



# Corporate M&A Report 2020

Disrupt or be disrupted? More companies choose to play offense with scope M&A.

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## **Acknowledgments**

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## Letter to readers

Dear friends,

This is our second edition of the Global Corporate M&A Report. We were thrilled by the response to our perspectives last year on the world of corporate M&A. Thanks to the many of you who provided us with feedback that advanced the dialogue.

Our mission with this report remains the same: We aspire to use our unique position in the M&A world to connect what we see happening in our clients' executive suites with the larger trends we are witnessing across the globe. The result, we hope, is to make all of us a little better at the craft of M&A.

Many executives adopted a recession footing in 2019, especially early in the year. Economic activity was volatile in 2019. This directly affected the level of M&A activity. M&A deal activity in Europe and Asia was way off in the first half of the year and then started to pick up. The US actually started off strong and then leveled off. Add it all up, and final global corporate M&A deal value for 2019 came in at \$3.4 trillion, based on Dealogic data—not a weak year by any count. Looking beyond the magnitude of deal activity, we see that some of the old norms governing M&A are evolving. Let's highlight two in particular.

On the geopolitical front, the Brexit specter and trade wars significantly lowered the appetite for cross-regional deals. This was evident from the drop in deal values in and out of the UK, and in outbound deal values from the US and Asia.

On the social front, there was open angst regarding the effectiveness of capitalism itself and specifically the unchecked power of large technology firms. This angst is rapidly expanding M&A regulation. Regulators are increasingly scrutinizing deals for considerations such as access to personal data and the impact on national interest and security as well as the effect deals may have on future competition.

Beyond these macro trends, the shift from scale to scope deals, which we first highlighted in last year's report, accelerated in 2019. Five years ago, the majority of large deals involved buying assets for scale, market power and getting to a lower cost position. After all, these were the proven routes to success.

Now we live in a world of business model disruption catalyzed by technological progress and the emergence of digital native competitors. Executive focus has substantially shifted to investing in future growth engines. It is no surprise that dealmaking has similarly evolved. Scope deals, which we define as deals intended to enter faster-growing segments or to acquire new capabilities for future growth, now comprise nearly 60% of all deals worth more than \$1 billion in value. This is up from around 50% last year and 40% five years ago.

We were asked repeatedly after last year's report: "Are scope deals successful?" We decided to pose this question to a group of nearly 250 senior executives. They were asked to rate their perception of success

with scale and scope deals. The response? Scope deals are considered at least as successful as scale deals—and among scope deals, those aimed at acquiring new capabilities were rated as most successful.

That said, this finding comes with a caution. It is based on the respondents' self-assessment, not backed by an analytical study or other tangible proof points. We are starting to see that some of these deals are successful, but we're still in early days. In fact, in 2019, some scope deals got substantially larger than usual and started looking like one-off big bets. This is dangerous, for the history of large, big-bet acquisitions has often not been pretty.

We have been writing on the topic of success in M&A for more than two decades, and the bottom line is this: Companies that develop a repeatable capability for M&A through frequent acquisitions outperform all others.

Remarkably, frequent acquirers don't only acquire the most, they also divest the most. Scope deals help companies expand into new growth segments and add new capabilities, scale deals help to build leadership positions, and divestitures release the time, talent, energy and capital that is locked up in nonstrategic businesses.

Experienced acquirers show us that doing scope deals, especially for technological capabilities, requires a different mindset and approach than those used for scale deals. In the second half of this report, we outline an approach to M&A capability building that is adapted for the changing times. A few things should and will feel different.

- A traditional target-screening approach within a defined industry boundary is barely adequate in today's environment. The best acquirers are rapidly developing broader market-sensing capabilities to identify and track new technologies and new business models.
- We know that most deals fail in the beginning, at diligence, and this has not changed, even if the deal mix has. Many acquirers are improving the odds through earlier cross-functional team involvement, longer diligence horizons and more robust relationship building to really understand the people, culture and talent. After all, that's where the value often is.
- We are seeing a real interest in acquiring new capabilities, whether digital or otherwise, to strengthen the existing business or for innovation. Clearly, traditional scale integration playbooks won't help to capture the value in capability deals. In a major departure from traditional approaches, successful acquirers are leading with joint value-creation plans, not functional integration.
- Finally, there is no way to invest in new growth engines without divesting businesses that no longer fit the future strategic agenda, but there is also no reason to lose value in the process. The best companies divest without needless delay, and they prepare ahead of time to get their fair share of value.

Will we experience a recession over the next couple of years? Whether or not we do, the most successful companies will take advantage of any opportunity to strengthen their structural positioning in the market through preplanned M&A and divestiture action.

We hope you enjoy reading the rest of this report. As always, please feel free to reach out to us to share your views and advance the dialogue.

Sincerely,  
The Bain Global M&A team

## Section 1: State of the M&A market

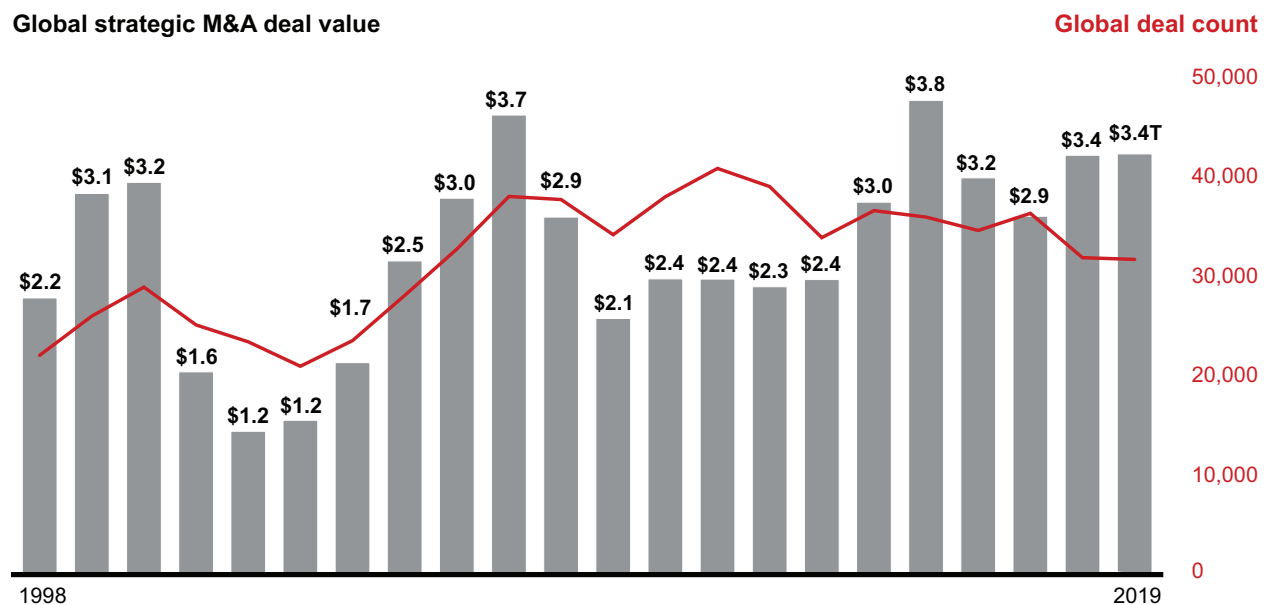
Worries about the global economy and a potential downturn dominated executive discussions in 2019. There were major geopolitical issues to deal with, too, headlined by the chaotic path to Brexit and US-China trade tensions. Executives also grappled with rising regulator intervention in dealmaking that dampened spirits, most notably in Europe. While it has never been easy being an M&A decision maker, the past year introduced multiple layers of unease.

### Resiliency in M&A

The numbers bear this out. The expectation going into 2019 was that a moderation in deal volumes would resume. The year, however, turned out to be surprisingly resilient. The deal count for 2019 was only 2% lower than 2018, and deal values increased by 1% year over year (see Figure 1.1). Strong megadeal activity in the US in the first half of 2019 was balanced out by a slower second half. In Europe and Asia, the opposite occurred: The year started slowly and then started to pick up.

In a bit of a surprise, at least to us, transaction multiples are now on par with the 15-year average (see Figure 1.2). This is true across all industries except technology and consumer products, where

**Figure 1.1:** Global strategic M&A deal value and volume were on par with 2018

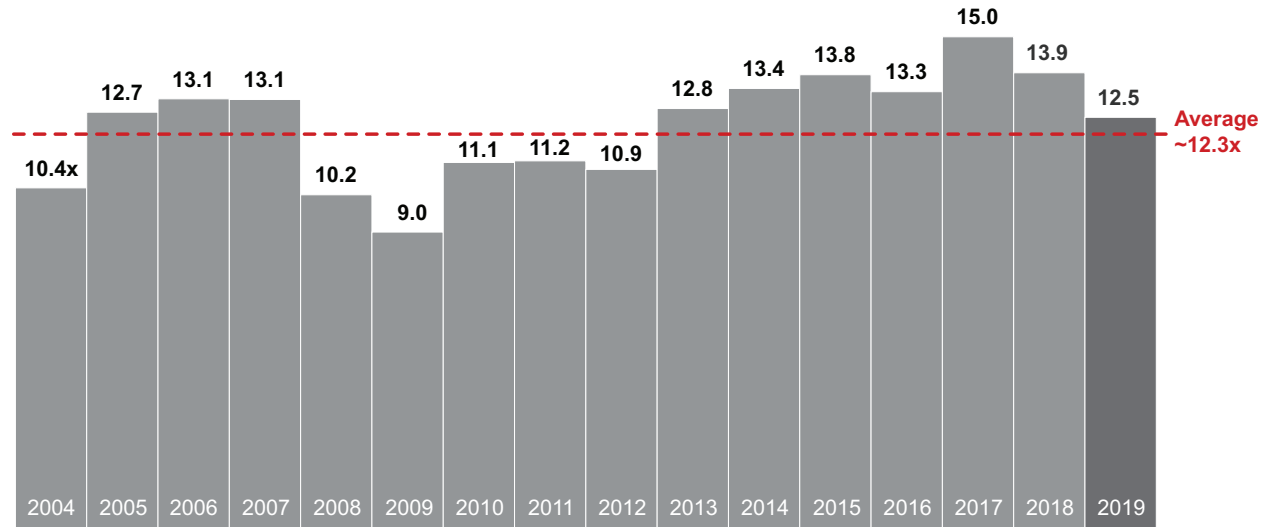


Notes: Deal value based on announcement year, including deals that are currently pending; strategic deal value includes acquisitions made by public or private companies, including any acquisitions from financial sponsors; only rank eligible deals included, except for buyback programs and equity carve-outs; data as of January 2, 2020  
Source: Dealogic



**Figure 1.2:** Transaction multiples have corrected from the 2017 peak

**Median EV/EBITDA transaction multiple, global**



Notes: EV=enterprise value; EBITDA=earnings before interest, taxes, depreciation and amortization; median deal multiples for announced strategic deals where multiple data was available; strategic deals include acquisitions made by public or private companies, including any acquisitions from financial sponsors; only rank eligible deals included, except for buyback programs and equity carve-outs; calendar year data for all years except 2019, which is January through September  
Sources: Dealogic; Bain analysis

multiples are still higher than the long-term average—a situation that could change in a world of slowing economic growth.

Amid trade wars and higher regulatory scrutiny on grounds of national interest, cross-regional deal value declined by 31% during the first nine months of 2019 vs. the same period in 2018 and continued a three-year decline in volume.

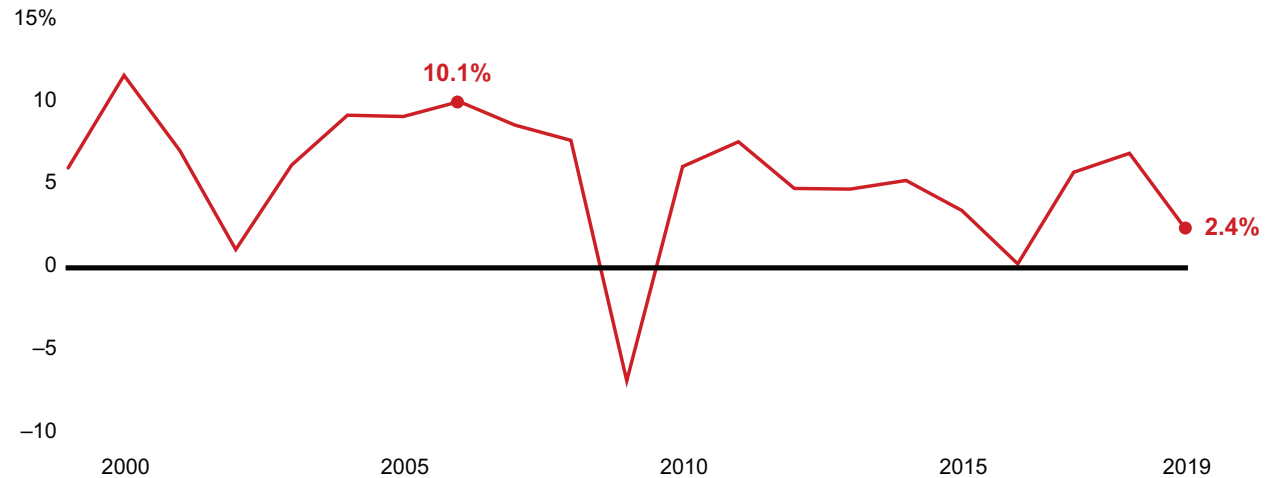
Despite slowing economic growth in 2019, capital conditions remained favorable, with low interest rates. We expect the interplay of economic growth and cost of capital to continue to determine the fate of deal volumes in the year ahead.

**Scope deals continue to gain momentum—for now**

Within this moderate M&A environment, the nature of dealmaking continues to evolve. Historically, the biggest deals were rooted in scale economics, capturing the benefits of cost and customer overlap by becoming a larger player in an industry. As we introduced in last year’s report, the fundamental justification for many deals has now shifted to a scope orientation—that is, more deals are predicated on getting into faster-growing lines of business or acquiring new capabilities. That trend intensified in 2019. Often the intent is to garner both growth and capabilities.

**Figure 1.3:** Revenue growth rates stumbled again in 2019, to around the low-single-digit mark**Annual revenue growth rate**

Median for nearly 900 companies from leading stock indexes



Notes: Leading stock indexes include the S&P 500, FTSE 100, CAC 40, DAX 30 and Nikkei 225; all growth rates are for the last 12 months ending in September of each year

Sources: Capital IQ; Bain analysis

Scope deals comprised nearly 60% of all large deals in the year ended September 2019 vs. 40% in 2015 (see “About the methodology” for more details on Bain’s approach to classifying approximately 1,200 strategic deals). Among deals with disclosed values of more than \$1 billion, the absolute dollar amount spent on scope deals rose 50% from 2015 to 2018, while the dollar amount spent on scale deals halved.

