

How you should align  
your acquisition  
approach with your  
growth strategy



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Companies often apply the same M&A diligence and integration playbooks to all deals, rather than tailoring activities to the strategic rationale behind the particular transaction.

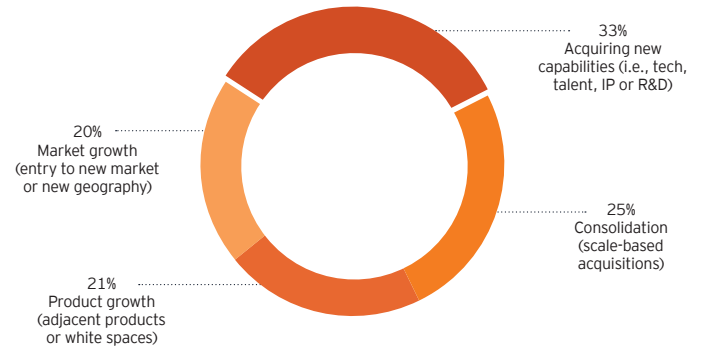
As more than half (52%) of companies expect to actively pursue M&A in the next 12 months, according to the 21st EY Global Capital Confidence Barometer survey, it's critical for them to align their deal processes with their growth strategies, whether it's to acquire new capabilities, consolidate or grow their products or their market share.

In the recent EY Buy & Integrate global pulse survey focused on the acquisition process, inadequate diligence was noted as a major challenge to achieving the targeted deal value for 25% of the 300 chief financial officers, chief operating officers and corporate development officers, trailing only regulatory and global risks (37%), as shown in Figure 2.

Meanwhile, when it comes to M&A integration, the two most frequently cited pain points include talent assessment or retention (23%) and technology integration (20%).

More than 70% of executives said their most significant acquisition met expectations for value creation, which is consistent with what we see in practice. But only 7% said their diligence accuracy, in particular, exceeded expectations, as shown in Figure 3. Clearly, there is more work to do. If companies fail to identify and focus the majority of their time on the most critical items during the fast-moving diligence process, big value drivers can be missed.

Figure 1. What was the primary strategic rationale for the most significant M&A transaction completed by your company?



Note: Total does not equal 100% due to rounding.  
Source for Figures 1-3: EY Buy & Integrate global pulse survey, September 2019.

Figure 2. Most significant challenge to achieving deal value

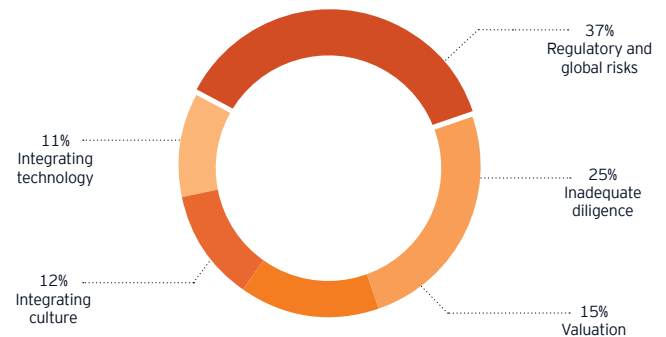
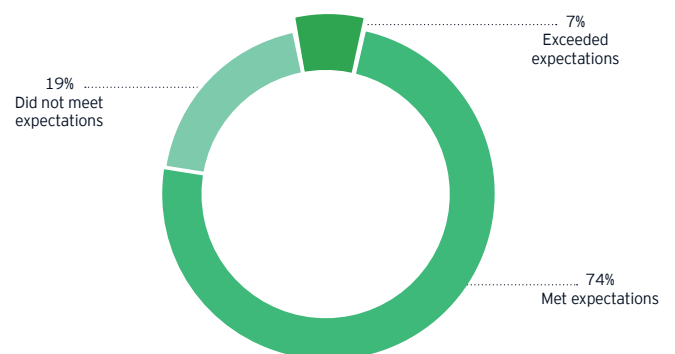


Figure 3. Did the diligence accuracy of your company's most recent major transaction meet expectations?



