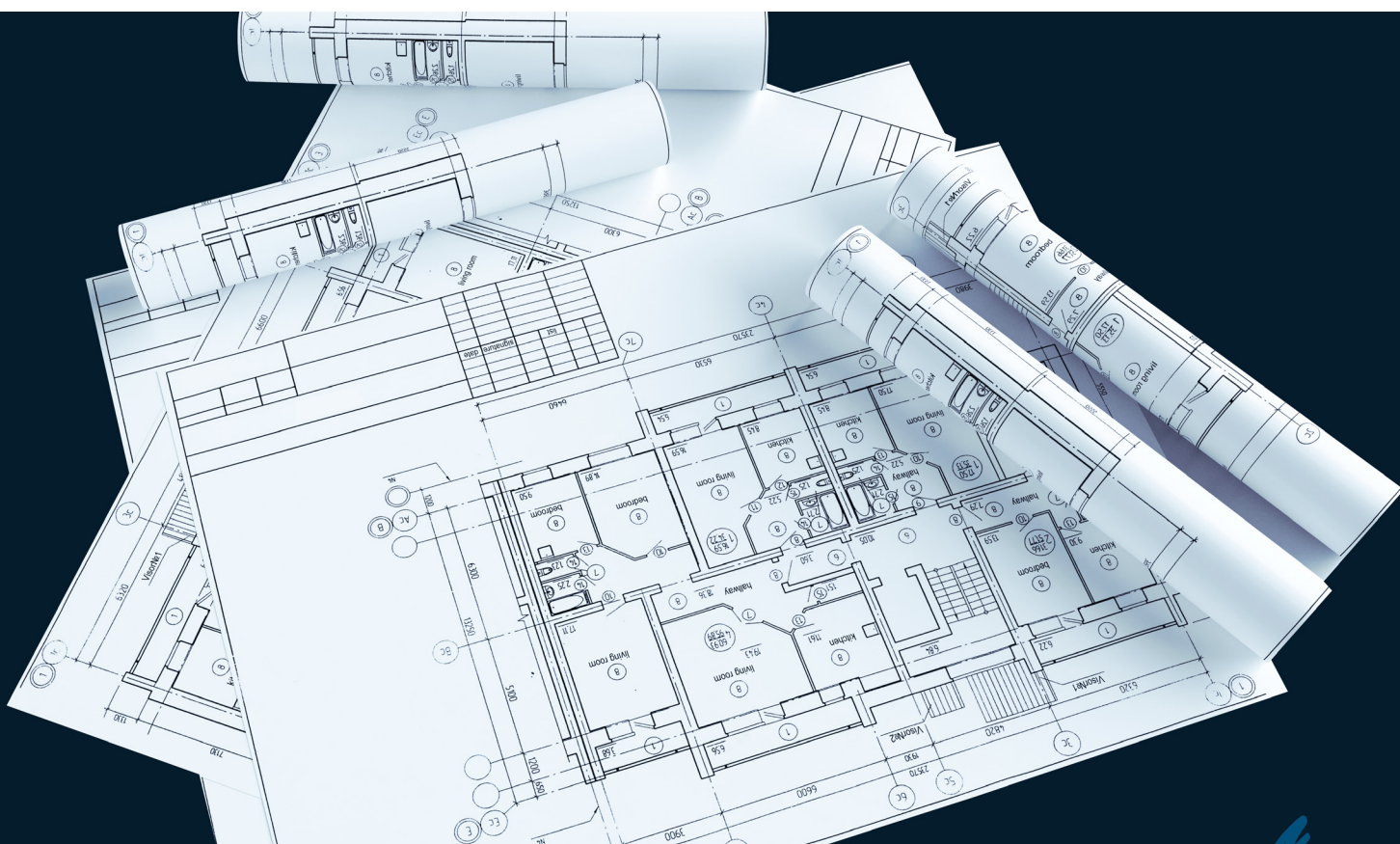


Strategy & Corporate Finance Practice

A blueprint for M&A success

Programmatic M&A can help companies build resiliency, but this approach to deal making requires a solid game plan—one that will guide proactive deal sourcing and opportunistic deal evaluation.