**This rise in scope M&A is a response to business model disruption and low growth.** Top-line growth rates continue to trend downward for the leading publicly traded companies (see Figure 1.3).

**The trend toward scope M&A also indicates that most executives are engaged in a strategic shuffling of portfolios.** Many are grappling with the need to migrate their portfolios from successful but slower-growing legacy businesses to new growth engines.

With economic concerns top of mind, it is good to remind ourselves that recessions are a moving target and that for most of us, market timing has not been a winning strategy. What we do know for sure is this: Every downturn produces its winners and losers. The winners prepare by using scale and scope M&A and divestitures proactively to reshape their portfolios.

## Section 2: Key M&A trends

### M&A regulation: Scrutiny of deals expands

#### At a Glance

- ▶ The year 2019 saw unprecedented regulatory scrutiny of M&A transactions.
- ▶ In a tech-enabled world, deal scrutiny is expanding to include issues such as data ownership and access to critical technology, often prompted by national interests, as well as the impact on future competition.
- ▶ The time, complexity and the resources to get deals over the regulatory hurdle are rising—it will take longer than you think and cost more than you expect.
- ▶ This all places greater demands on preparing for regulator consultations and broader stakeholder communications during the deal diligence and negotiation phases.

#### Scale deals are getting harder to clear

Many industries are reaching their natural limits on consolidation, a nagging reality that makes it harder to get deals approved. Consider T-Mobile and Sprint's \$59.6 billion merger in the US. After two unsuccessful bids, it was finally approved by the federal regulatory authorities, but the deal still faces objections from multiple states. In Asia-Pacific, regulators blocked the \$6.2 billion merger of Vodafone Group's Australian business with TPG Telecom. In Europe, the Competition and Markets Authority (CMA) halted the \$10 billion Sainsbury's-Asda merger.

European regulators have also been hawkish on pan-European deals. In February 2019, the European Commission (EC) blocked the merger of Siemens Mobility and Alstom's rail transport business. The companies failed to address the EC's concerns regarding competition in the signaling and high-speed rolling stock markets. Alstom CEO Henri Poupart-Lafarge said, "If I have one regret, it is using that phrase 'European champion.'" The EC also blocked a joint venture between Germany's Thyssenkrupp and India's Tata Steel (Europe) in June 2019, which would have created Europe's second-largest steel producer.

For companies undertaking scale deals, there are proven ways to prepare for navigating regulatory consultations.

Let's look at the proposed merger between the No. 3 and No. 4 telecommunications players in a European country. The two companies were offering mobile services in the same market, with a combined market share of 25%. The EC had a past record of requiring remedies or even blocking such in-country telecom deals. Over the previous five years, Europe saw two such mobile-mobile scale deals rejected or withdrawn, and five were approved with remedies, which, over time, progressed in their severity.

Knowing this history, the acquirer still decided to go ahead but to prepare rigorously and perform vast and in-depth analysis on issues such as:

- local and European market and competitor analysis, including both core mobile and adjacent markets;
- infrastructure investments made by players and the outlook for future developments;
- business rationale for the deal and the expected benefits, in particular to customers;
- risks for the two companies in the event that they did not merge and the effect on competition; and
- merger efficiencies (synergies) and their specificity and verifiability.

The comprehensive analysis addressed the regulator's concerns by showing how the deal would be a win-win for the merging companies and customers as it would both improve services and increase competition. The robust responses prepared to address all political and competitive arguments against the deal were strong enough to allow the acquirer to ask for and receive unconditional approval from the EC.

The time, expense and required remedies to get scale deals approved is rising. Increased regulatory scrutiny—enabled by digital technologies such as e-discovery, which can scan hundreds of thousands of documents on company IT systems and devices—raises the bar on deal evaluation, due diligence and the depth of preparation needed for regulatory filings and engagement.

Companies need to be ready for a longer time to close, including the timing implications on value capture and, more importantly, the people costs. A lengthy time to close can wear out the most motivated leadership teams, and as regulators ask for more internal data, it can also drain other resources. Assessing regulatory risks at the diligence stage and preparing for remedy negotiation ahead of time bring great value.

### **Scrutiny on nontraditional grounds is rising**

The rising tide of populism and widespread angst around economic and political well-being are raising questions about the role of large corporations and their influence over day-to-day life. The resulting political pressure has led to some fundamental rethinking about antitrust laws and national security mandates in approving deals. As such, regulatory oversight is evolving beyond issues of market concentration to include consumer data and privacy, national interest and security, and future competition.

Some sectors, such as technology, aerospace and defense, telecommunications, and healthcare, lend themselves to more scrutiny on nontraditional grounds than others do.

There are several recent instances of blocked deals and even rescindments on these grounds. In 2019, the Committee on Foreign Investment in the United States (CFIUS) required Beijing Kunlun Tech to sell Grindr, a dating app purchased over 2016 to 2018. Some believe that the request came after scrutinizing app developers over the safety of the personal information of millions of Americans. (CFIUS did not disclose the reasons.)

Around the same time, CFIUS demanded that Chinese digital healthcare company iCarbonX divest its interests in PatientsLikeMe and HealthTell, two US companies that collect health data. While the reason for CFIUS's decision in this particular deal is unknown, it was speculated that the regulatory body had concerns that the private health data of American citizens would be exposed to the Chinese owner.

In September 2019, the US Department of the Treasury proposed regulations to broaden the CFIUS's oversight to smaller foreign investments that involve a critical technology, critical infrastructure or sensitive personal data of US citizens.

Recently, regulators have increased scrutiny on what are being termed “killer acquisitions.” In these deals, a large company acquires innovative targets only to discontinue the development of the targets' innovative projects to prevent future competition. Indeed, acquisitions of start-ups by larger incumbents could eliminate future competitive threats, increasing the incumbents' overall market power in a way that would not be captured with traditional market share analysis. These acquisitions often go undetected due to low deal value, scale or consumer impact.

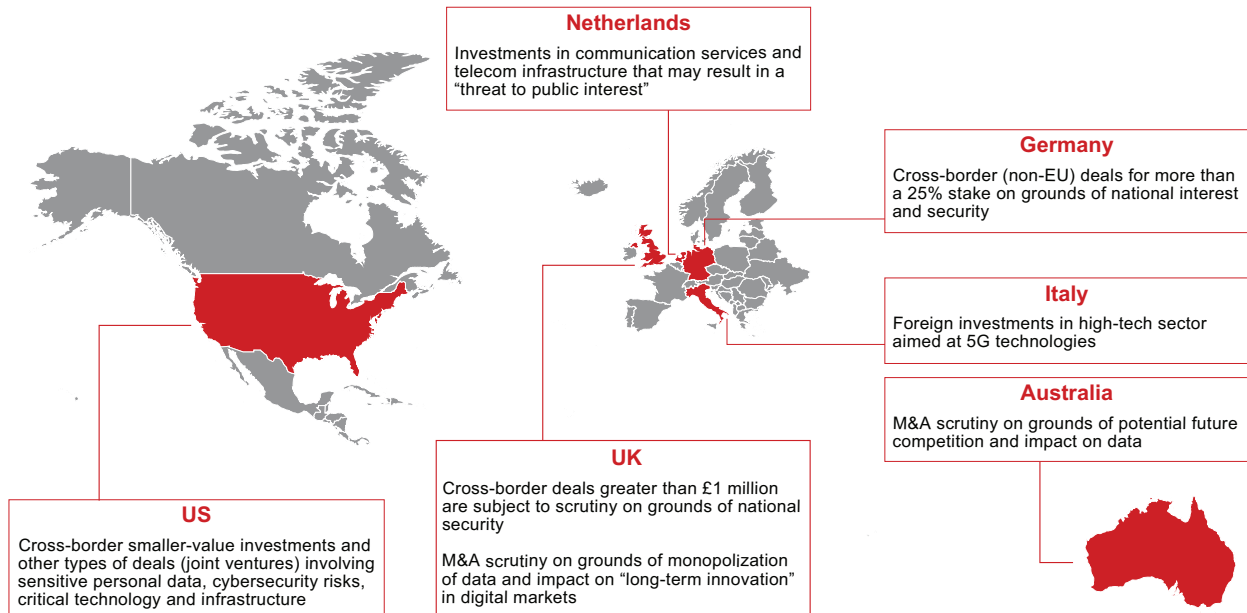
Amazon's attempt to take a minority stake in Deliveroo, an online food delivery business, through a financing round with several other investors (totaling \$575 million) is under inquiry by the CMA after German authorities had already cleared the deal.

This type of scrutiny is not only limited to tech companies. Mexican officials blocked Walmart's deal to acquire Cornershop, a small grocery delivery business. The deal was blocked on the grounds of unfair access. Walmart could not guarantee a level playing field for rival retailers whose customers use the application to order groceries and other goods.

Even in pharma, deals in which a big company acquires a nascent rival and halts its drug development are coming under scrutiny. Questcor (currently Mallinckrodt ARD) had a US monopoly on adrenocorticotrophic hormone drugs with its Acthar formulation. It acquired the US rights to a potentially competing drug, Synacthen Depot, in 2013, and later stopped its development. Acthar's vial price was raised from \$40 in 2001 to \$34,000 in 2015, while outside the US, Synacthen Depot was available at a fraction of Acthar's price, according to the complaint. To settle the complaint, the company agreed to grant a license to develop Synacthen Depot and pay a \$100 million fine to the Federal Trade Commission (FTC) for violating antitrust laws (by preventing another bidder from developing and launching the drug in the US).



**Figure 2.1:** Regulatory deal scrutiny is expanding to nontraditional areas



Note: Proposed or implemented regulatory changes over 2018 to 2019 (not exhaustive)  
Source: Bain analysis

Lately, the FTC chairman has gone so far as to say that he's ready to break up major technology platforms if necessary by undoing their past mergers. For many companies, this is new territory to navigate (see Figure 2.1).

For dealmakers, scale and market power are no longer the only considerations to get regulatory approval. Addressing the evolving regulatory discussions and stakeholder communications will require greater thought and preparation, but doing so can pay off by reducing the friction and costs required to get a deal over the regulatory hurdle.

## Nature of dealmaking: How will the scope M&A boom pan out?

### At a Glance

- ▶ Scope dealmaking accelerated in 2019 and now represents roughly 60% of all large deals as companies stay motivated to buy into new growth areas and capabilities.
- ▶ Within scope, capability-driven deals have grown their share from 2% of large deals in 2015 to 17% in 2019.
- ▶ Executives consider scope deals to be at least as successful as scale deals.
- ▶ Some of the really large scope deals of 2019 look a lot like big-bet scale transactions, which carry more risks.

### Scope dealmaking is accelerating across industries

Scope deals now account for roughly 60% of all strategic deals valued in excess of \$1 billion. This is a trend we have seen accelerate over the past five years (*see Figure 2.2*). We believe this is in response to the low-growth environment and business model disruption across several industries (see “About the methodology” for more details on Bain’s approach to classifying approximately 1,200 strategic deals).

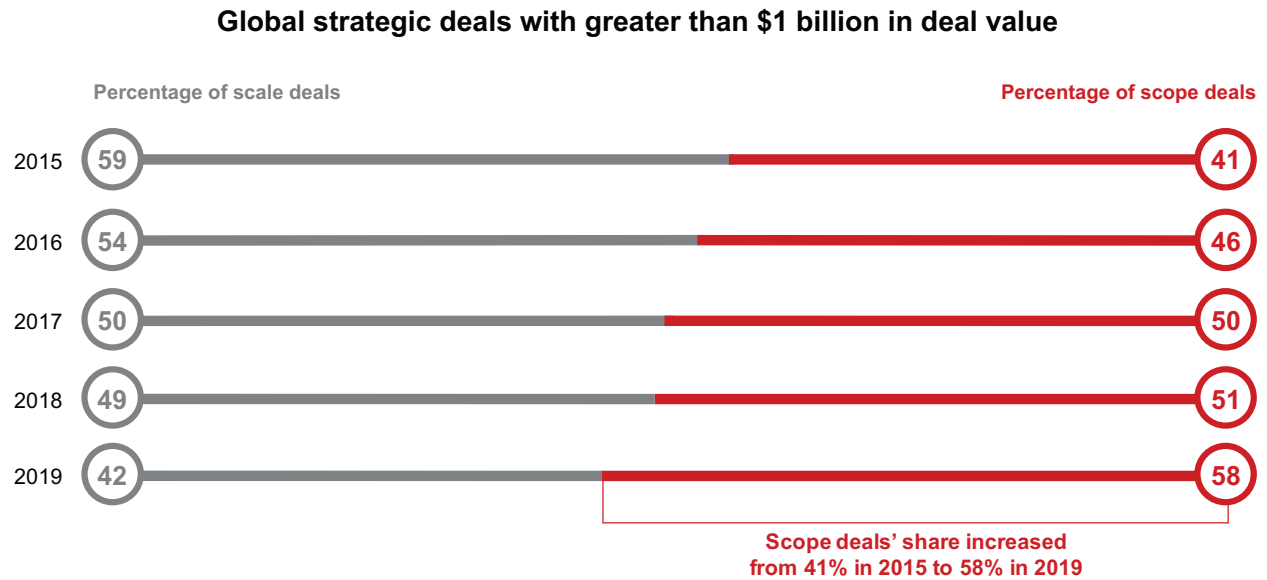
While scope dealmaking is prevalent across sectors, healthcare, technology and consumer products lead the charge (*see Figure 2.3*).

Consider the different flavors of scope deals across sectors. In healthcare, players bought their way into high-growth therapeutic areas such as oncology (Pfizer-Array BioPharma, Lilly-Loxo Oncology) and gene editing (Vertex Pharmaceuticals-Exonics Therapeutics). Some also acquired digital capabilities—for example, Johnson & Johnson purchased Auris Health to develop a combined robotics surgery portfolio.

Within technology, the financial technology subsector saw three blockbuster deals with similar rationales in which traditional card payment processors acquired merchant-side capabilities: Fidelity National-Worldpay, Fiserv-First Data and Global Payments-Total System Services. Large technology companies also invested in high-value data science and analytics capabilities to add to their offerings. Salesforce bought Tableau for its data visualization platform, and Google bought Looker Data Sciences, which specializes in analytics and machine learning.