### EY Buy & Integrate global pulse survey

This article incorporates results from the EY Buy & Integrate global pulse survey of 300 CEOs, CFOs and CDOs to gain insight into how companies make decisions around M&A strategy and the challenges and steps they take to capture deal value. Executives answered the questions according to their company's most significant M&A transaction that has been closed for at least six months.

## What successful companies do right

Successful companies answer the following questions to inform their M&A diligence and integration playbook and maximize deal value:

- ▶ Why did we acquire this company or asset?
- ▶ What are the key growth drivers?
- ▶ What are the critical assets and operations that we need to protect and grow? Are we the best – or at least a better – owner for the asset?
- ▶ Is the value creation potential large enough to justify the human and capital investment necessary to be successful?
- ▶ What are the most significant operational risks we are likely to face, both in the ordinary course of business and during the integration?
- ▶ Does the target's culture fit with ours?
- ▶ What are the right governance and resourcing to help successfully execute the deal?

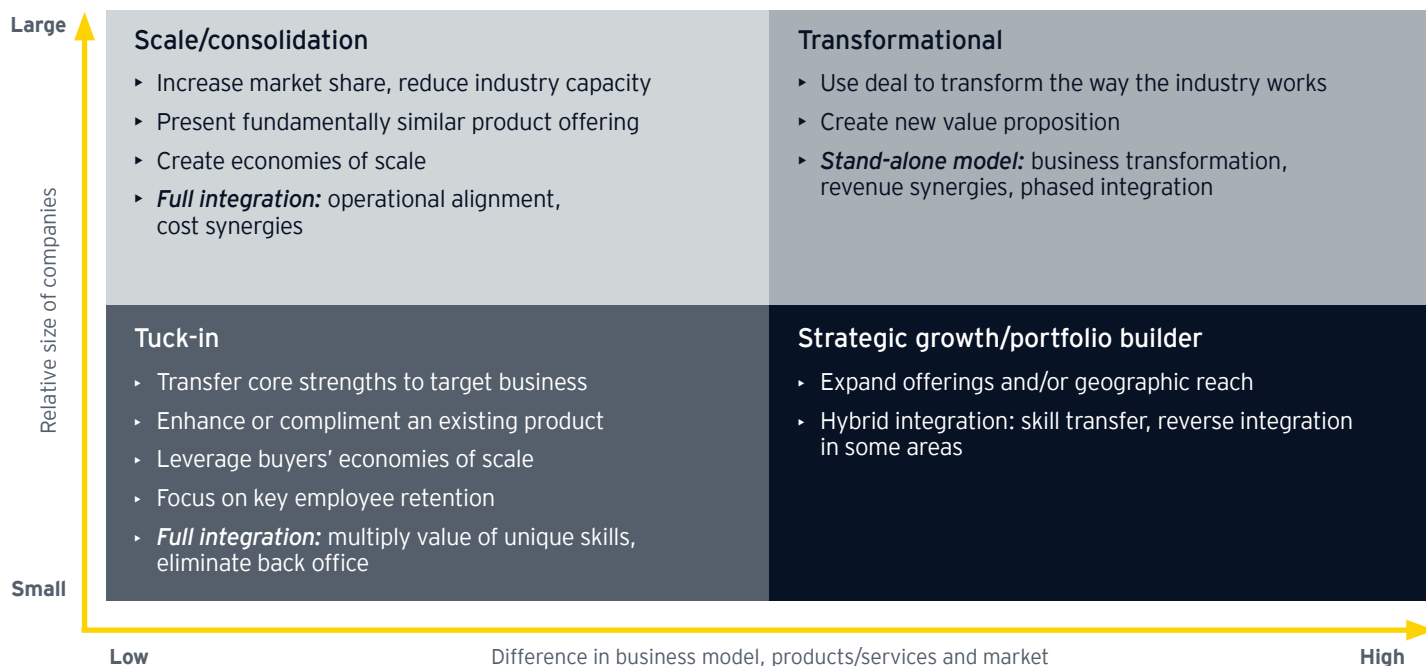
Our C-suite survey also revealed that the most effective strategies to ensure companies met or exceeded value creation and synergy realization goals were:

- ▶ 75% looked to procurement as an area to achieve near-term cost synergies.
- ▶ 58% started integration earlier.
- ▶ 58% used tools and technology to maintain timelines, manage work streams and capture synergy targets.
- ▶ 54% set more aggressive synergy targets.