by Sophie Clarke, Robert Uhlener, and Liz Wol



Large mergers and acquisitions (M&A) tend to get the biggest headlines, but, as McKinsey research indicates, executives should be paying attention to all the small deals, too. These smaller transactions, when pursued as part of a deliberate and systematic M&A program, tend to yield strong returns over the long run with comparatively low risk.¹ And, based on our research, companies' ability to successfully manage these deals can be a central factor in their ability to withstand economic shocks.²









The execution of such a programmatic M&A strategy is not easy, however. Consider the situation at one global cosmetics company (a hypothetical case based on real-world experiences). Enthusiastic executives all had different ideas about which M&A opportunities the company should pursue (exhibit).

The CEO was pushing for a big bet on digital given the company's superior financial position. Some senior leaders proposed expansion in greater China, the fastest-growing market for premium cosmetics. Other business-unit leaders saw potential in the markets for organic products and men's grooming. All had their own agendas (see sidebar, "Undue influences").

Propelled by a healthy dose of FOMO (or fear of missing out) but lacking a clear set of priorities, the M&A team made multiple small bets on a range of businesses—even on some unexpected targets in adjacent markets (such as pet grooming). But the team did not have a clear plan for creating value from these targets nor for integrating them into the current business structure. The result?

Exhibit

When there is no clear connection between M&A strategy and corporate strategy, deals may falter.

Enthusiastic ideas for acquisitions ...	 Let's leverage our superior financial position (healthy balance sheet) vis-à-vis peers to make a "big bet" on digital channel.	 Let's expand our business to greater China. That is the fastest-growing market for premium cosmetics.	 Let's acquire an organic beauty company. Consumers want organic, and we have nothing to offer.	 Let's enter the men's grooming business. Men need products, too.
... wither due to lack of underlying rationale and integration plans	 This digital target could have allowed us to do online sales ... it was just too expensive.	 We acquired a few exciting, high-growth targets in Asia. Unfortunately, integration took longer than we had hoped, as scaling our existing processes in Asia was very complicated.	 I know we weren't planning on buying a pet-grooming company, but it turned out to be a great deal and had a surprising amount of synergy with our business.	 Our bank managed to find a ton of targets in all the adjacent businesses we were interested in (organics and men's grooming), and we acquired one of each.

¹ Jeff Rudnicki, Kate Siegel, and Andy West, "How lots of small M&A deals add up to big value," July 2019, McKinsey.com.

² Martin Hirt, Sven Smit, Chris Bradley, Robert Uhlaner, Mihir Mysore, Yuval Atsmon, and Nicholas Northcote, "Getting ahead of the next stage of the coronavirus," April 2020, McKinsey.com.

The M&A blueprint prompts business leaders to conduct a thorough self-assessment along with a comprehensive market assessment.

The organization ended up wasting time and resources on deals that were mostly unsuccessful, and its executives unintentionally created an unwieldy portfolio of businesses.

As this example illustrates, success in programmatic M&A requires much more than just executing on a long string of deals. Acquirers must articulate exactly *why* and *where* they need M&A to deliver on specific themes and objectives underlying their overarching corporate strategies. In addition, they must give careful thought as to *how* they plan to pursue programmatic M&A—including constructing a high-level business case and preliminary integration plans for each area in which they want to pursue M&A.

Taken together, these factors combine into what we call an M&A blueprint. In this article we discuss how it can be implemented to help organizations remain unrelentingly focused on their investment thesis throughout the deal process. Having a clear M&A blueprint is even more critical as companies begin to consider how to rebound from COVID-19. Without an M&A blueprint, it will be more difficult for companies to distinguish between through-cycle opportunities that are consistent with their corporate strategy and “low hanging, distressed asset” deals that are not.