Consumer products saw a mix of growth and capability acquisitions. Companies invested in direct-to-consumer channel capabilities (Edgewell-Harry’s in razors, Natura-Avon in beauty products), high-

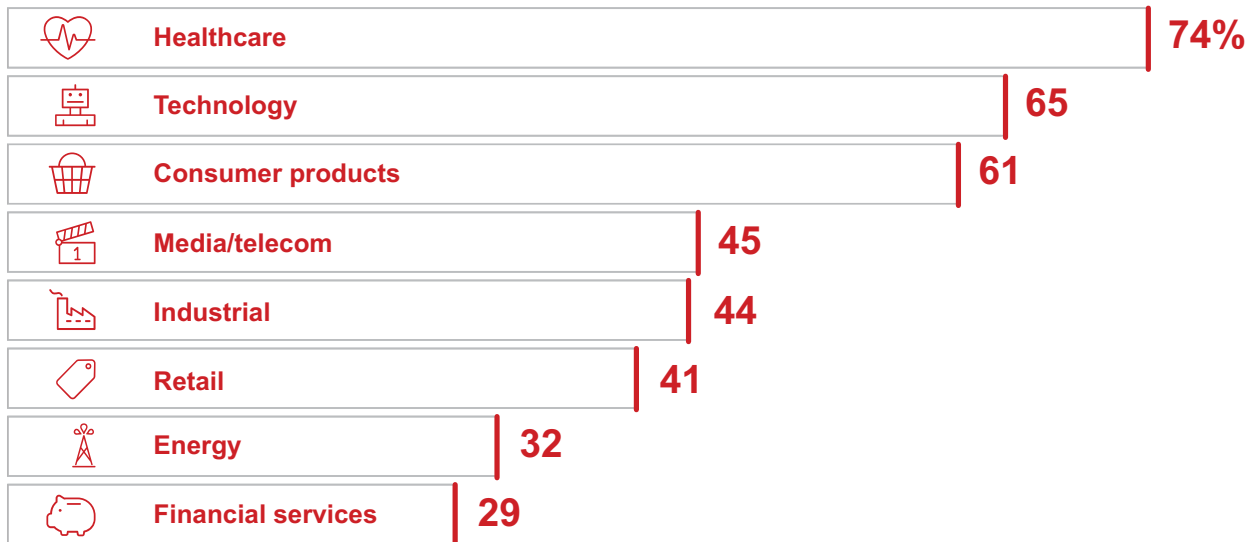
**Figure 2.2:** Scope deal momentum continues in response to growth pressures and disruption



Notes: Top 250 strategic M&A deals of the year (top 165 for 2019 year-to-date until September) identified by excluding nonstrategic deals such as asset or property acquisitions, financial investment deals, government acquisitions, internal reorganizations, or minority stake acquisitions; deals classified by primary rationale using a proprietary classification framework, as per stated strategic rationale at the time of announcement  
Source: Bain M&A deal database, 2019

**Figure 2.3:** Scope deals are prevalent across industries, with healthcare, technology and consumer products showing the strongest momentum

**Share of scope deals within strategic deals valued at greater than \$1 billion, 2015–2019**



Notes: Top 250 strategic M&A deals of the year (top 165 for 2019 year-to-date until September) identified by excluding nonstrategic deals such as asset or property acquisitions, financial investment deals, government acquisitions, internal reorganizations, or minority stake acquisitions; deals classified by primary rationale using a proprietary classification framework, as per stated strategic rationale at the time of announcement  
Source: Bain M&A deal database, 2019

growth product lines and channel capabilities (Colgate-Filorga in premium skincare), and portfolio diversification across markets and price points (Saputo-Dairy Crest, E.&J. Gallo Winery-Constellation Brands' value wine and spirits portfolio).

### **Scope M&A is an increasingly common way to buy capabilities**

This year, nearly one out of five large strategic deals were capability-driven deals made to strengthen an existing competitive advantage, target digital opportunities or redefine the company through cross-sector or cross-value chain moves. Later in the report, we discuss how astute acquirers are using capability deals in support of their strategy, the unique characteristics of these deals and what a successful integration approach looks like.

While we examined deals that were greater than \$1 billion in value, we know that a majority of capability deals are much smaller in size. Likely, there is a lot more of this type of dealmaking than we see in our numbers.

In fact, as they seek emerging technologies and new business models, companies are pursuing other capital- and risk-efficient routes, such as minority stake investments, corporate venture capital (CVC) and partnerships, in addition to M&A. This comes with its own set of complications arising from lower control, diverging partner objectives and the sheer complexity of managing multiple investments. While we don't examine these challenges in detail in this report, we see our clients facing new issues that they do not face with traditional M&A. Certainly, developing the capability to nimbly leverage and manage these different approaches will become increasingly important in the coming years.

### **Not yet the end game for scale deals**

None of this means that it's time to forget about scale deals. With the strong growth of scope deals in recent years, we could easily gloss over the fact that scale dealmaking still accounted for about 40% of all deals valued at more than \$1 billion in the year ending September 2019. In many industries, such as financial services, manufacturing and natural resources, where further consolidation is feasible, scale deals remain an effective way to stave off earnings pressures for the short term. In others, such as media and telecom, digital disruption is actually causing incumbents to join forces and use their combined scale to invest in new capabilities.

Although scope deals have grown their share, scale deals remain a proven route to building and extending a leadership position in chosen businesses. Would a recession scenario lead to a return to scale dealmaking? Certainly, deal math based on near-term earnings growth enabled by tangible cost synergies could be back in favor. In more commoditized and scale-driven industries, there may be more targets coming on the market, and regulators may take a more lenient stance than they recently have taken. It remains to be seen how the deal mix would develop in a downturn or recessionary scenario. What's clear is that winners out of a downturn will use scale M&A, scope M&A and divestitures to change their structural market positioning.

### Are scope deals successful?

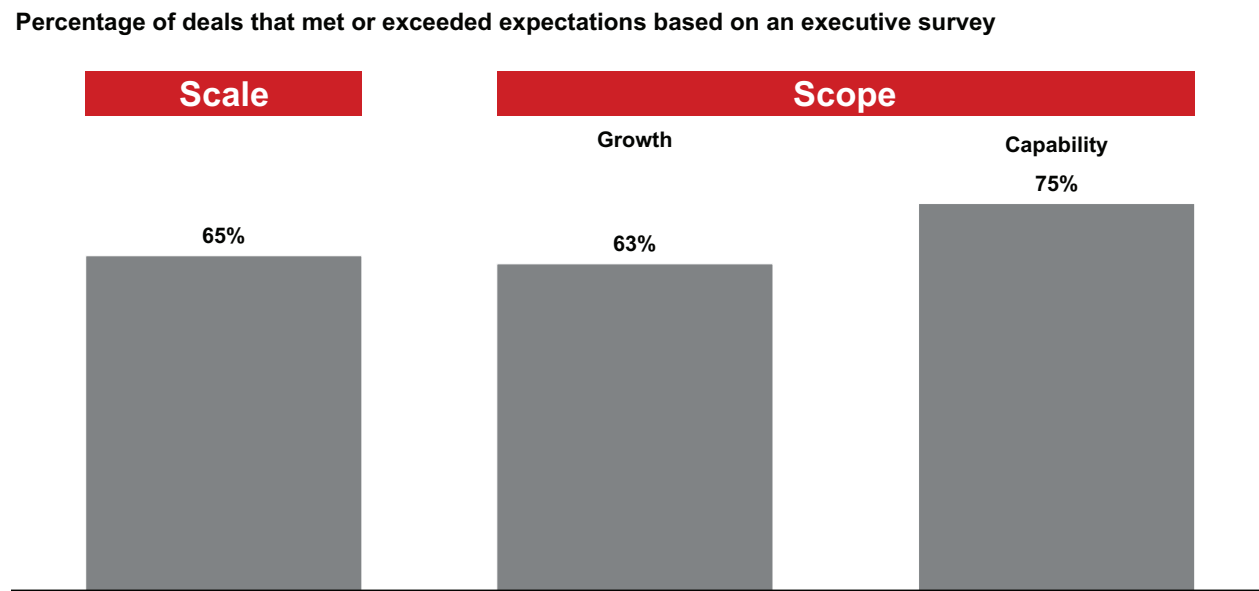
As scope deals stake their claim in today’s M&A landscape, the natural question arises: Are these deals a good idea? We increasingly hear this question, so we decided to pose it to a group of nearly 250 senior executives with deep experience in M&A. The executives’ perception is that M&A is generally a successful endeavor and that scope deals are at least as successful as scale deals (see Figure 2.4). Respondents believe that, on average, roughly 63% of growth scope deals met or exceeded expectations and created value for the company. This is similar to the results for scale deals. Capability deals are even more successful, with 75% of deals seen as creating value.

With these rates of perceived success, it is no surprise that more than 80% of executives expect to do more scope deals in the future.

This finding is based on our respondents’ self-assessment of deal success and not backed by an analytical study.

Another way to answer the original question of “are scope deals successful?” is to look at what successful acquirers do. We noted in our 2019 M&A report that, over a 10-year period, frequent acquirers’ average total shareholder return (TSR) was 27% higher than infrequent acquirers’ average TSR. (TSR is defined as stock price changes assuming reinvestment of cash dividends.) Frequent acquirers also

**Figure 2.4:** Executives believe scope deals are at least as successful as scale deals



Notes: Deal success rates reflect respondents’ assessment of scale (n=165), growth scope (n=195) and capability scope (n=99) deals done by their companies over the previous five years; more details on the survey in the appendix  
 Source: Bain M&A and Divestitures Executive Survey, July 2019



make relatively more scope acquisitions. When considering deals worth more than \$1 billion over the past five years, scope deals represent 60% of frequent acquirers' deal mix vs. 40% for infrequent acquirers. Frequent acquirers use scope M&A as part of their repeatable playbook to enter new growth businesses and acquire new capabilities, such as technology, intellectual property (IP) and talent, to further reinforce their leadership.

At a time of disruption, it may be tempting for many companies to rely on scope deals to chase growth. But rushing into scope deals carries risks if not backed by a cohesive strategy and accumulated experience. Such caution is most critical for the really large scope deals we started to see in 2019.

### **What about the really big scope deals?**

This year established that capability M&A is no longer limited to small deals. We even saw several capability megadeals—that is, in excess of \$10 billion.

Despite acquirers' experience and executives' best intentions, larger deals, scale or scope, sometimes don't work out as planned. Some recent deal failures are raising valid questions around the success of large scale and scope deals alike.

As we know, deals fail in the beginning, not the end, and the failure warnings are already there in the diligence process. Later in this report, we discuss how the best acquirers are adapting their diligence approaches to improve their odds of success.

Scope deals represent tremendous potential and opportunity for firms to transform and leapfrog the competition, but realizing this vision requires breaking the traditional molds of thinking across the entire M&A process, from screening to diligence to integration. Acknowledging this fundamental shift in thinking is step zero for success—companies that are willing to change their approach will earn greater success with scope deals.

In Section 4 of this report, we explore some of the new approaches for scope deals:

- How can companies efficiently search for growth and capability assets outside of traditional business boundaries yet within the guardrails of their overall strategy and distinct capabilities?
- How can acquirers best perform diligence on a less-familiar sector and business model, including diligence on technological capabilities, IP assets and talent?
- How can acquirers tailor integration to realize the value that sits at the intersection of the organizations while minimizing the risks in getting people from two different business cultures to work together?

## Private capital: Financial sponsors make good partners

### At a Glance

- ▶ Public capital, which represents the majority of corporate M&A activity, is competing hard with private capital—and winning share, for now.
- ▶ In increasing numbers, corporations are partnering with cash-rich financial sponsors, but the union is not without complications.
- ▶ The resurgence of take-private plays by both private equity (PE) firms and activist investors provides an option for companies to pursue their transformation away from the public eye.
- ▶ For corporates, financial sponsors remain a primary source of liquidity for portfolio actions, either by selling them carve-outs or acquiring PE-owned assets.

Let's be clear at the outset, 85% of all M&A is the domain of corporate acquirers—of which about 70% involves publicly listed firms (see *Figure 2.5*). Financial sponsors, including PE firms, account for the rest—and private equity is sitting on almost \$2.5 trillion in dry powder, nearly an all-time high. These firms are highly motivated to put that money to work.

### Emerging partnerships but not yet a blissful union

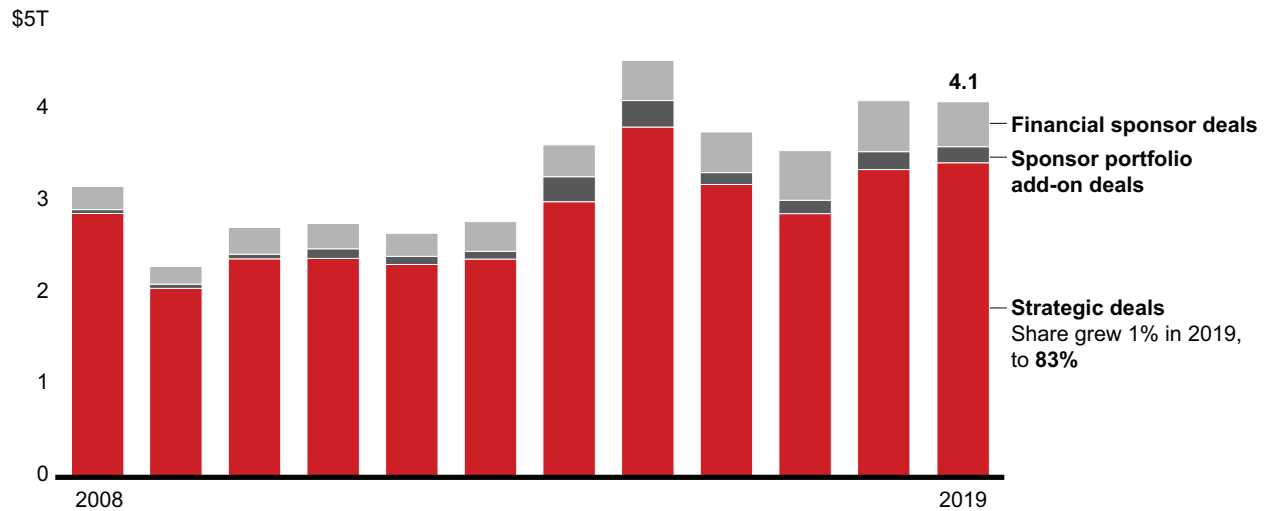
Cash-rich financial sponsors offer a source of capital and risk sharing for corporates. Financial sponsors generally have better transaction capabilities—finding deals, providing validation given their strong diligence capabilities, and structuring and closing deals. For their part, corporates bring strong industry knowledge and experience. The complementary offerings are fueling a steady flow of coinvestments with a variety of objectives:

- short- and long-term financial support;
- coinvestment in new technologies or emerging business models;
- partnerships to provide local anchoring in new markets;
- a path to a two-step exit for PE firms; and
- enabling a separation of operational and infrastructure assets.

