The renaissance in mergers and acquisitions: How to make your deals successful

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If you set out to build a globe-spanning, market-leading beer company, you might not pick Johannesburg (South Africa) or São Paulo (Brazil) as the launching pad. Yet those two cities are exactly where the world's two largest brewers, SABMiller and Anheuser-Busch InBev, got their start. The two companies have grown from modest origins to world-straddling giants, with about 30% of the global beer market between them.

The remarkable trajectories of these two businesses hold a number of lessons. One is the fast-growing presence of companies from emerging markets. Another is the power of cross-border acquisitions, and not just in the direction of developed to developing countries. But perhaps the most compelling lesson lies in how the two companies achieved their current positions. Both arrived where they are today using similar business models: a repeatable method of mergers and acquisitions (M&A) supported by a disciplined management system. SABMiller, for instance, branched out from its South African home into other African nations, Europe, India, Latin America, the US and China—all by acquiring local brewers.

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In many ways, the two companies' approach represents the new normal for high-performing companies. Bain has long tracked the activities of what we call sustained value creators (SVCs)—companies that increase revenue and earnings at least 5.5% a year over an 11-year period, such as 2000 to 2010, while earning their cost of capital. Our study of mergers and acquisitions during this time frame showed that 9 out of 10 SVCs were active in the deal market, and companies in this group were more than twice as likely as other companies to derive at least 75% of their market cap from M&A. That fact is consistent with the broader findings outlined in Part I of this series, which show that frequent material acquirers earn higher returns than bystanders. The use of M&A, moreover, is likely to grow. In a world of superabundant capital, low interest rates and high investor expectations, M&A is one of the best tools available to companies to help them hit their growth targets, as we detailed in Part II of the series.

If you agree that M&A creates shareholder value and that the deal-making environment is likely to be favorable for some time to come, you can turn your attention to three important questions:

- First, how can you tell when a prospective transaction is a good one for your company? Most companies will have many likely candidates; the challenge is to find the right deal for your business.
- Second, should you be looking for scale deals or scope deals? As we'll see, the balance between the two depends partly on your experience in M&A.
- Third, how can you create a repeatable model for M&A success? As SABMiller and Anheuser-Busch InBev have learned, along with many others, the "virtuous circle of M&A repeatability" requires a significant investment in training, culture and analytics. But the rewards are also substantial.

How do you recognize a good deal for your company?

A merger or an acquisition can succeed if and only if it supports your company's strategy.

Strategy defines how you realize your ambition for the company (see Figure 1). A company needs to determine the markets in which it will compete. It must develop the differentiated capabilities that enable it to outperform the competition. Most often, winning strategies aim to create *leadership economics*. Market leaders generally have lower costs than their competitors. They often enjoy greater pricing power, brand recognition and differentiation. These advantages translate into better performance. Measured by return on capital, for instance, leaders typically outperform followers by a factor of two.

If an acquisition can help your company attain a leadership position in its markets, it may be a good deal. Nestlé's acquisition of Pfizer's infant nutrition business, for example, greatly improved the acquirer's market position in a number of strategic Asian markets, including China, Indonesia, the Philippines and Thailand. The deal helped Nestlé take an already strong infant formula business and consolidate its leading position worldwide.

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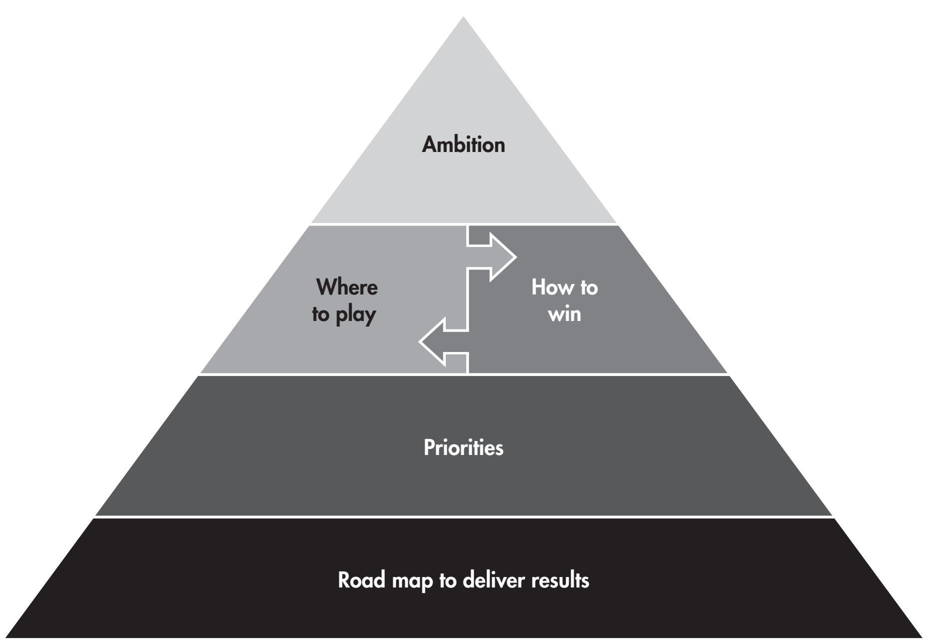
Another defining characteristic of a good deal: It provides you with critical capabilities that plug a gap or address a weakness in your existing business. An acquisition can strengthen or extend your product portfolio. It can open up new geographic regions, customer groups