M&A blueprint: The building blocks

The M&A blueprint can help executives answer three main questions: *Why* and *where* should we use programmatic M&A to achieve our corporate strategy? And *how* should we use programmatic

M&A to achieve our corporate strategy? Answering these questions will require asking still more clarifying questions about specific organizational strengths and capabilities, resources available, and other inputs to effective deal making.

Understanding ‘why’ and ‘where’

The M&A blueprint prompts business leaders to conduct a thorough self-assessment along with a comprehensive market assessment. The self-assessment helps establish the baseline from which to identify gaps in corporate ambitions as well as the opportunities for M&A to fill these gaps. It involves examining a company’s key sources of competitive advantage and testing their scalability to determine whether they would still play to the company’s advantage after a transaction. For its part, the market assessment acts as a “sense check” for business leaders, ensuring that the company’s M&A strategy capitalizes on the most recent and relevant trends, accounts for potential disruptions, and acknowledges competitors’ likely actions and reactions.

An M&A blueprint should also define any boundary conditions, or limits to the company’s use of M&A. These conditions, which are typically imposed by the CFO or the board investment committee, provide an important reality check: they define the constraints on certain types or sizes of deals, thereby further narrowing the scope of potential targets. In setting these conditions, business leaders should account for preexisting financial hurdles—for instance, a rule that “deals must be accretive in the first year” likely would not apply to deals targeting growth and might therefore

overly constrain M&A activity. Establishing these boundary conditions at the outset—with explicit agreement from the CFO and the board—can help put teeth into investment commitments and align everyone on negotiable and nonnegotiable terms.

Taken together, the self-assessment, market assessment, and review of boundary conditions can help executives understand the circumstances under which the pursuit of M&A makes the most sense, as well as the markets they are best positioned to enter. Indeed, the output of business leaders' discussions about "why and where" will be a set of M&A themes that reflect the company's best value-creation opportunities—those for which the company has the capabilities and resources to achieve intended strategic goals.

What does a good M&A theme entail? For each theme, senior leaders should identify important deal criteria (categorizing potential targets by geography, sales channel, product type, and so on) as well as standard screening metrics like company size, number of employees, revenue growth, product portfolio, ownership, and so on. With this detailed

information, organizations and M&A deal teams can continually cultivate potential targets within focused M&A themes while still being opportunistic about deals that present themselves.

Once these themes have been identified, business leaders should test them to ensure that they can execute against them—for instance, are there enough targets available, and do the right targets exist to fill gaps in the company's capabilities? The M&A blueprint will be particularly critical in target-rich environments to help narrow down the list of potentials.

A "gold standard" M&A blueprint is detailed and focused on critical competitive information (value-creation levers, company capabilities, and so on). To understand whether their companies' M&A themes are detailed enough, business leaders should consider whether they would be comfortable broadcasting those themes to competitors. The answer should be "no." If the answer is "yes," more work on the blueprint will be needed, as it and the related themes are likely not specific enough to be useful to M&A teams.

Undue influences

The hypothetical case of the global cosmetics company points to two common cognitive biases that can emerge when *any* company attempts to pursue programmatic M&A: the shiny-object syndrome and Maslow's hammer.

The shiny-object syndrome—also known as extreme distraction. Companies that continually chase down the next new thing run the risk of pursuing initiatives in the wrong order, skipping foundational tasks, or duplicating efforts and investments.

The M&A team at the cosmetics company, for instance, was reactive. It was swayed by deals sourced by third parties, and it ended up inventing growth strategies around possible, exciting targets without a clear understanding of how they could generate value.

Maslow's hammer. In his 1966 book *The Psychology of Science* (HarperCollins), psychologist Abraham Maslow stated, "I suppose it is tempting, if the only tool you have is a hammer, to treat everything as

if it were a nail." This is the approach the cosmetics company favored—establishing a well-organized M&A team but then using it to drive almost *all* growth rather than applying it only to those opportunities best suited to be bought, not built.