But what should executives really focus on? Focusing on specific priorities based on the deal type is essential for maximizing value. Following are some areas to prioritize for M&A diligence and integration, whether the deal type is strategic growth, scale or consolidation, transformational or tuck-in.

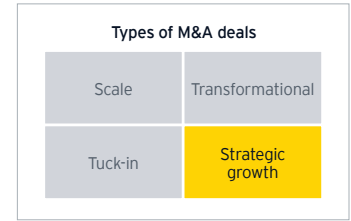
### Four deal types

Understanding strategic rationale will help determine overall integration approach



# Strategic growth (or portfolio builder) deals

In a strategic growth transaction, the acquirer effectively buys its way into an adjacent area to take advantage of the growth in that area or to acquire an adjacent asset that it cannot build on its own quickly enough to take advantage of the market opportunity. Examples of these deals include Amazon's purchase of Whole Foods to accelerate its push into grocery and Microsoft's acquisition of LinkedIn to bring in the business-focused social network, its immense data and its technology – eventually being able to integrate platforms such as the internal Microsoft Office network within various companies.



## Diligence priorities

Our recent survey shows inadequate diligence as being the foremost challenge for strategic growth acquisitions. Companies must identify both the “crown jewels” to protect and the operational areas likely to provide the greatest sources of synergy. They must then perform commercial diligence to understand “how wide the moat is,” including the strength of the competition and the target’s ability to defend its turf. Overall, companies need to answer these critical questions:

- ▶ **How attractive is the market?** This is typically a function of market size, growth outlook, cyclicity and competitive intensity.
- ▶ **Is the target well-positioned as a stand-alone entity?** Companies that are well-positioned typically have satisfied customers and either high, stable relative market share or competitive advantages that can propel rapid share gains.
- ▶ **Will the acquirer’s customer relationships or capabilities better position the target to succeed?** Or, can the target’s capabilities and relationships do the same for the acquirer? These kinds of synergies can justify a price premium.
- ▶ **How can we measure the health and sustainability of the underlying growth?** This is critical because chances are the acquirer is paying a high multiple on this future growth and earnings.
- ▶ **What will motivate employees, beyond the management team, to remain with the company?** Among the strategies that companies use to retain talent, demonstrating a career path (73%) and empowerment to make decisions (60%) were the two most frequently cited.

**Case study: consumer products strategic growth deal**

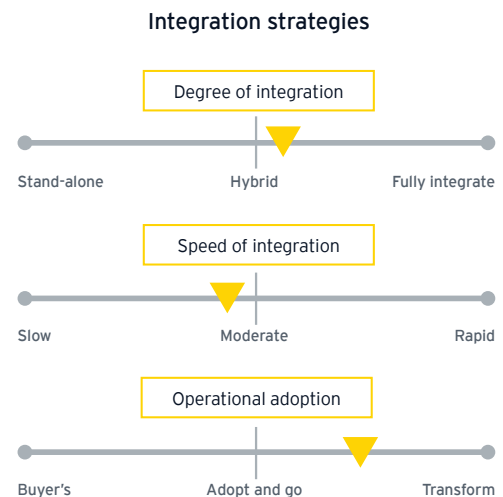
In one case, a large global beauty care company acquired a founder-led, multichannel brand in order to increase its total points of distribution and expand its presence overseas. Rather than focus on back-office synergies, the acquirer quickly tried to integrate marketing, sales, business planning and R&D. The result was a culture clash between the established company and more entrepreneurial target, followed by a backlash and significant talent drain, causing the target’s growth to decelerate and ultimately led to a write-off of some of the value of the business.