Figure 1: Strategy reflects your choices about where to play and how to win



Source: Bain & Company

and distribution channels. It can provide you with supply chain assets or access to proprietary research. While a business may not fit well in one company's portfolio, it may be perfect in another's, thanks to what is known as parenting advantage. Volkswagen, for example, has acquired several auto manufacturers, including SEAT, Skoda, Bentley and Porsche, and has added value to the acquisitions through cross-brand technologies, such as its new modular transverse matrix. The matrix allows the company to use common platforms for several different brands, reducing both cost and production time.

There are several other questions to ask about a merger or an acquisition prospect, including the predictability of the target's cash flows and how the market views the asset. (See the sidebar, "What makes an asset worth buying? A checklist.") Your own company's situation affects the answers, however, because a deal that makes sense for a strong company may not have good odds of success for a weaker one. Financially healthy companies can afford the time required for careful due diligence. They can invest more in successful post-merger integration.

Scale or scope?

For many acquirers, viewing a deal through the lens of scale vs. scope yields critical insights about the long-term value of a potential acquisition. Scale deals involve a high degree of business overlap between the target and acquirer, fueling a company's expansion in its existing business. In scope deals, the target is a related but distinct business, enabling an acquirer to enter a new market, product line or channel. Both can be useful—and "scale vs. scope" has been a great debate in the M&A world.

What makes an asset worth buying? A checklist

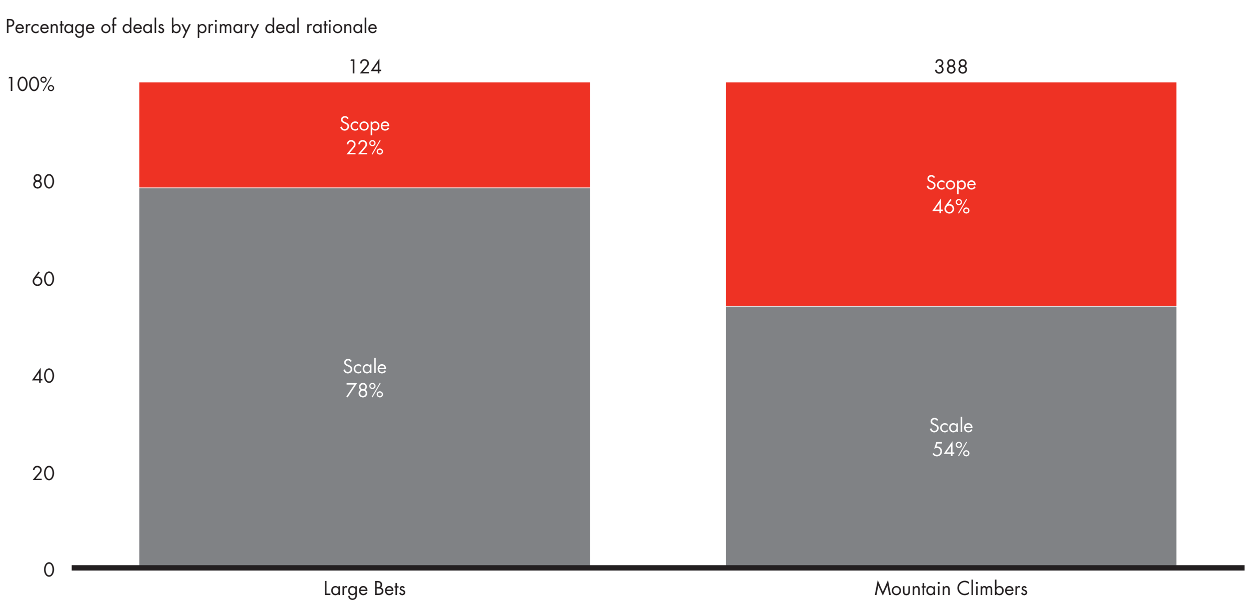
Though M&A is a part of most winning companies' success, disciplined acquirers pursue *only* those deals that satisfy a list of key strategic criteria. A typical list includes questions like these:

- Can the asset generate leadership economics—that is, returns above the industry average due to superior costs, customers, capabilities or leverage?
- How predictable are the cash flows, and how are you discounting potential variability of return (risk)?
- What is the conventional wisdom associated with the asset? Where is that conventional wisdom wrong? How does that influence the price?
- What must you believe to be true to capture cost and revenue synergies?
- What is the option value that owning the business generates?
- What is your parenting advantage, and how will you manage the business?
- How will the market react to the announcement of the acquisition?

Today, the verdict is in. Inexperienced acquirers tend to focus mainly on scale deals, those that improve or consolidate their position in a given market. Experienced acquirers average a 50-50 mix of scale and scope deals, improving their market positions while also adding product lines, geographic reach or other important capabilities. Figure 2 highlights that contrast: It compares what we call "Mountain Climbers"—frequent acquirers whose acquisitions amount to at least 75% of their market cap—with "Large Bets," companies making occasional big acquisitions. A recent Bain survey shows how much more confident these experienced acquirers are: Asked about moving into an adjacent market, 73% felt that M&A was likely to be as successful or more successful than building a business from scratch. Only 55% of inexperienced acquirers felt the same way. And it is the experienced acquirers, as our research shows, that usually turn in the best results.

Different patterns of risk and reward accompany each kind of deal. Scale deals, historically, have put cost synergies at the top of the deal thesis: *If we buy this company, we will have a larger presence in the market and realize greater economies of scale*. The risk is that the acquirer winds up creating a slow-moving behemoth and the synergies never materialize. Scope deals, by contrast, usually put growth at the top of the deal thesis: *Buying this company gives us access to new and faster-growing markets*. The risk here is that the acquirer will stumble as it learns to manage an unfamiliar business. Because of the intrinsic differences between scale deals and scope deals, every element of the deal cycle, from strategy through integration, has to be managed differently. Scale deals succeed on the basis of rapid overall integration, capture of cost synergies and full cultural integration. Scope deals succeed when the acquirer preserves the unique attributes of the company it has just bought, integrating the two only where it matters—

Figure 2: Almost half the deals done by "Mountain Climbers" are scope deals



Note: Analysis of deals valued at more than $250 million by 194 companies classified as "Mountain Climbers" (n=117) and "Large Bets" (n=77) from 2000–2010
Sources: Bain M&A study 2012; Dealogic; Thomson; Bain SVC database 2011; Bain analysis

and when the two businesses begin to cross-pollinate, creating platforms for future growth. As an acquiring company becomes more experienced, it learns the differences between scale and scope deals, and can thereby manage the risks and maximize the benefits.

What the most successful acquirers have in common is sustained institutional investment in an M&A capability, much as if you were building a marketing or manufacturing function from scratch.

SABMiller illustrates the advantages of experience, particularly in cross-border deals. The company has moved into more than 30 countries in the last 20 years, in nearly every case by acquiring local brands. It maintains and develops these brands, reflecting the industry axiom that all beer is local. ("You can't be a real country unless you have a beer and an airline," declared the late rocker Frank Zappa, a quote SABMiller used in a 2013 presentation highlighting its broad portfolio of brands.) At the same time it has created a disciplined business system that enables it to add value to each acquisition. Global procurement and shared brewing techniques reduce cost. An innovation tool called SmartGate facilitates the introduction of new products in each market. Eight cooperatively developed "SABMiller Ways" define best practices in marketing, brand management, talent development and other facets of the business, and are rigorously applied to local operations.[1]

Anheuser-Busch InBev, which traces its managerial origins to a small Brazilian brewer, incorporates similar disciplines and has been equally successful with its M&A strategy. The two companies have become experts at what are essentially scope deals, because most moves into a new country are likely to involve new value propositions, new supply chains, new distribution channels and so on. No coincidence, both companies have remarkable records of profitable growth.