As an example of financial support, consider how LEGO, through its owner Kirkbi (single-family office for the Kristiansen family), partnered with US PE firm Blackstone and the Canada Pension Plan

**Figure 2.5:** Strategic deals gained marginal share of global deal value last year

**Global M&A deal value, 2008–2019**



Notes: Deal value based on announcement year, including deals that are currently pending; strategic acquirer deal value includes acquisitions made by public or private companies, including any acquisitions from financial sponsors; financial sponsor acquirer deal value includes leveraged buyouts and secondary buyouts; only rank eligible deals included, excluding buyback programs and equity carve-outs  
Source: Dealogic

Investment Board to acquire a majority of UK theme park operator Merlin Entertainments for \$5.7 billion. This coinvestment deal will provide Merlin with the long-term investment it needs to execute on its growth plans. In another such deal, Suez partnered with CDPQ, a pension fund, to acquire GE Water for \$3.4 billion in 2017.

For an example of coinvestment in new technologies, Volkswagen, BMW, Goldman Sachs Capital Partners and other investors made a \$1 billion coinvestment in Northvolt, Europe’s biggest lithium-ion battery plant.

While the corporate–financial sponsor marriage makes sense on paper, these partnerships are structurally complex. It can be a worthwhile effort, as a PE partner can structure and close the deal faster for the corporate partner as well as provide validation for the investment—all while sharing the financial risk. Aligning on the objectives, sources of value creation and exit path with a PE partner, however, are better resolved before the deal is inked. It is an easier ride when the partner is a pension fund or sovereign wealth fund with similar long-term investment horizons as corporates.

**Resurgence of public-to-private deals**

Over the past three years, the number of publicly traded companies taken private by PE firms has sharply increased (a trend first highlighted in Bain’s *Global Private Equity Report 2019*). In 2018, these

deals amounted to about \$227 billion in value, which represents some 40% of all PE global buyout deal value (including add-on deals). The trend continued in both count and value terms in the first half of 2019. A recent example is KKR taking the \$5.6 billion German digital publisher Axel Springer private. Axel Springer completed the first stage of a remarkable transformation from traditional media to digital media and intends to chart out the rest of its path as a private company.

Linked to this public-to-private trend is the rise in activist takeovers—that is, activist hedge funds acquiring control in a company or even taking it private with a full-stake acquisition. Activist capital is another form of private capital, and the activist takeover thesis accounted for around 20% of M&A activism in the year ended September 2019, an increase from about 14% in 2018, according to Activist Insight. For example, Elliott Management Corporation has aggressively pursued the activist takeover strategy and, after a protracted campaign, ended up taking the keys to bookseller Barnes & Noble in June 2019.

Most corporates' interaction with private equity will be in portfolio management, either by selling noncore assets to a corporate sponsor or by buying new assets from them. At times, coinvestments will work favorably for both.

## Section 3: Portfolio choices—back to basics during disruption

### At a Glance

- ▶ During a time of disruption and low growth, portfolio decisions are more important and challenging than ever.
- ▶ It is even more important now to base those decisions on fundamental strategic principles—leadership delivers superior economic returns, and unique capabilities should guide enter, invest and exit decisions.
- ▶ Faster-growing companies are able to systematically enter and accelerate new growth businesses using a repeatable M&A and divestiture playbook.
- ▶ Divestitures are an underutilized but indispensable tool for portfolio reshaping.

### Invoke fundamental strategic principles for portfolio choices

In times of flux, it is critical to invoke two time-tested principles around portfolio choices.

- The first strategic principle is to play for leadership—that is, to have a clear route to achieving leadership in a correctly defined market.
- The second is to consider the joint value creation possible by combining your unique capabilities with those of the acquired companies.

Leadership position within correctly defined business boundaries is the route to superior economic returns. We say “correctly defined business boundaries” to account for the fact that economic returns are linked to different definitions of scale in different industries—for example, local or regional scale in banking, category leadership in pharmaceuticals and consumer products, and asset portfolios in traditional resource-based industries. In a tech-led world, leadership increasingly is determined by unique capabilities, such as customer loyalty and network effects, technology platform, and talent pool. Leadership matters because leaders have more time to react to disruptive trends, more resources to take action and more stability to ride out the change—this makes their businesses more sustainable.

As more companies start to look outside traditional business boundaries, it is good to remember that your probability of success is greater in sectors in which you can leverage your unique capabilities. These could be unique managerial, technological, financial, operational or cultural capabilities that



enable you to achieve greater joint value than another owner. Your unique capabilities or gaps in desired capabilities should guide your portfolio targets—today and in the future.

Portfolio decisions are about the future and are inherently complex. Disruption compounds this complexity. More than 85% of executives we surveyed reported increased complexity in portfolio decision making compared with five years ago because of the uncertain evolution of existing and potential growth businesses.

### M&A and divestitures fuel an ongoing growth playbook

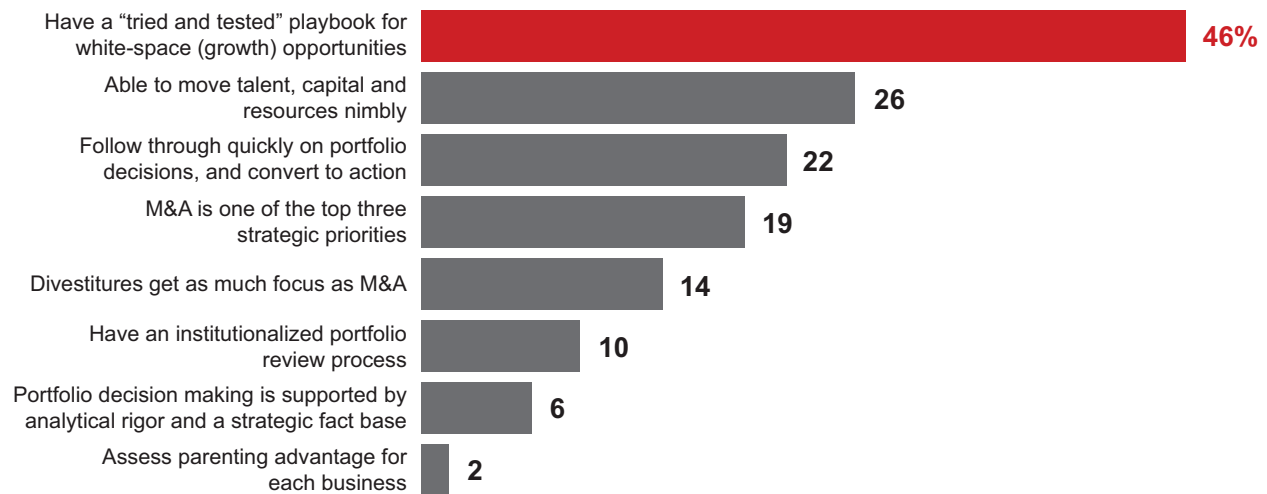
From a recent senior executive survey on M&A and divestitures, we determined that faster-growing companies have a differentiated capability to target new growth opportunities through a tried and tested playbook involving M&A and divestitures (see Figure 3.1). They also have greater organizational agility and speed.

Beyond the survey, we looked at a few companies that are known for their strong portfolio management capabilities and that have successfully adapted their portfolios over long periods. As you will note in the commentary below, what underpins their success is the role of M&A and divestitures to reshape the portfolio and consistently enter and expand into new growth businesses (see Figure 3.2).

**Figure 3.1:** A white-space (or new growth) playbook is the biggest differentiator between fast-growing and slow-growing companies

#### Portfolio management best practices based on an executive survey

Difference between fastest-growing and slowest-growing companies



Notes: The bars represent a comparison of the fastest-growing and slowest-growing companies in our survey, which is based on the percentage of respondents who strongly agree or agree with the corresponding statement; the fastest-growing companies are those with an annual revenue growth rate greater than 15% over the past five years, while the slowest-growing companies are those with an annual revenue growth rate less than 5% over the same period  
Source: Bain M&A and Divestitures Executive Survey, July 2019

**Figure 3.2:** Successful companies consistently use M&A and divestitures to enter and expand into new growth areas



Source: Bain & Company

L'Oréal has been using M&A and divestitures to reshape its global portfolio of leading brands over multiple decades. In fact, only one out of more than 30 brands (L'Oréal Paris) didn't start out as an acquisition. L'Oréal's strategy is to acquire emerging brands and use its parenting advantages—namely, marketing expertise, global distribution network, and research and development (R&D) capabilities—to scale the brands to global leadership. This has resulted in consistently expanding margins and revenue as well as global expansion.

In another example, Assa Abloy has made more than 200 acquisitions over the past 25 years to become a global leader in entry and access systems. Two elements of the company's M&A capability stand out. It maintains a clear M&A roadmap in support of corporate strategy, building leadership positions by acquiring regional market leaders. The second element is its consistent use of scope deals to enter new growth markets and strengthen capabilities—this includes digital capabilities, such as its 2017 purchase of August Home, a smart lock company.

Portfolio evolution often requires adjustments or a redesign to the operating model over a long period of time. Said another way, the M&A roadmap decision often prompts other decisions about how to organize to run those assets. Plan for changes in your operating model alongside your portfolio roadmap.

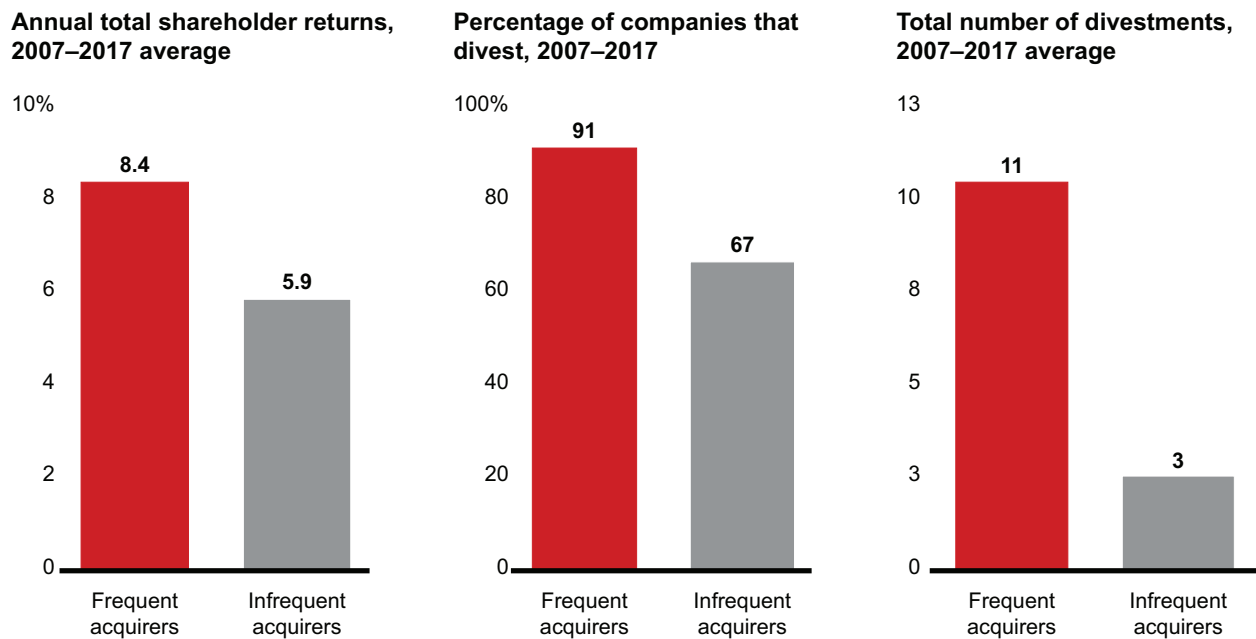
### Divestitures are an underutilized but indispensable tool for portfolio management

For companies with successful legacy businesses that are looking to invest in new growth engines, the decisions around divestitures can be the trickiest. That said, without divestitures, companies cannot truly free up the time, talent, energy and capital to invest in those new growth businesses.

In fact, our extensive research in M&A value creation over the past two decades shows that companies that actively manage their portfolios outperform. They typically are frequent acquirers, and almost 90% of them also divest (see Figure 3.3). These companies generally are the longer-term winners within their industries.

Axel Springer transformed its business from traditional to digital media through about 100 acquisitions and approximately 80 divestitures over the past decade. What’s notable is Axel Springer’s financial discipline—both in terms of investing and in timely divestitures that ensured prudent use of capital. Its M&A roadmap supported the strategic transformation to a digital media company through systematic dealmaking across three business areas: news/content, classifieds and marketing. All the while, the company made proactive divestments. This 2013 statement made by the CEO following the sale of a flagship media asset, leading women’s publication *Bild der Frau*, sums up the company’s approach to divestitures: “[W]e are not the market leader, by far not the market leader, in the women segment. And there was no realistic path to achieve that.... *Bild der Frau* is ... generating in the sales process a

**Figure 3.3:** Frequent acquirers outperform—91% of them actively divest and do so significantly more than others



Note: Frequent acquirers defined as companies that made at least 10 acquisitions over 2007–2017  
 Source: Bain M&A deal database, 2018

lot of money with regards to the multiples. And we wanted also to get access to significant financial firepower for the projects that we have in mind with regard to the transformation of the company.”

New industry dynamics are creating new opportunities for M&A and divestiture practitioners. Scope deals, in particular, require a distinct approach across the entire M&A process from screening to diligence to integration. In the following sections, we summarize what we have observed working alongside clients that have learned the rules for success with scope deals and divestitures.

## Section 4: Building a best-in-class M&A and divestiture toolkit

### M&A screening: New strategies require a wider view

#### At a Glance

- ▶ A differentiated end-to-end M&A capability that links directly to the corporate growth strategy is the common denominator of the most successful companies.
- ▶ One of the cornerstones of a strong M&A capability is an ongoing and systematic search for acquisition targets as well as early relationship building.
- ▶ In today's disruptive environment, traditional target screening is rapidly evolving into developing broader market-sensing capabilities, as corporate growth strategy demands developing new growth engines.
- ▶ New approaches enable you to widen the aperture on sectors and targets and expand your understanding of the broader ecosystem.

#### Ongoing target identification underpins the M&A capabilities of leading acquirers

Leadership begets leadership. One of the advantages of being a leader is the information advantage. From a higher vantage point, it is easier to not only spot market trends, emerging technologies and business models but also any acquisition opportunities that come on the market.

Consider this quote: “If anyone in the world wants to sell a beauty business, the first people they will call is us,” said L'Oréal CEO Jean-Paul Agon. “So we are looking every year at every opportunity, and continue to. Makeup, skin care, hair care, hair color—everything.”

However, L'Oréal does not solely rely on its leadership pull; the company complements this advantage with a rigorous and thoughtful process for finding new acquisition targets.

“We are always busy studying good potential acquisitions,” said Agon.

This is common among the most successful companies that we've studied over the past two decades. Sure, they have built a strong M&A capability over time with the right teams and processes. Yet the behavior that trumps it all is their continuous lookout for acquisition opportunities that guides them toward success. It never stops.