## M&A integration considerations

Since strategic growth transactions are about revenue growth, trying to aggressively integrate too much too soon can unduly burden management and employees of the acquired business, risking a talent exodus and reducing the value of what the buyer was trying to acquire. Overall, executives should be wary about adding complexity and near-term business disruption.

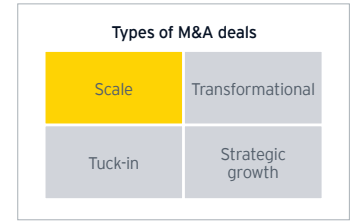
Typically, critical parts of the business are left to stand alone in these deals, at least for the first two to three years, so that the acquirer can more properly understand and assess performance drivers and learn from them. On the other hand, integrating functions related to regulatory, compliance, and financial and accounting requirements often still needs to be completed early on. This is also true of some aspects of compensation and benefits. Decisions about other infrastructure or back-office areas, such as information technology and the supply chain, are highly dependent upon the current state operating models of both the acquirer and target.

Many commercial aspects, such as sales, marketing and customer strategy, are never fully integrated because they are often precisely the capabilities or growth drivers that drove the deal and deal premium in the first place.



# Scale or consolidation deals

Consolidation deals are essentially the opposite of strategic growth deals. They create value through cost and sometimes through revenue or pricing synergies – essentially, they are about scaling up and leveraging the same infrastructure or manufacturing or go-to-market capabilities to enhance profitability and, to some extent, market share. In a “winner-take-all” corporate world, these deals have become critical in many industries. Examples include T-Mobile/Sprint (telecom), Bayer/Monsanto (agribusiness) and Marriott/Starwood (hospitality). In our survey, 56% of respondents said that improvement in procurement and distribution is the most crucial approach for cost savings in these types of deals.



Consolidation deals can be challenging due to the time and complexity of hitting what are typically very large synergy targets. Underestimating cultural differences can be another potential pitfall. The transactions are also typically subject to the most antitrust scrutiny.

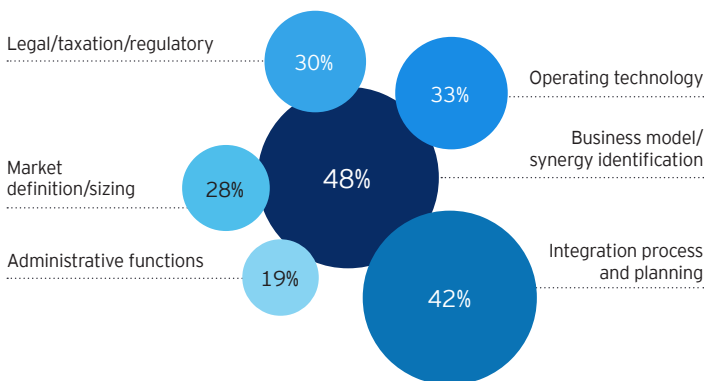
## Diligence priorities

As these acquisitions provide a large field of potential synergy or cost savings, it may not be surprising that synergy identification and modeling was named as one of the most critical aspects of the diligence process, as shown in Figure 4.

Some considerations:

- ▶ **Examine the quality of the earnings.** Is the target’s growth sustainable? What will the quality and sustainability of the earnings be for the combined entity?
- ▶ **Consider the target’s infrastructure.** How easily can it be integrated into the acquirer’s? Which parts will be redundant?
- ▶ **Understand cultural compatibility.** Since the deal value comes from complete integration, it is essential to make sure that the acquired company’s culture is compatible with that of the buyer. This can include performance evaluation philosophy, whether the structure is hierarchical or flat, working hours and other areas.

Figure 4. Critical aspects of the diligence process, ranked in order of importance to achieving deal value (Percentage chosen indicates most or second-most important aspect to respondents.)