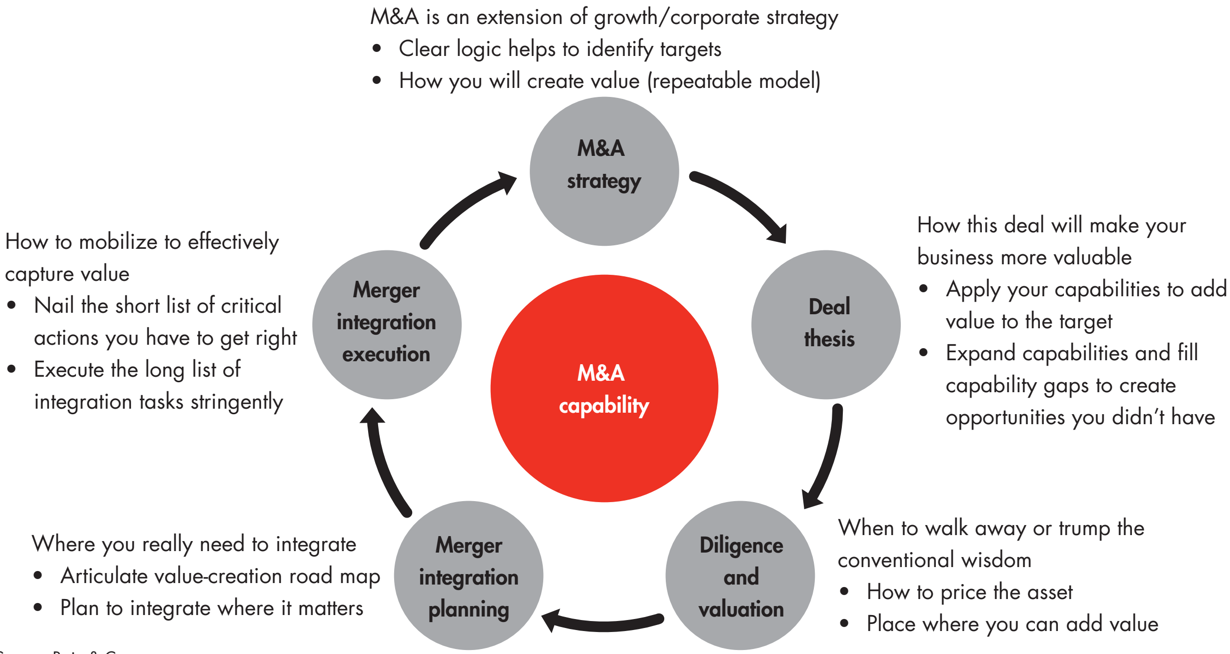
Building a repeatable M&A capability

The brewers are hardly alone. Many leading companies have created a repeatable M&A capability and then turbocharged their growth through a series of acquisitions. What all these acquirers have in common is sustained institutional investment in this capability, much as if they were building a marketing or manufacturing function from scratch.

One way of picturing the capability is to think of the acquisition process as a cycle of steps repeated with each deal—a virtuous cycle of M&A repeatability, so to speak *(see Figure 3)*. The key for the purposes of this article is the red circle in the middle of the figure, without which the other steps are more likely to fail. Let's look at the elements a company must put in place if it wants to build this kind of M&A capability:

1. **A strong business development office** at the center, typically with close links to the company's strategy group, CEO and board. IBM's office is a great example. The company has completed more than 140 deals since 2000, acquisitions that played an important role in redirecting the company's business toward higher-value, more profitable technologies and market opportunities in software and services. Its business development office ensures a strong, ongoing connection between M&A and strategy, linking the company's accumulated dealmaking experience to strategic decisions. The office asks three critical questions about each potential acquisition: Does it build on or extend a capability IBM already has? Does it have scalable intellectual

Figure 3: The "virtuous circle of M&A repeatability" depends on an M&A capability at the center



Source: Bain & Company

property? Can it take advantage of our reach into 170 countries?

IBM's office is also responsible for working with M&A service providers and maintaining liaisons with business units. It also measures and tracks the results of each deal, essentially creating an M&A learning organization.

2. **Accountability for new business activity lodged with the business units.** Business units can come to corporate with ideas for deals, but they must own the process of managing the business. At Illinois Tool Works, a diversified manufacturer that routinely buys small and medium-sized companies to expand its operations, business unit leaders are tasked with identifying new M&A opportunities to pursue in their respective business lines. In recent years, for example, the company built its car-care business group with acquisitions of a number of brands of car wash, wax and other maintenance products.