In fact, many successful acquirers resemble private equity firms when they scout for and assess potential targets, with a formal investment board and ongoing updates to the target list. That said, the M&A roadmap starts with a defined corporate strategy and investment themes.

### **The hunt for new lines of business and capabilities requires quite a future-back mindset**

Charting out an M&A roadmap for finding and developing new growth engines starts by deeply understanding your unique strategic direction and differentiated capabilities. The M&A roadmap should be derived from corporate strategy. M&A in support of developing new sources of growth also requires a strong in-house capability supplemented by external sources.

Identifying growth and capability assets means widening the aperture on potential sectors and targets, likely venturing beyond existing business boundaries. If not guided by a cohesive strategic direction and done systematically, however, there is a real risk of catching deal fever and buying expensive assets that don't fit.

To sum up, a successful M&A screening capability for new growth engines looks something like this:

- Develop a high-level M&A roadmap derived from the corporate strategy.
- Open the aperture on potential sectors for investment, considering future profit pool shifts.
- Conduct an ongoing Agile approach to screening for targets and engaging with them.

KLA Corporation's moves to expand into adjacent businesses illustrates how successful acquirers operate. KLA is a leading player in the process control systems and solutions industry, serving the semiconductor and related nanoelectronics industries. In this highly consolidated sector, there are limited options to make further scale deals. Therefore, KLA embarked on a strategy to build sustained profitable sources of growth by moving into adjacent markets.

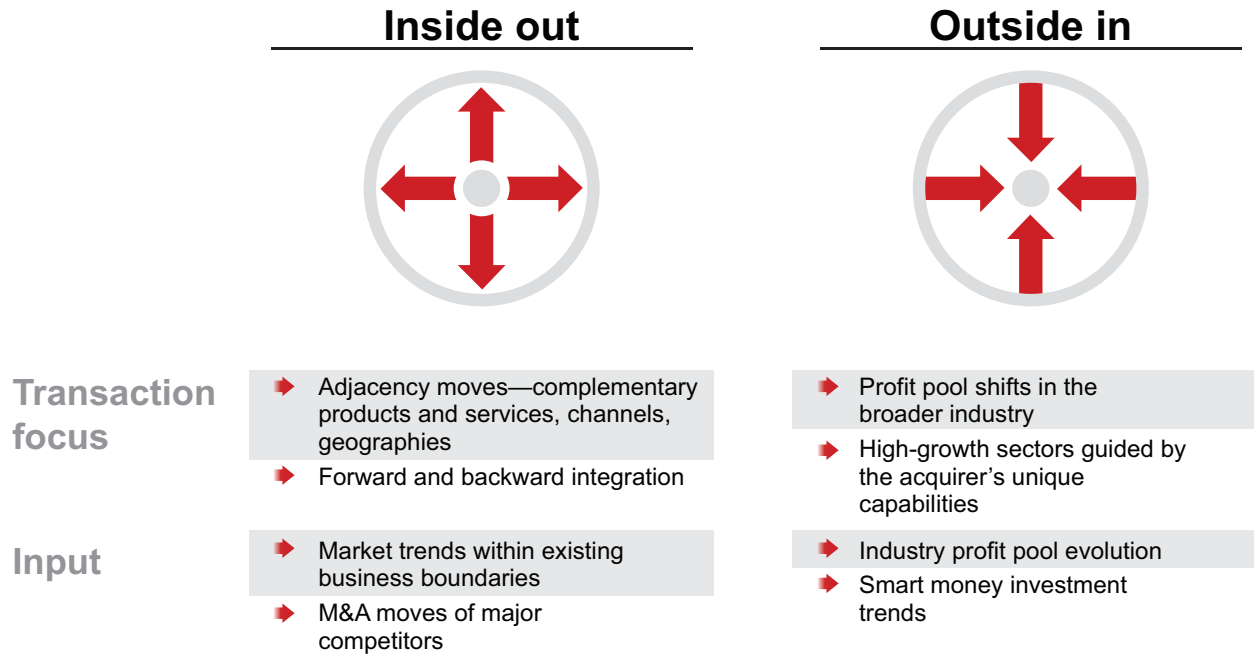
### **M&A roadmap down on paper**

A clear M&A roadmap in service of the broader corporate growth strategy brings cohesion to M&A efforts. KLA defined the objectives for M&A moves across multiple time horizons and the types of M&A deals that would help meet those objectives, and it set the financial targets for each time horizon. For instance, short-term business objectives required tuck-in deals, whereas medium- and long-term objectives relied more on scope deals and venture capital-style investments, respectively. This blueprint guided the entire process for the M&A team.

### **Open the aperture**

Most companies take an inside-out approach to M&A. They start with the current business and think about the vectors along which they can expand. Effectively scouting for new growth and capability targets, however, requires an unconstrained view. That means not being bound by historical knowledge and experience.

**Figure 4.1:** M&A screening is evolving to an outside-in approach



Source: Bain & Company

Indeed, the emerging approach is outside in. It starts with identifying high-growth sectors in a broader addressable market, involving an assessment of how profit pools may shift in the future and where the smart money is heading (see Figure 4.1). You then narrow it down to sectors that have a strong match with your existing differentiated capabilities that define your right to win in these newer businesses. Sectors and targets identified using the outside-in approach still need to be relevant to the existing portfolio of assets. You are likely to be more successful going after attractive businesses in which you can deploy your unique capabilities to create joint value.

KLA’s distinct technical and go-to-market expertise provided the guardrails to evaluate worthy segments and categories in the broader ecosystem. To validate the short list, the company also tracked the career paths of former employees to confirm prioritized sectors, using publicly available data from a professional networking database.

Traditional M&A screening is quickly evolving into broader market sensing. Several market leaders have set up their own corporate venture capital units to bring them closer to grassroots innovations that they might miss when using a traditional M&A lens. Some have CVC units operating within their M&A teams, offering M&A as a service to business units. While direct M&A resulting from a company’s own CVC unit is modest, the broader market-sensing capabilities it offers for a minimal capital investment is fully justified. Everyone recognizes that CVCs are a route to the long game and



that they enable executives to have a broader perspective on things they may want to own outright in the future.

Companies are also increasingly adding founder and start-up scans and immersions to their M&A screening. For example, a retail company wanted to understand the robotics space to evaluate potential investments. But since this was outside its existing business boundaries, the company partnered with the Bain Innovation Exchange (BIE) to conduct an ecosystem scan and assess various use cases. (BIE is a global community of change-makers, entrepreneurs, futurists, venture capitalists and innovation experts who connect with one another to push the boundaries of digital transformation.) BIE performed a robust global screening to lay out the robotics market, evaluate key start-ups and assess strategic fit with the retailer. BIE also enabled the retail company to connect with founders in the space to get a firsthand look at robotics solution developments and the requisite talent pool.

### **Agile approach to decision making and target engagement**

Target screening was traditionally conducted using a funnel approach in which acquirers would create a long list, narrow it down to a short list based on defined screening criteria and then proceed with further target profiling. Ideas from investment banks would typically flow into the long list or be evaluated opportunistically.

The canvas needs to be broader in a search for scope targets. Companies are required to expand their view of the sectors in which to invest, the investment themes (single play or multitarget play) and the sequence of these investments.

KLA managed these dynamics by using an Agile approach that not only enabled faster decision making but also helped the company prioritize the most valuable efforts (*see Figure 4.2*).

Most companies are slow to act on target short lists. In scope deals, and particularly capability deals, in which the level of familiarity tends to be low, target engagement needs to start earlier so that an acquirer can learn more about the capabilities over time. The best acquirers start a dialogue with targets and keep it going to prepare the ground for an eventual deal.

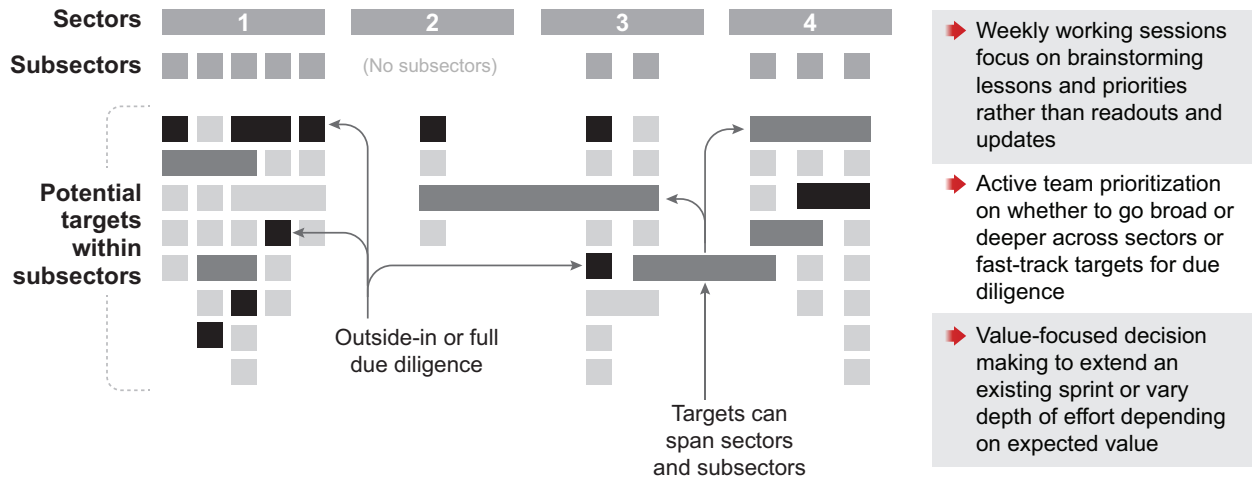
This was the case in lockmaker Assa Abloy's recent acquisition of August Home, a smart lock company. The acquisition grew out of an ongoing relationship. Assa Abloy had participated in August's access program, which introduced investors to an open software platform that enables in-home delivery. For Assa Abloy, learning more about the development of August's capabilities in the smart lock space and identifying the complementary capabilities to Assa Abloy's existing Yale brand hardware was a key reason behind its investment in August Home.

Companies that develop the capabilities to search outside immediate business boundaries create a proprietary deal flow and get differentiated assets earlier than anyone else. That gives them a massive advantage in today's competitive deal market.

**Figure 4.2:** A successful screening approach is an ongoing one, using a “living” dashboard

**Agile target screening using a “living” dashboard**

This approach uses a visual dashboard to present a comprehensive view of all opportunities (sectors and targets)



Source: Bain & Company

## Due diligence: Evolving approaches boost the odds of success

### At a Glance

- ▶ The root cause of most deal failures can be traced back to the beginning—the diligence phase.
- ▶ The best acquirers improve their odds of getting it right through clean teams and cross-functional teaming, especially in scale deals.
- ▶ Scope deals, primarily done for growth and capabilities, are even harder to get right, sources of value creation and risk are less predictable, and outcomes can vary a lot from the base-case expectation.
- ▶ As such, scope deal diligence requires a deeper assessment in two areas: standalone asset quality and joint value-creation potential. The latter is particularly challenging and elusive.

### Most deal failures can be traced back to poor diligence

We have said this before. Although failed integrations grab the headlines, poor diligence is the most common root cause of deal failure. We surveyed senior executives earlier this decade, when scale deals were the norm, about the reasons for their disappointing deal outcomes. Almost 60% of executives attributed deal failure to poor due diligence that did not identify critical issues.

Not much has changed since then. Our 2019 survey of senior executives confirms that this finding holds true for scope deals as much as it does for scale deals. Failure of due diligence to highlight issues around asset quality was the No. 1 reason for unsuccessful capability deals. Similarly, success of capability deals was attributed in great part to a deeper diligence process. The key factors for deal success and failure have not changed much, even as M&A trends shift toward scope deals.

Before we dive into the bespoke approach for scope deal diligence, let's recap some of the basics of good diligence for all deal types.

### Getting the basics right

Experienced and successful acquirers take a systematic approach to diligence (*see Figure 4.3*). They start with a clearly articulated and testable deal thesis that guides where diligence efforts should focus. Beyond market growth drivers, competitive assessment and customer feedback, seasoned acquirers assess big swing factors such as a recession scenario or digital disruption risk.

**Figure 4.3:** Classic good diligence approach

Source: Bain &amp; Company

In scope deals, starting with an independent deal thesis and assessing the outcomes for different scenarios takes on added importance. The outcomes can vary by significantly greater degrees of magnitude from the base case than they can in scale deals. Usually, things will be much better or much worse than you expect. Even so, we see many acquirers not paying enough attention to the downside scenario and the need to think through potential responses.

In scale and scope deals alike, the best acquirers assess both the standalone target's attractiveness (playing defense) and the full potential for joint value creation under their ownership (playing offense). In scope deals, at today's valuation levels, playing offense is increasingly the norm to stay in the game. Corporates desperate for growth are indeed stretching the bounds of valuations that can be justified based on reasonable and tangible synergy assumptions alone. This raises the bar to be creative in the search for the joint value-creation potential.

### When the stakes get higher, get the odds on your side

Especially in scale deals, we now see more companies relying on cross-functional teaming and clean teams to make better value assessments at the diligence stage. By bringing together functional experts, acquirers go deeper on key sources of value and risks. Within strict legal protocols, clean teams enable sharing certain types of data between the prospective acquirer and the target company. This enables an analysis of specific value drivers, such as cost positions, customer overlap, salesforce coverage and

procurement spending, to identify and quantify synergies before signing the deal. These approaches enable better synergy assessment and faster realization, greatly improving deal outcomes in scale deals.

For example, a global chemical company was considering its largest acquisition. The acquirer's five-month diligence effort, with the help of 13 cross-functional teams, included extensive commercial and cost synergy sizing. The level of rigor enabled it to get a handle on specific value-creation opportunities. The cross-functional teaming delivered added benefits—namely, early buy-in for the deal across the organization and the identification of potential integration risks.

Similarly, a due diligence clean team was instrumental when a US medical device maker pursued a target with an innovative neurology product line and strong sales relationships. During the six-month diligence effort, the clean team analyzed both companies' sales data and confirmed key deal value assumptions on dis-synergies such as account overlaps and salesforce compensation differences.

### **What's unique about assessing the value in scope deals?**

To recap what we discussed in last year's report, in scale combinations, the buyer intimately knows the industry and the rules of the road. There is a well-established playbook for diligence and integration. After all, the primary value-creation levers are market position, cost synergies and operational efficiencies.

