying factors that, if overlooked, can result in overpaying for a deal. Diligence can also inform decision-making in a competitive bid scenario.

## 06 Prioritize business model integration

Revenue synergies often tend to be prioritized first in alternative deal approaches. Brand and go-to-market strategy alignment and cross-selling are emphasized along with product and platform integration. Often, cost synergies, such as headcount reduction or back-office integration, take a back seat. The goal is to build a combined business model as quickly as possible and realize an integrated revenue stream that is greater than the sum of its parts.

### Hitting the “right” premiums<sup>9</sup>

Acquirers using alternative deal approaches and paying an average multiple of 10 times (10x) revenue per deal were able to increase TSR by 113% over the five-year period between January 2015 and December 2019, while acquirers using classic deal approaches that paid 10x saw their TSR increase only by 81%. The difference was even more pronounced for acquirers paying a 40x multiple: alternative deal approaches helped realize a TSR lift of 132%, which is more than six times the 21% lift for classic deal approaches over the same period.

<sup>9</sup>EY analysis based on S&P Capital IQ data.

# Alternative M&A can be an effective strategy in the new normal

Alternative M&A can be an effective part of the corporate strategy toolkit to build resilient portfolios, create new growth opportunities and navigate the post-pandemic business world.

Successful alternative strategies consistently apply a holistic value-driven lens to dealmaking. Alternative deal approaches tend to be highly focused on business model integration and top-line synergies, starting with the customer and the product. These strategies are often realized via well-equipped corporate development functions that can execute quickly and effectively through target selection, diligence and integration.

Alternative deal approaches in our analysis appear to be upending their classic peers. They not only show strong M&A results but also have likely become forces of disruption themselves.

## Contacts



**Amiya Setu**  
Principal, EY-Parthenon  
Ernst & Young LLP  
amiya.setu@parthenon.ey.com



**Jeff Wray**  
Americas Strategy Leader  
EY-Parthenon  
Ernst & Young LLP  
jeff.wray@parthenon.ey.com



**Barak Ravid**  
Americas Technology, Media & Entertainment,  
Telecommunications Leader,  
EY-Parthenon, Ernst & Young LLP  
barak.ravid@parthenon.ey.com

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