3. **A commitment to differentiated due diligence.** Many companies don't start due diligence on an acquisition target until they receive an offering memorandum from an investment bank. H.J. Heinz takes a different approach. On key strategic areas, the company systematically assesses potential acquisitions before they are actively shopped. That way, executives have a sophisticated point of view on the asset's value when it comes on the market. Heinz's disciplined process leads to a higher percentage of proprietary deals. The company also establishes a firm walk-away price for each prospective deal, and it plans post-merger integration from the beginning. Heinz's due diligence is linked to its deal thesis at all times, which helps to maintain discipline during the entire process.

4. **Integration where it matters.** As we noted, the integration process is fundamentally different for scale deals compared with scope deals. But any integration has to focus on the sources of value, the people involved and the processes upon which each party to the deal depends. Kraft, for example, had to integrate 41 country organizations when it bought the candy maker Cadbury in 2010. But it concentrated on the 11 countries that accounted for 75% of the revenues and potential synergies. In those countries, dedicated local teams led the integration process, with senior executives focusing on critical decisions, such as how to combine the high brand recognition of Kraft products with Cadbury's distribution and supply chain networks. Experienced acquirers like Kraft understand the merger integration paradox: A few big things matter—but the details will kill you. And they know that functional groups, left unchecked, can become a serious liability in any post-merger integration.

   Veteran acquirers also invest to build a repeatable integration model. They evaluate each integration and determine what they will do differently next time. They build a playbook and invest in building the skills of their integration experts. In effect, they make integration a core competency—and it enables them to beat the M&A odds time after time.

5. **Reliance on good change management principles.** People create a big risk for any acquisition. They typically undergo an intense emotional cycle, with fear and uncertainty swinging abruptly to unbridled optimism and then back again to pessimism. Experienced acquirers understand this natural rhythm and manage the risks involved. When Merck KGaA, the German chemicals and pharmaceuticals concern, acquired US biotech equipment supplier Millipore in 2010, one of the first moves in the post-merger integration process was a series of workshops for executives from both companies. First, participants focused on creating a vision for the combined entity. Second, they drew up a more concrete view of the company's future state: What would the firm look like five years down the road? Third, they defined the initiatives required to achieve full potential. When the vision, the future state and the firm's full potential are crafted with full participation by all members of the leadership team, the odds of success increase dramatically.

These five components are the building blocks of a repeatable M&A model that can foster steady, profitable growth. It's been a successful formula for Godrej Consumer Products, the India-based maker of household and personal-care items. Recognizing that M&A was essential to its global growth goals, the company prepared for two years before setting foot in the deal market. It assembled a strong M&A team. It developed a playbook that included a rigorous screening process to identify appropriate acquisition candidates. It followed a disciplined M&A approach based on a strong understanding of each market, a robust deal thesis and detailed due diligence. Godrej focuses on emerging market deals and just three categories of products (household insecticides, hair color and personal cleanliness). It targets companies with leading positions in their markets, knows how it expects to create value from each deal and takes a tailored approach to integration. The company's 11 acquisitions outside India since 2005 include large deals such as Megasari, Indonesia's second-biggest household insecticides company.

This disciplined M&A strategy contributed to Godrej's consistently strong performance between 2002 and 2012: sales growth averaging 27% a year and earnings growth averaging 33%. The share price rose 42% over the same period, outperforming peers and resulting in a more than 45-fold increase in the company's market capitalization.

Looking ahead

Our three-part analysis of M&A points to a few key insights.

One is this: You ignore deal making at your peril. Companies that did no acquisitions between 2000 and 2010 turned in poorer performance than the deal makers. The more deals a company did, and the more material those deals were, the better its performance was likely to be.

A second conclusion is that the business environment has rarely been more favorable for M&A. Capital is superabundant and interest rates are low. The world economy abounds with big opportunities. Buying into a market is often a company's best tool for tapping into that growth potential.

The third conclusion—the subject of this article—is that M&A winners develop a repeatable model. They can do one deal after another and integrate each one successfully because they have created the necessary capability in their organizations. SABMiller and Anheuser-Busch InBev show what's possible: Both companies launched their business in relatively small developing markets, and then expanded into one country after another. Today they straddle the globe.

Not every company has what it takes to pursue M&A successfully. The best have a deep understanding of their strategy and begin from a position of strength. They commit to developing a repeatable model, and they make the necessary investments. Their reward, as we have seen, is growth—in revenue, earnings and total shareholder return—that far outstrips the competition.

1 See SABMiller Annual Report 2008, http://www.sabmiller.com/files/reports/ar2008/2008_annual_report.pdf
See SABMiller CAGNY presentation, February 19, 2013, pp. 19, 50, http://www.sabmiller.com/index.asp?pageid=70

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