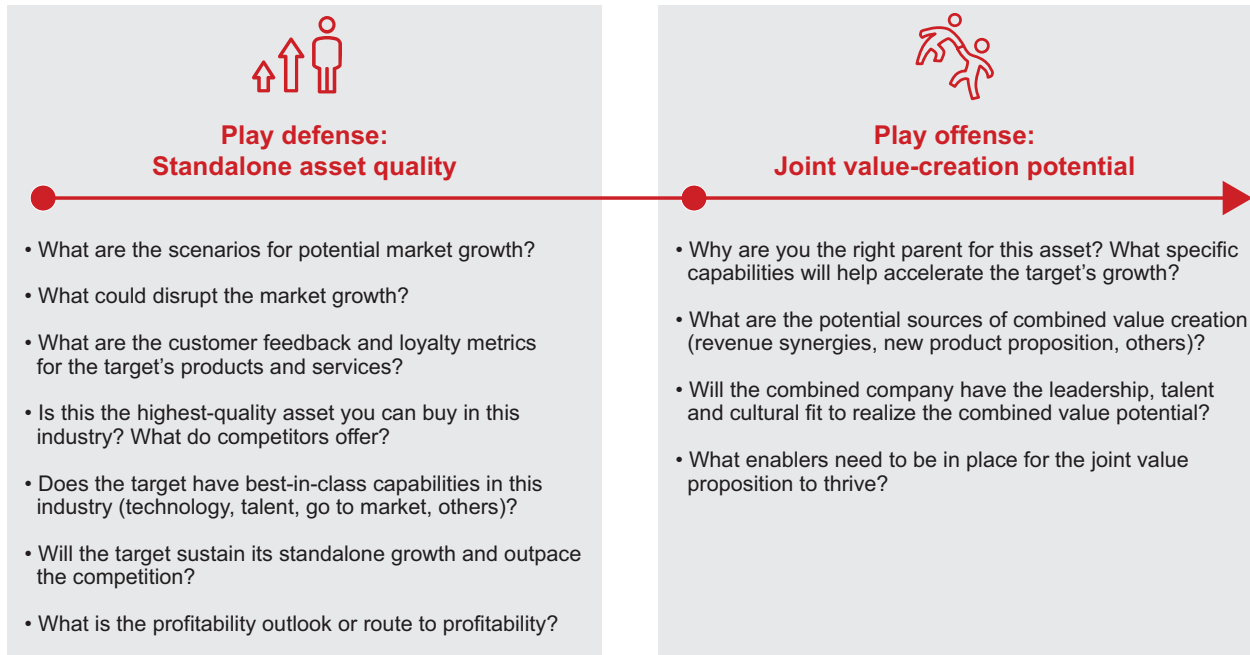
It is different with scope deals. They carry higher deal premiums and yield much lower cost synergies. The sources of value often come from revenue synergies and capability transfer. The risk of disrupting the target's base business is equally high in both types, but talent flight risk is a bigger concern in scope deals. An acquirer does not know the target's business and cannot run it with its own talent. These unique considerations need to be assessed at the time of diligence.

Scope deal diligence involves a much deeper dive into the target's industry attractiveness, business model, keystone capabilities, standalone growth potential and the caliber of the management team. Value assessment tends to be more forward looking around revenue synergies and future option value.

Scope deals require playing defense and offense (*see Figure 4.4*). First, you need to be able to assess the standalone asset quality well: How robust are its value proposition and business model? What do customers say about it? That's the defense. Next, you play offense by understanding the combined value-creation potential: How can you accelerate the target's growth or the growth of your own related businesses? What value can you create over and above the target's standalone potential?

Evaluating and quantifying the joint value-creation potential in a scope deal is tough. Cost synergies are hard enough to assess, but revenue synergies are even more elusive. In many deal models, revenue synergies are rightly assigned low probabilities. On the other hand, we also see scope deals at high valuations that can only be justified by revenue upside. Getting a better handle on how to assess and realize the value greatly improves the outcomes from scope deals.

**Figure 4.4:** Assessing the value in scope deals



Source: Bain & Company

For example, a European industrials company that makes tools for the automotive industry wanted to strengthen its product portfolio. During diligence on the standalone asset quality, the acquirer quickly narrowed its focus to very specific questions by involving a group of relevant experts and business leaders early in the process. Among the big questions: How good is the capability when compared with competitors' technology? How future-proof is it? How complex would it be to integrate the target's capabilities with existing products?

External validation through customer interviews helped confirm the products' reputation and feedback. By involving in-house technical professionals early in the process, the company was also able to estimate the R&D investment that would be required to further refine the target's technology and integrate with the existing product range. Given the high valuation levels, the company also identified some quick wins—for example, cross-selling opportunities that would help to show early momentum on value creation.

In another example, a global personal care brand acquired a premium skincare company operating in four European countries and China. The target was a young, high-growth company with a strong brand image for quality. It was growing rapidly and profitably on a standalone basis. The ability to outline the joint value-creation potential was the key to winning this hotly contested deal. The acquirer's proposition included leveraging its global distribution network to enable the target company to enter

new geographies while also benefiting from the latter's presence in China. Given the deal's high multiple, it is clear that a large part of the valuation hinged on the ability to accelerate the target's growth through combined capabilities.

Scope deals represent investments typically outside your immediate industry boundaries. As such, it takes longer to understand the target's industry, competitive dynamics, business model and capabilities. Also, it is harder to assess revenue synergies and other sources of combined value creation. The best acquirers apply the same rigor in assessing revenue synergies as they would for cost synergies.

Ultimately, investing the time and energy to pressure test and articulate a robust deal thesis is a no-regrets move. Either you dodge the bullet on an overvalued deal, or you set yourself up with a strong plan for successful integration later.



## Integration: Why less is more in capability deals

### At a Glance

- ▶ Capability deals represented around 20% of all deals valued at more than \$1 billion in 2019 as companies buy new capabilities to respond to business model disruption.
- ▶ These deals are brand-new territory for most companies, including experienced acquirers.
- ▶ Capability deals are a different breed of M&A; they often involve entrepreneurial targets and sources of value creation that are quite distinct from traditional deals.
- ▶ Accordingly, successful dealmakers don't approach these deals with the traditional integration playbooks; they disproportionately focus on joint value creation and the hard and soft enablers required to foster joint collaboration.

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### Capability deals continue to rise in prominence, yet we are early on the experience curve

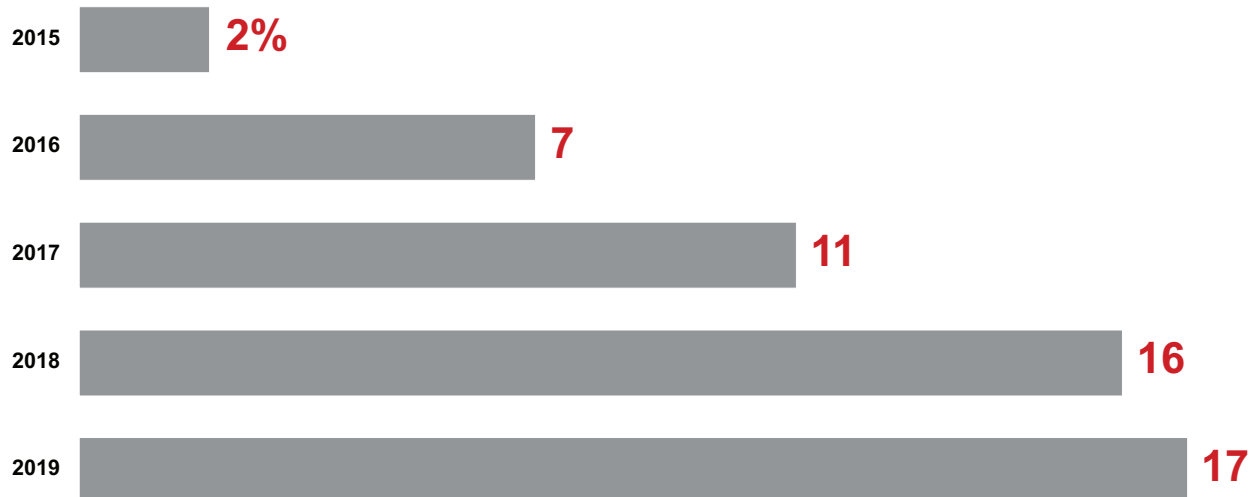
Within scope deals, capability-driven deals have accelerated and are now about 20% of all large deals globally as more companies choose to buy new capabilities than build them (*see Figure 4.5*).

Capability deals are different from the more common growth scope deals that involve buying companies with faster-growing products or in faster-growing markets for an immediate growth uplift. Capability deals are about combining the complementary capabilities of the acquirer and target for a new value proposition or product development to generate future growth. That value creation is harder to quantify than either cost synergies (scale) or revenue synergies (growth scope).

We see three flavors of the capability deal: those aimed at strengthening an existing competitive advantage; those targeting digital opportunities; and those that aim to redefine a company through cross-sector or cross-value chain moves. Let's look at these rationales one by one.

Examples of the first type include Salesforce's \$16.3 billion acquisition of Tableau, which enables Salesforce to strengthen the analytics capabilities of its customer relationship management offering, using Tableau's data visualization platform. In media, Publicis Groupe bought Epsilon Data Management to develop the capabilities to provide data-driven advertising services.

The second major type of capability deal involves buying digital capabilities in emerging areas, such as robotics, artificial intelligence, e-commerce, the Internet of Things and big data analytics. Johnson & Johnson bought Auris Health to leverage its robotic platform technology (currently used in lung-related diagnostic and therapeutic procedures) to build a combined digital surgery portfolio. Bridgestone,

**Figure 4.5:** Capability-driven M&A now accounts for nearly 20% of all large strategic deals**Share of capability-driven M&A within strategic deals valued at greater than \$1 billion**

Notes: Top 250 strategic M&A deals of the year (top 165 for 2019 year-to-date until June) identified by excluding nonstrategic deals such as asset or property acquisitions, financial investment deals, government acquisitions, internal reorganizations, or minority stake acquisitions; deals classified by primary rationale using a proprietary classification framework, as per stated strategic rationale at the time of announcement  
Source: Bain M&A deal database, 2019

the tire manufacturer, bought TomTom's telematics fleet management business to establish itself as a key partner in the growing mobility-as-a-service industry. To target continuing growth in e-commerce, Edgewell Personal Care, a consumer products company, acquired Harry's, known for its subscription-based online sales of shaving and other grooming products.

Finally, some companies are combining capabilities to redefine the joint business. These include cross-value chain deals and cross-sector deals such as United Technologies' acquisition of Raytheon in the aerospace and defense sector, which combines capabilities in commercial aircraft and missile and defense systems.

Despite the rapid increase in capability dealmaking, these deals still are not very common. In a recent survey of senior executives, 70% to 80% of respondents had experience with scale and growth-oriented deals, but only about half of them reported doing a capability deal.

**This is a different breed of M&A**

Success in capability deals starts by acknowledging that they are different from what most acquirers may have done and experienced before. Capability deals are different in two meaningful ways: the characteristics of the target company itself and sources of value creation.

In capability deals, the target assets are likely to be smaller and more entrepreneurial with an Agile working culture—that is, with entirely different ways of working from the acquirer. The target's value

resides in the people who carry specialized knowledge of the technology, R&D capability or customer insights—knowledge that the acquirer does not yet have.

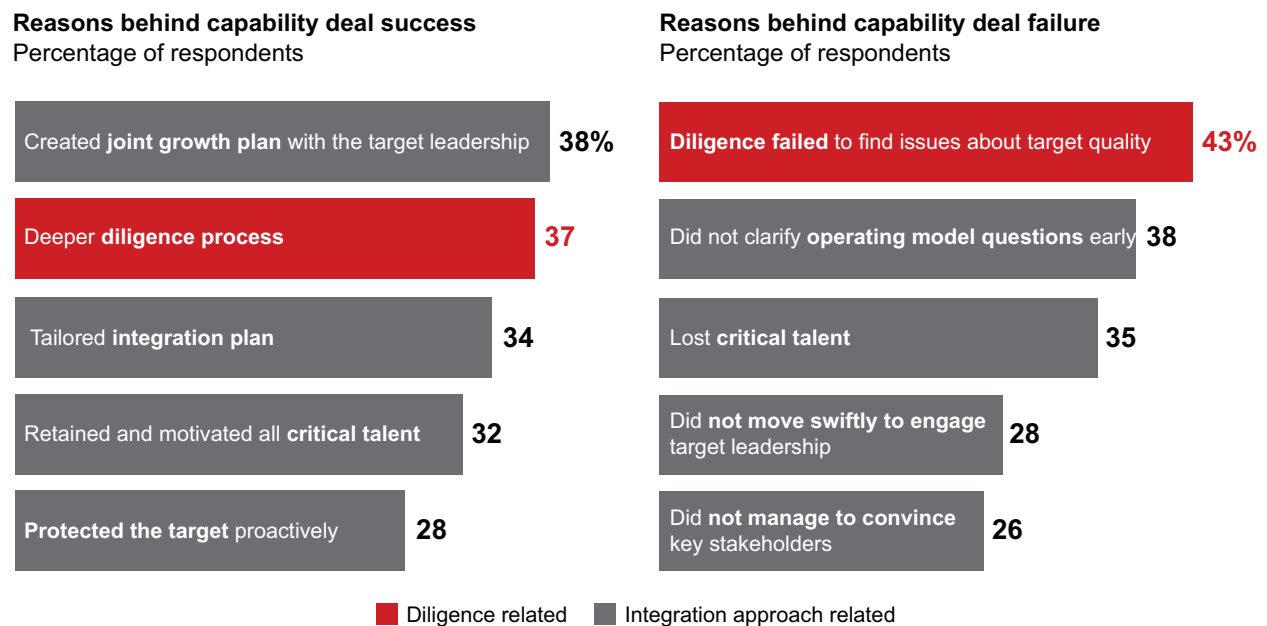
Second, the value in capability deals is not as obvious and visible as in scale and growth scope deals. The value in scale deals is mainly around cost synergies and in growth scope deals mostly around revenue synergies. The value in capability deals comes from bringing a new-to-the-world value proposition or new products for potential future growth.

The acquirer and target bring complementary capabilities to the table, and value creation lies at the intersection of these capabilities. While the acquirer’s business model represents the industry business model as it stands today, the target’s capabilities provide a future-back view of what could be—and both need to work together to realize that vision. Consider this comment by Salesforce Founder and Chairman Marc Benioff on the Tableau acquisition: “Tableau didn’t want our cash—they wanted our equity, because they know that the real value here is in the company that we’re creating together.”

This is new territory to navigate for most acquirers, even highly experienced ones. At the outset, the quality of diligence on the standalone asset is itself an indicator of success or failure (see Figure 4.6).

Many acquirers take the conservative approach of not integrating the asset within the first few years. This is an easy but ineffective solution. No value is created, and it makes it hard to start integration once the cement has set. The best acquirers take the right actions while the cement is still wet.

**Figure 4.6:** Key reasons behind capability deal success and failure



Note: Based on an executive survey in which respondents were required to choose up to three reasons (n=97 on causes of capability deal success, n=65 on causes of capability deal failure)  
Source: Bain M&A and Divestitures Executive Survey, July 2019

## Fulfilling the promise of the deal—joint growth planning and fostering collaboration

Successful capability acquirers know that they cannot simply rely on their traditional integration playbooks. It takes getting into the right mindset by staying open to learning from the smaller target and ensuring an equal share of voice for the target leadership.