## M&A integration considerations

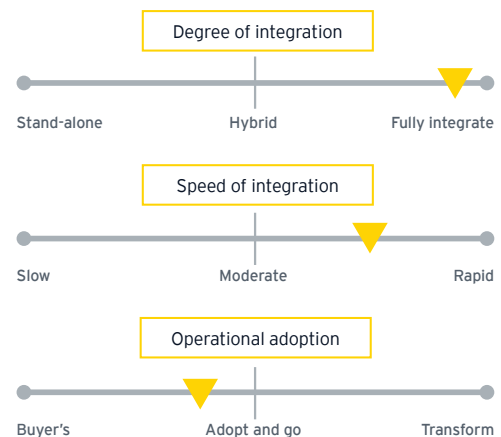
As much of the deal value will come from synergies, teams must have a clear and granular understanding of the present top-line and cost structure components, and how they will look in the future. Too often synergy estimates are missed because a team does not have intimate knowledge of the true recurring earnings of the businesses – first on a stand-alone basis, and then on a combined basis.

Companies should capture synergies early in a well-planned integration process with a shared understanding between various functional areas. A rule of thumb is to capture 60% to 70% of the run rate target within 12 months post-close.

A consolidation deal also presents the opportunity to eliminate redundant and obsolete legal entities, minimize costs and risks, and provide some quick synergy wins.

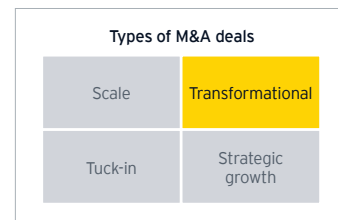
There are several areas of risk in these types of deals, however, including making sure any changes do not prompt the loss of prominent customers to competitors. Other considerations include understanding the compatibility of IT and enterprise resource planning systems and the broader IT environment more generally.

### Integration strategies



# Transformational deals

Transformational deals are the rarest and the most challenging. The deal goal is to create a new value proposition for the acquirer, add to its core competencies and bring about industry disruption. Despite the name, the cost to transform a business need not come at a multibillion-dollar price: one example is Google's acquisition of Android in 2005, for a fraction of that amount,\* which allowed Google (and others) to compete successfully in the smartphone market.



## Diligence priorities

These deals inherently require rigorous diligence, especially as the acquirer may have little experience with elements of the target's business. Things to remember:

- ▶ **Think strategically first and operationally second.** Ask, how can we use this as an opportunity to transform the entire business?
- ▶ **Be aware of blind spots if the business is unfamiliar.** This requires bringing in resources with the expertise in the target's sector to accurately address sector-specific diligence questions.
- ▶ **Focus on revenue growth potential.** For example, a life sciences acquirer should check that the R&D capabilities of the potential target can return long-term profits.
- ▶ **Involve the integration team early** so that you know which information to gather before the deal closes and you can experience a seamless integration with more successful outcomes.
- ▶ **Understand the operational technology of the target company** to better plan its IT spend or tech strategy. In our survey, "operational technology" was named by one-third of respondents as one of the top two most influential factors for deal value during the diligence process.
- ▶ **Use technology to expedite analysis.** Given these are large-scale deals, diligence should be heavily complemented by tools and technology to enhance the efficiency of analyzing large data sets and unearth better insights quicker. Use of analytics has become table stakes for leading-class acquirers.

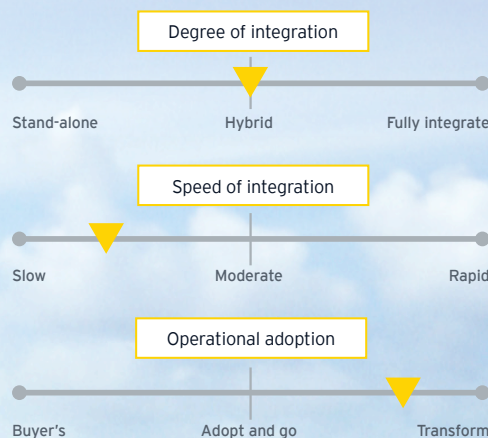
## M&A integration considerations

A transformational deal can typically take three or more years to fully integrate. Companies should focus on cost synergies right away; capturing revenue synergies for transformational deals is a long-term process. Organizations should find cost reductions not just in the target company but in their own companies as well.

