Where's the Value? Strategies for Successful Acquisitions: Part 1

We are living in an M&A world where many acquisitions fail to create value. But the corollary, of course, is that some acquisitions DO create value, and the obvious question is why. In the current environment, where companies are relying more heavily on M&A to drive revenue growth, that's a significant "why", so we went looking for an answer.

We've discussed post-merger integration (PMI) as a critical factor in any successful M&A transaction. But a recent McKinsey article, The Six Types of Successful Acquisitions, takes a front-end perspective. The authors suggest that successful deals are initiated with specific and detailed value creation strategies, typically fitting with at least one of six archetypes. We will discuss the first three archetypes this week, and the remaining three in next week's article, along with some overarching value creation principles.

Successful Acquisitions: Value Creation Strategies

1. Improve the target company's performance

This is one of the most common value-creating acquisition strategies, often used in successful private equity acquisitions.[1] Margins and cash flows are improved with a reduction in costs, and additionally, an acquirer may invest in opportunities that drive revenue growth. We would add that rigorous PMI is particularly important when executing this value creation strategy.

2. Accelerate market access

Small companies with innovative products often lack the distribution network to reach their potential market. An acquirer with a large sales force and similar or complementary products can accelerate revenues for this type of target. IBM has utilized this strategy extensively, acquiring smaller companies and significantly increasing their revenues by distributing their products through IBM's global sales force

3. Acquire skills/technologies faster or at lower cost than building from scratch

The McKinsey authors appear to apply this archetype as it relates to tech companies buying other tech companies, acquiring enhancements to their own technologies[2]. Lately, however, there has been a proliferation of non-tech companies making tech acquisitions, and it is unclear how much value will be created in this arena. As venture capitalist Brad Feld recently noted in response to this trend: "a small number of those companies extract significant value out of [those deals] because they buy well at the right time on their curve

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[1] Where a target company was "bought, improved, and sold, with no additional acquisitions along the way," operating-profit margins increased by an average of 2.5% more in successful private equity acquisitions relative to those at peer companies during the same period.

[2] The authors limit examples to tech acquiring tech, including Apple's acquisition of Siri to enhance its iPhones.

and they're able to do something with it", but "a whole bunch" will not. His reasoning: many of these acquirers simply don't know what else to do in today's rapidly evolving technology environment, and they pay inflated prices for their tech acquisitions, squeezing out any prospect of future value.

It's important to recognize that successful execution of any of these strategies requires the buyer to provide its target with something that renders it more competitive. In the first example, that something is better management and additional capital, and in the second, a far-reaching distribution network. In the third example, this may be the factor that explains why tech/tech acquisitions are more successful than non-tech/tech. Non-tech buyers typically have less to offer their tech targets. We like the way that Roger Martin describes this principle in his article M&A: The One Thing You Need to Get Right:

"Companies that focus on what they are going to get from an acquisition are less likely to succeed than those that focus on what they have to give it."