When Microsoft embarked on a series of capability deals under CEO Satya Nadella, cultural openness and transformation was a key enabler for deal success. The company evolved from what Chris Capossela, the company's chief marketing officer, referred to as a “know-it-all” culture to a “learn-it-all” culture, adding that “everything we do now is rooted in a growth mindset.” Said CEO Nadella: “Longevity in this business is about being able to reinvent yourself or invent the future.” Indeed, underpinning this transformation was the fundamental conviction that the firm needed these acquired capabilities to continue thriving.

In addition, successful acquirers intentionally force collaboration right out of the gate. This is how they learn to work together. It involves spending the time required to get to know each other, aligning the top leadership on the joint future vision and on the rules of engagement.

When it comes down to the tangible actions, a few things need to happen by deal close for all deal types—for example, closing the books, combining financial reporting, communicating to employees and other stakeholders. These actions have nothing to do with integration or the lack of it.

But that's not where the value is. Successful acquirers get three things right in capability integrations.

- Develop a value-creation plan jointly with the target leadership.
- Protect the target's talent, culture and ways of working, and find ways to scale it to support the value-creation plan.
- Consider operating model changes in support of the value-creation plan—both hard and soft tactics to get the teams to work together.

You don't lead with functional integration in capability deal integrations; you lead with the value-creation plan. Given the valuation multiples involved, the true value lies in the revenue potential. If you chase after small cost synergies, you risk using up valuable and limited management bandwidth on things that don't matter. That is a missed opportunity.

The window before and soon after deal close is a real breakthrough time to set the appropriate tone. Successful acquirers get the right people together, start with taking a future-back view of the customer, develop the product/service proposition in service of customer needs and use that to inform decisions around where to create connections. Functional integration, if any, would be a by-product here. In fact, if functional integration is required, it may be a few years down the line, when the product or service proposition is ready for rollout.

To see this approach in action, consider the example of an animal nutrition company (AgriCo) that acquired a small, fast-growing producer of natural additives for animal feed (FeedCo). The acquisition was aimed at accelerating combined growth and developing industry-leading capabilities and natural solutions for animal health and food safety.

This was both a growth scope and capability scope deal. FeedCo operates in the faster-growing natural solutions segment of the animal nutrition market and has proprietary products and technology. Given the relative size of the companies (AgriCo was many times larger than FeedCo) and the need to protect and accelerate FeedCo's growth, AgriCo had to create a thoughtful plan to realize the deal thesis.

This integration approach was different from a traditional approach in many ways.

- The acquirer developed a value-creation plan jointly with the target leadership:
  - Early joint sessions focused on learning and knowledge transfer, without jumping ahead to opportunity brainstorming and implementation planning.
  - The value-creation plan was led and owned by the target leadership and enabled by the acquirer leadership.
  - The value-creation plan was translated into an action plan, including both product development and go-to-market initiatives, and the enablers required to take action.
- The acquirer protected the target's talent, culture and ways of working:
  - AgriCo invested in building relationships and embraced the new leadership team as equals.
  - People-first priorities, such as engagement and retention plans, were managed separately from HR onboarding efforts to ensure dedicated focus.
  - Gatekeepers were appointed initially to protect the target management from direct requests from the acquirer side.
- The acquirer considered operating model changes in support of the value-creation plan:
  - Functional integration was minimized to what was required for operationally critical tasks.
  - Moreover, they took a "how can we help you?" posture that set the tone in the early days of integration. Joint growth teams were created to bring together the right people from both sides, with appropriate governance, to ensure successful implementation of the growth plan.

As a result of this integration approach, AgriCo and FeedCo jointly developed a five-year growth plan to double FeedCo's revenue and ensured 100% retention of critical FeedCo employees.

They say a goal without a plan is just a dream. Successful acquirers embarking on capability deals proactively convert the deal thesis into an action plan. They leverage a capability deal's tremendous potential to transform their company and leapfrog the competition.

## Divestitures: Greater preparation equals greater value

### At a Glance

- ▶ An active and ongoing portfolio management strategy involving regular acquisitions and divestitures always beats ambitious portfolio transformations.
- ▶ In today's disruptive environment, divestitures are instrumental to accelerate the transition to a future portfolio; they release the time, talent, energy and capital tied up in nonstrategic businesses.
- ▶ In practice, many companies delay and underprepare for divestitures, resulting in value leakage.
- ▶ Systematic preparation helps divesting companies get ahead of common divesting pitfalls—for both proactive divestitures and regulator-mandated ones.

### Divestitures can create value when done proactively

Divestitures are quite common. On average, almost two-thirds of strategic deals, by value, involved divestitures over the past decade. Timely divestments can accelerate the transition to a future portfolio by releasing the time, talent and energy tied up in nonstrategic businesses. Divestments are also a source of capital to fuel growth. Some companies use this lever more frequently and to greater effect than others do.

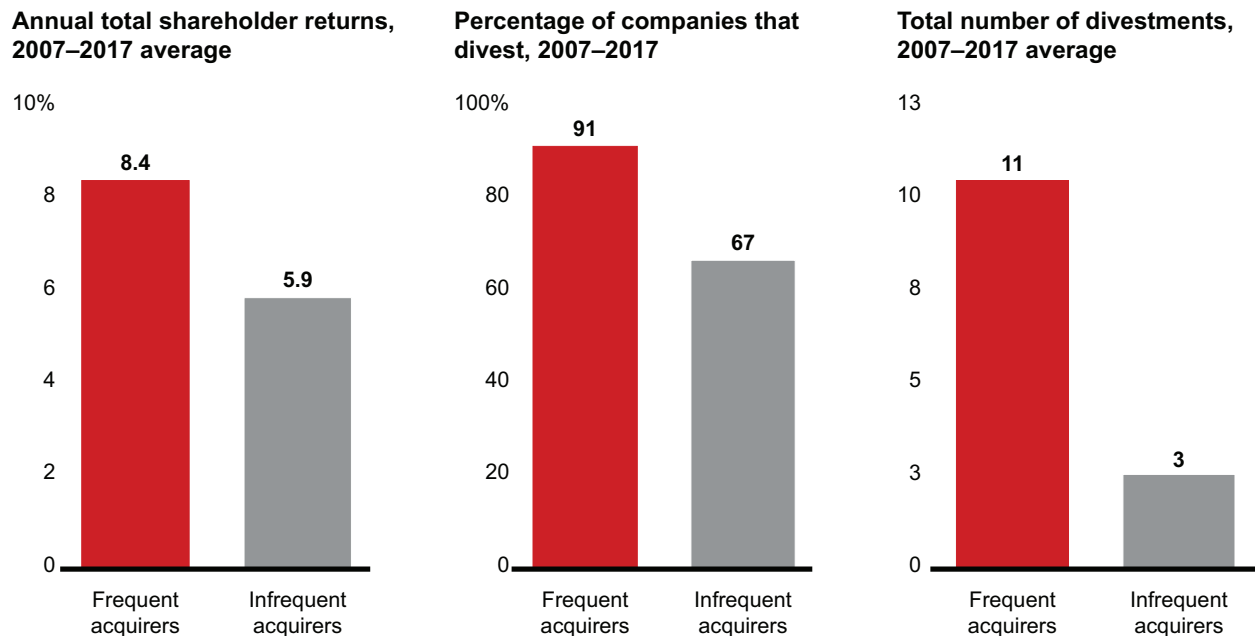
Our extensive research on M&A value creation over the past two decades shows that frequent acquirers outperform other companies (see *Figure 4.7, left panel*). We define frequent acquirers as companies that make at least 10 acquisitions within a decade. What also stands out is that these companies are active portfolio managers that both acquire and divest proactively. We found almost 91% of frequent acquirers divest and that they divest around 2.5 times more than others (see *Figure 4.7, middle and right panels*).

M&A practitioners also agree that divestitures can be value-creating transactions. In a recent senior executive survey on M&A and divestitures, about 200 respondents who had experience with divestitures reported that about two-thirds of their divestitures met or exceeded expectations and created value for the company.

### Holding on to assets past their due date destroys value

Despite the value in making timely divestitures, roughly 60% of our survey respondents reported that divestment decisions take longer than other strategic decisions. They say action often is delayed by months, if not years. The biggest cause of delay is waiting for better market conditions—that is,

**Figure 4.7:** Frequent acquirers outperform—91% of them actively divest and do so significantly more than others



Note: Frequent acquirers defined as companies that made at least 10 acquisitions over 2007–2017  
Source: Bain M&A deal database, 2018

hoping for a better sale price (see Figure 4.8). Among the other reasons for delay were difficulty in separating operations, legacy/cultural resistance, deprioritizing divestitures, and concerns about stranded costs and dis-synergies.

We believe that operational concerns, such as the complexity of functional separation or the challenge of assessing and mitigating stranded costs and dis-synergies, are all addressable with better preparation.

Cultural reasons for delaying divestitures are harder to navigate and lead to tremendous value leakage. They come in various forms. There is the hold-and-hope mentality in which a company expects the business to turn around. There are concerns about shrinking the size of the business, or companies simply deprioritize divestitures on the belief that the business impact is minimal. There may also be a fear of exposing a bad business to the market. Overall performance and investor reaction to divestitures shows that these are generally unfounded concerns.

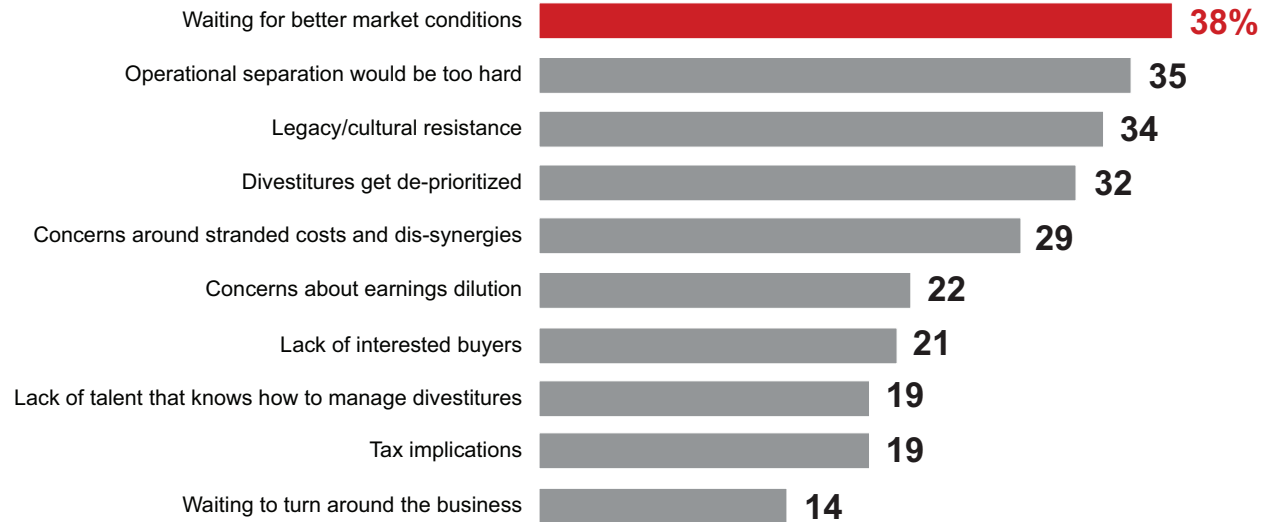
Companies should instead change the narrative to one in which they honestly ask who the right parent is and then find that parent for their nonstrategic businesses. Delays in divestitures not only stop a company from fully focusing on its strategic growth businesses but also weaken the nonstrategic businesses in the process. For the majority of corporates, capital is limited, and assets tagged nonstrategic are the first to see funding cuts. This perpetuates a cycle of value erosion over time (see Figure 4.9). If getting



**Figure 4.8:** Main reasons for delayed divestitures include timing the market as well as cultural and operational issues

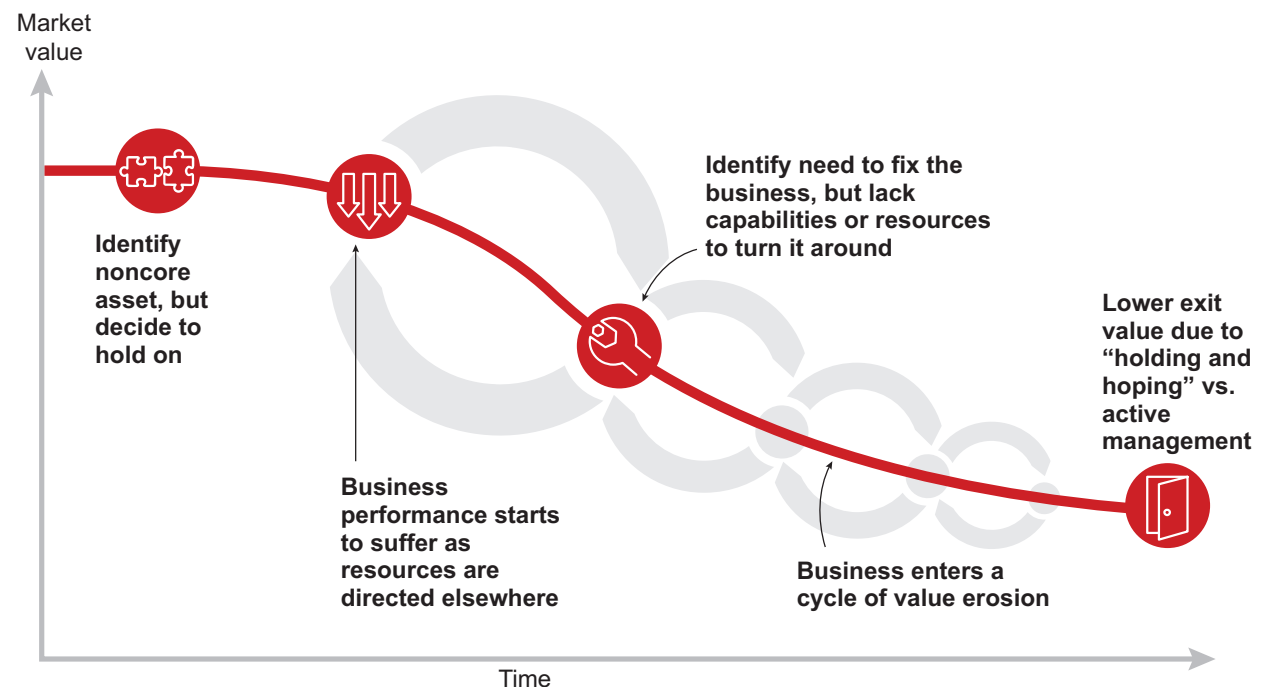
**Reasons for delayed divestitures**

Percentage of respondents



Note: Based on an executive survey in which respondents were required to choose up to three reasons (N=119)  
 Source: Bain M&A and Divestitures Executive Survey, July 2019

**Figure 4.9:** The delayed divestiture doom loop



Source: Bain & Company

good value for the business was a concern at the starting point, it’s certainly a bigger concern after a period of value erosion. The bottom line: Companies need to act faster when it comes to divestitures.