Communication is especially important for transformative deals. Buying a business that is outside of the acquirer's core competency requires a long-term strategic vision that must be understood by employees and stakeholders. Attention to external stakeholders, such as customers and business partners, is also critical, lest they pull away from the new entity.

Value creation will be based on stability and growth of the business, so the integration team needs to think beyond the scope of the acquisition to truly transform the business, making deep sector knowledge critical. This means understanding where the most valuable assets are, the profit pools and the competition. Maintaining focus on the strategic rationale for the deal and the integration plan along each step in the integration process is essential.

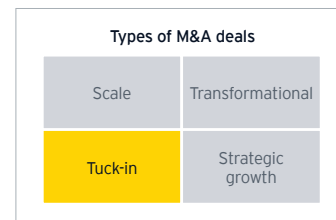
### Integration strategies



\* US\$130 million was the total for all of Google's acquisitions in 2005; the amount paid for Android was never separately disclosed.

# Tuck-in deals

Tuck-in deals are typically relatively smaller acquisitions of businesses that fit into the acquirer's core business, such as Disney's acquisitions of Pixar, Marvel and Lucasfilm Ltd.; Brown-Forman's acquisitions of the Maximus Vodka brand, Slane Castle Irish Whiskey and Casa Herradura tequila; and Johnson & Johnson's acquisition of Vogue International LLC shampoo. While the acquirer is quite familiar with the target business, companies still need to conduct thorough diligence to avoid surprises.



## Diligence priorities

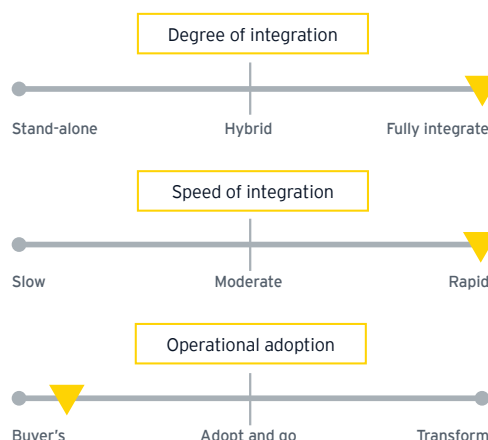
The diligence priorities are similar to the ones in transformation deals above, except given that these are typically smaller transactions, operational diligence becomes paramount as these deals often require more fixing and investments than acquirers realize. For example, in the personal health and beauty care space, we have often seen acquirers underestimate the changes they need to make to R&D, quality and the supply chain in order to successfully "tuck in" these deals. Even integrating supply chains with different pallet sizes can involve a material cost.

- ▶ **Validate the deal drivers.** These include quality of revenues, customer retention or attrition, recurring EBITDA levels and fixed vs. variable costs.
- ▶ **Identify liabilities or exposure.** Put protection against these into the purchase agreement.
- ▶ **Assess the sufficiency of the business operations.** Determine which areas will require post-close investment.

## M&A integration considerations

Rapid involvement of the business units with the acquired business is essential, as these deals almost always involve a full integration, with the possible exception of marketing and creative. This supports the opportunity to increase revenue by leveraging brand strength across a larger organization.

### Integration strategies



### Case study: life sciences tuck-in deal

What happens when companies don't integrate quickly? A large life sciences company executed a number of sequential acquisitions but decided to leave each business "as is" and not integrate the financial or IT systems, or the field force, due to other near-term priorities. Ultimately, overall business performance slowed, and the acquirer then had to launch a multiyear delayed integration process, resulting in significant revenue and earnings losses.

## Summary

The diligence and M&A integration playbook for any deal can be as different as the deal itself. Sticking to a single playbook for all deals can destroy value. Companies need to consider how the deal fits into their overall growth strategies and adopt a fully integrated view of due diligence and integration steps that fit the deal rationale.

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## Further reading

This article is a follow-on to the report, *How can your growth strategy evolve faster than the market?* In today's world of accelerating disruption, many companies are setting their strategy against a flawed view of the industry and markets in which they compete. In this report, we look at how to understand a company's true competitive position, how technology is rapidly making current market assumptions outdated and how companies can use a market context to drive sustainable growth through M&A.

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