Without an M&A blueprint to provide an incontrovertible fact base and action plan, the cosmetics company's efforts to implement programmatic deal making turned into a quixotic, time-wasting effort.

Understanding 'how'

An M&A blueprint also prompts senior leaders to come up with a plan for “how” they will use M&A to further their overarching corporate strategies. Specifically, the M&A blueprint should delineate the high-level business case and preliminary integration plans associated with each M&A theme.

The business case should explain how the acquiring company plans to add value to the target or targets within a given M&A theme—for instance, the capital and operating expenditures needed (beyond the acquisition price) to integrate and scale the asset or assets. It should also outline the operational changes and capabilities that will be required to integrate the new assets—for instance, the creation of a new business unit or a set of new business processes to manage an acquired digital platform.

One large US healthcare company had committed to a strategy of building scale in its services businesses through M&A. First, it consolidated existing disparate service businesses under a new brand and organized them into three distinct units: pharmacy-care services, diversified health and wellness services, and data-analytics and technology services. These became their three M&A themes. Then, over a ten-year period, this programmatic acquirer closed more than 60 deals, spending well over \$20 billion, as it sought to fill out its portfolio along these three themes. The organization knew where it wanted to play and how.

Of course, the business case should include a preliminary integration plan for the acquired asset or assets that is consistent with the deal’s value-creation thesis—for instance, all shared services will be absorbed by the acquirer, and the target company’s product portfolio will be cross-sold to the acquirer’s existing customers.

Through their use of the M&A blueprint, business leaders can stay focused on those parts of the deal that can create the most value—especially important when companies are pursuing multiple deals within the same M&A theme. What’s more, they can prepare functional leaders, suppliers, and others well in advance for the actions they may need to take to integrate an asset or multiple assets.

M&A blueprint: Putting it all together

An M&A blueprint cannot and should not be developed based on “gut instinct” by a single executive or defined post hoc to validate the theory behind an exciting deal. An executive or business-unit leader should lead its development but should be supported by corporate-strategy and corporate-development executives. The blueprint itself can take the form of a frequently updated and disseminated written report, or it can be a standing agenda item in every M&A and corporate-strategy meeting. Regardless of format, it can help decision makers assess critical factors relating to deal sourcing, due diligence, and integration planning before making any moves and taking steps to identify targets.

Looking back at the case of the cosmetics company, it becomes clear how an M&A blueprint could have helped the organization prioritize a bunch of scattershot ideas into a comprehensive programmatic M&A strategy.

With its market assessment, for instance, it might have seen that the market for digital cosmetics is projected to grow five times faster than the market for nondigital cosmetics. What’s more, market data might have revealed that customers want and expect to buy cosmetics through digital channels, and that there is no clear leader in the space. In its self-assessment, the M&A team might also have seen a gap in the company’s product portfolio compared with peers. And a look at boundary conditions might have revealed the time and latitude required to pay off initial acquisition investments, enabling the team to look beyond “base hit” deals with lower acquisition costs.

The M&A blueprint would have led the cosmetics company to a different outcome—perhaps a laser focus on acquiring the set of assets and capabilities needed to build a digital platform for selling cosmetics.

Spending time up front creating an M&A blueprint will pay off over the long term—particularly given the volume of deals associated with a programmatic

M&A strategy. With M&A themes and criteria well defined and understood by all, companies can not only be more proactive but also more opportunistic. The top team will be aligned on strategy and focused on deal must-haves prior to reaching out to potential targets. Negotiations with potential targets can be grounded in the business case. Diligence processes can be accelerated and focused only on the most critical sources of

value. Integration planning can begin early, with a focus on realizing the strategic intent of the deal rather than just stabilizing companies, people, and processes in the wake of change. Most important, the M&A blueprint can help executives tell a compelling story (inside and outside the company) about its deal-making strategy and its vision for the future.

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The authors wish to thank Anthony Chui, Jack Gordon, Steve Santulli, and Lexi Wang for their contributions to this article.

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