### A little preparation goes a long way in getting your fair share

Once a company decides to divest, the question is whether that company is getting its fair share of value. Our experience shows corporates tend to underestimate the value of the assets they are divesting.

Private equity firms are eager to buy corporate carve-out assets. Yet while companies may hold off on divestitures, awaiting a better sale price, the bigger issue is that they don’t capture their fair share of value from carve-outs when they do sell because they are underprepared. It is a particularly important issue when corporates go up against sophisticated PE buyers.

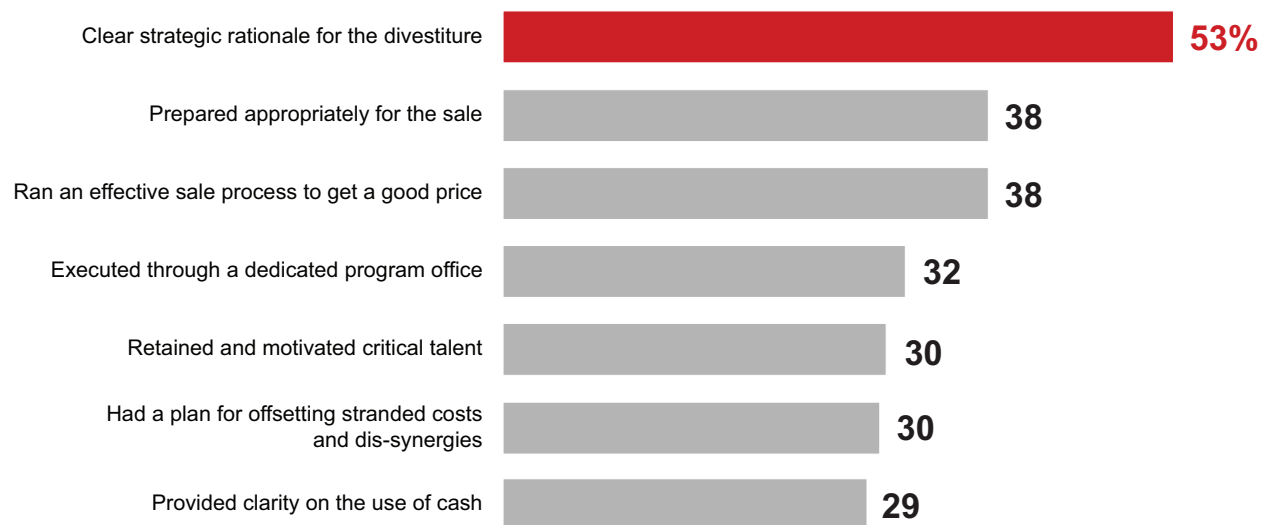
Several PE transactions involving corporate carve-outs illustrate this situation. For example, in October 2018 a Blackstone-led consortium acquired 55% of Thomson Reuters’ financial and risk unit, valuing the business at roughly \$20 billion. This asset was proposed to be sold within a year to the London Stock Exchange at a valuation about 35% higher, at \$26.7 billion.

Our senior executive survey shows that a clear strategic rationale and adequate preparation lead to success in divestitures (see Figure 4.10). Applying the PE playbook to maximizing exit value is the best way to prepare.

**Figure 4.10:** Strategic rationale, effective preparation and sale process are the reasons behind divestiture success

#### Reasons behind divestiture success

Percentage of respondents



Note: Based on an executive survey in which respondents were required to choose up to three reasons (N=198)  
Source: Bain M&A and Divestitures Executive Survey, July 2019

A PE exit playbook applied toward preparing for divestitures incorporates the following:

- **Capture quick-win improvements.** Implement and realize sustainable in-year profit improvements from high-impact opportunities.
- **Build an exit story.** Create a strategic action plan to realize the full potential of the business, and back it with a robust fact base and proven traction on specific initiatives to show early signs of success.
- **Embed the future buyer perspective.** Outline a value-creation plan for the next owner (tailored for a corporate vs. financial buyer).
- **Prepare for sale well ahead of time.** Ensure early preparation of selling documents, typically a year before the actual sale, and create a short list of buyers 6 to 12 months before the sale.

The following two examples show how proactive preparation helped the divesting companies find buyers and realize a better-than-expected sale price.

A US-based global aerospace and defense company wanted to divest its services business due to underperformance and limited future growth prospects. The company had not taken steps to adapt the business to current and expected top-line declines. To prepare the asset, the company pressure tested its business plan against market projections and peer forecasts, identified a requisite set of growth and cost initiatives to close the gap to new performance targets, and began implementing a subset of no-regrets cost initiatives. These actions increased in-year operating profit by roughly 50% and improved the likelihood of finding a buyer. In fact, the growth and cost initiatives identified during preparation reflected about 70% of the synergies ultimately identified by the strategic buyer.

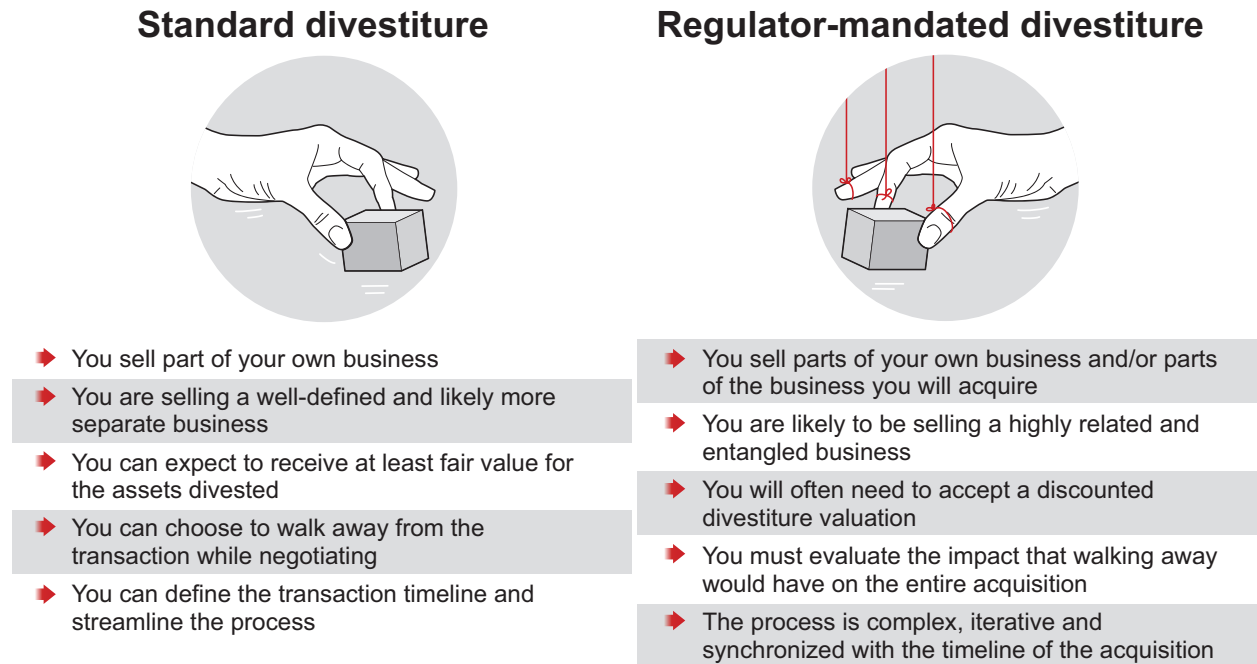
A major European telecom company had a small innovative business unit that established a new product in partnership with business-to-business (B2B) clients. That new product had few synergies and little integration with the core business—not to mention low growth prospects. The company initially planned to sell the business to its B2B partner at a loss of several million dollars. After a few months of systematic preparation, however, including a strategic opportunities assessment and buyer screening, the divesting company was able to realize a profit from the sale instead of incurring the loss that it had expected. It also found a buyer other than its B2B partner.

### **With adequate preparation, regulator-mandated divestitures don't have to be painful**

With many industries hitting the limits of consolidation, the likelihood that a scale deal will require regulator-mandated divestitures is high and poses a risk to both the timeline and synergies.

Regulator-mandated divestitures add tremendous complexity to the divestiture process. They can feel more unnatural than planned divestitures and must be completed within a short time frame (*see Figure 4.11*). Often, the remedies require selling a part of the target's business, something you

**Figure 4.11:** Regulator-mandated divestitures add multiple layers of complexity



Source: Bain & Company

don't know very well. It puts you in a compromised negotiating position with the buyer, and you may find yourself surrounded by advisers with conflicting objectives. Moreover, you may be running the sale process alongside regulator negotiations—all while dealing with ongoing integration planning. It is certainly not for the faint hearted.

Getting ahead of this complexity requires preparing for regulator consultations and monitoring the interdependencies between the integration and separation efforts. The best acquirers take the time to study the regulator's approach and develop their own war-gaming scenarios to prepare for consultations.

A systematic approach to preparing for regulator-mandated divestitures involves five steps:

- **Identify potential categories at risk.** Understand how the regulator views the market to identify overlapping business areas that would come under scrutiny.
- **Define the business perimeter of remedy options.** For each overlapping business, define the potential remedy options (products, geographies) and whether they belong to the acquirer or target's business.
- **Identify the value at risk.** Assess the revenue and margin impact of each remedy option.

- **Define discrete divestiture packages.** For each remedy option, assess feasibility—supporting infrastructure, probability of finding buyers, impact on closing timeline and so forth.
- **War-game potential scenarios.** Rank order your potential remedy options, and run a scenario analysis to prepare your response to various regulator reactions.

This is usually a complex exercise involving trade-offs among minimizing the impact on deal value, satisfying regulatory concerns, attracting interested bidders and limiting separation complexity. A key aspect is also identifying walkaway conditions—namely, those in which the original deal would no longer make economic sense.

As all deal types face increasing scrutiny, there is great value in preparing in advance for remedy negotiations. Such preparation delivers a huge pay-off by minimizing the drain on leadership, resources and the costs of getting into protracted regulatory issues. The most successful companies are proactive. They start to assess and plan for regulatory risk at the deal diligence and negotiation phase.

## Methodology and approach

### About deal classification—scale and scope deals

To understand the nature of M&A activity, we first identified the top 250 strategic deals of each year (top 165 strategic deals for 2019 year-to-date until September, since the analysis was concluded in October). From the initial list of deals with values greater than \$1 billion, as reported by Dealogic, we excluded nonstrategic deals. These include asset or property acquisitions, financial investments, internal reorganizations, and minority stake acquisitions.

We then classified the strategic deals into scale or scope deals based on our proprietary framework applied consistently across the years. The proprietary framework uses the stated strategic rationale by the acquirer at the time of announcement to identify the key elements of the deal thesis. Based on these elements, the deals were categorized as scale or scope deals.

Scale deals are intended to strengthen market leadership and lower cost position through the benefits of scale, such as cost synergies. Scope deals are intended to accelerate top-line growth by entering or expanding into faster-growing market segments, or by bringing in new capabilities. In reality, some deals are a blend of both scale and scope; however, the vast majority lean toward one or the other (see Exhibit A).

#### Exhibit A: About the methodology



Source: Bain & Company

## **About the M&A and Divestitures senior executive survey, 2019**

In partnership with the Gerson Lehrman Group, we conducted a survey of 247 senior executives on the topic of corporate M&A and divestitures. The survey ran throughout July 2019 in the US, UK, Germany, France, China, Australia and Japan. Survey participants were from companies with greater than \$500 million in annual revenue and held senior executive roles in the capacity of CEO, CFO or head of strategy/business development/M&A.

The survey covered the topics of portfolio management best practices, divestiture decision making and keys to success as well as M&A success drivers for scale and scope deals.



## About Bain & Company's M&A and Divestitures practice

Bain has partnered with leading corporate clients for 40 years on more than 10,000 M&A-related projects. Nearly half of our strategy projects involve M&A consulting. Bain-supported merger integrations result in approximately 20% more shareholder value than typical mergers and deliver almost twice the synergies when compared with deals in which Bain is not involved.

Our work includes every major step in M&A—M&A strategy, due diligence, post-merger integration, divestitures, spin-offs, joint ventures and alliances, venture capital, and M&A capability. We have substantial experience across all geographies, industries and transaction types.

**M&A strategy:** For most companies, M&A isn't an optional part of strategy, it's an essential component. Bain M&A strategy support helps you improve your odds of successful deals by facilitating strong alignment with the broader corporate strategy, honing your M&A objectives, and ensuring that you have a process to systematically screen for sectors and targets so that you are always ahead of the curve.

**Due diligence:** The best strategic acquirers know that due diligence is critical, and they do it right. Bain Corporate Due Diligence support provides a fact-based, rigorously quantified assessment using advanced analytics and digital capabilities that helps you ward off deal fever, spots synergies the market didn't see and starts preparing you for integration long before your deal is inked.

**Post-merger integration:** Successful integration is the key that unlocks the full value of your deal. Bain Merger Integration support helps you mitigate common risks and offers a systematic approach to managing change for your business, people and culture, ensuring results that exceed your deal expectations.

**Divestitures:** Bain divestiture support ensures that companies realize the highest possible value from divestitures by preparing the asset for sale, running a low-risk carve-out program and shaping the remaining business to thrive.

**Spin-offs:** Bain spin-off support ensures that companies realize the highest-possible value from spin-offs by developing the spin-off thesis, ensuring robust spin-off and transaction plans, and setting up both companies for success.

**Joint ventures and alliances:** Bain Joint Ventures and Alliances support helps you maximize the value of your joint ventures and alliances and build the internal capabilities that you need to support them.

**Venture capital:** If only companies could take the "corporate" out of corporate venture capital. They often find it difficult to shake the conservative mindset that not only hinders corporate venture capital activities but also is the very antithesis of a successful venture capital strategy. Bain can help you get it right. With our newly launched Bain Venture Capital as a Service support, we act as your venture capital arm, amplifying the reach, leverage and success of your venture capital program.

**M&A capability:** A repeatable end-to-end M&A capability reflecting accumulated experience is a major competitive advantage for the most successful companies. Multiple elements work together to develop a strong capability that spans different types of transactions (M&A, joint ventures, divestitures) and the complete transaction cycle. Bain supports in developing and integrating elements such as the people, processes, organizational structures, tools and advisers that enable continued successful outcomes.

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