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How lots of small M&A deals add up to big value

New research confirms that companies that regularly and systematically pursue moderately sized M&A deliver better shareholder returns than companies that don't.

by Jeff Rudnicki, Kate Siegel, and Andy West

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Nearly a decade ago, we set out to answer a critical management question: What type of M&A strategy creates the most value for large corporations? We crunched the numbers, and the answer was clear: pursue many small deals that accrue to a meaningful amount of market capitalization over multiple years instead of relying on episodic, "big-bang" transactions.[1] Between 1999 and 2010, companies following this programmatic approach to M&A generally outperformed peers.[2]

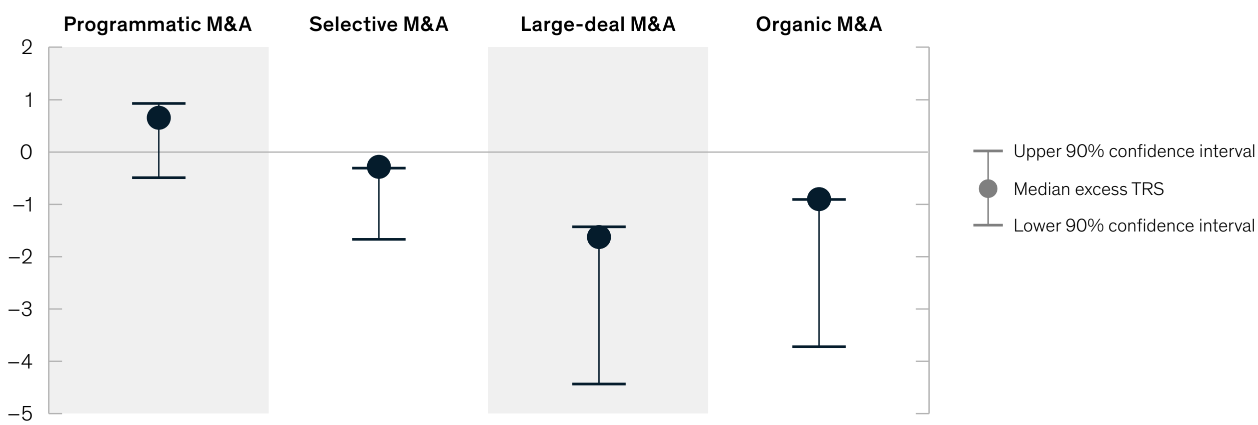
That pattern is even more pronounced in today's fast-moving, increasingly uncertain business environment (see sidebar, "The staying power of programmatic acquisition"). A recent update of our research reflects the growing importance of placing multiple bets and being nimble with capital: between 2007 and 2017, the programmatic acquirers in our data set of 1,000 global companies (or Global 1,000) achieved higher excess total shareholder returns than did industry peers using other M&A strategies (large deals, selective acquisitions, or organic growth).[3] What's more, the alternative approaches seem to have under-delivered. Companies making selective acquisitions or relying on organic growth, on average, showed losses in excess total shareholder returns relative to peers (Exhibit 1).

The data also confirmed just how challenging it is for individual companies to make the transition to programmatic M&A from any of the other models we identified. For instance, none of the companies that followed an organic approach between 2004 and 2014 had shifted to a programmatic model

Exhibit 1

Programmatic acquirers achieved excess total returns to shareholders that were higher than the median.

Median excess TRS for companies that remained in the Global 1,000 from Dec 2007 to Dec 2017,[1] %



[1] TRS = total returns to shareholders. Global 1,000 comprises companies that are among top 1,000 by market capitalization; excludes companies headquartered in Africa and Latin America.

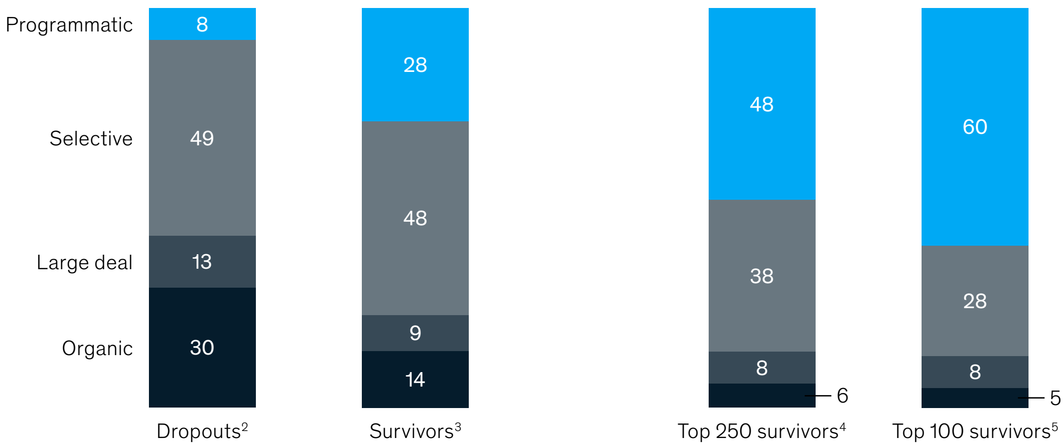
Source: Global 1,000, 2017; Thomson Reuters; Corporate Performance Analytics by McKinsey

[1] Werner Rehm, Robert Uhlaner, and Andy West, "Taking a longer-term look at M&A value creation," January 2012, McKinsey.com.
[2] The definition of programmatic M&A is when a company makes more than two small or midsize deals in a year, with a meaningful target market capitalization acquired (median of 15 percent).
[3] In the large-deal approach, a company makes one deal or more per year, and the target market capitalization is equal to or greater than 30 percent of the acquirer's market capitalization. In the selective approach, a company makes two or fewer deals per year, and the cumulative value of the deals is more than 2 percent of the acquirer's market capitalization. In the organic approach, a company makes one deal or fewer every three years, and the cumulative value of the deals is less than 2 percent of the acquirer's market capitalization.

Exhibit 2

Programmatic acquirers composed nearly one-third of the companies that remained in the Global 1,000 over ten years.

Distribution of 2007 Global 1,000 in 2017,[1] %



[1] Global 1,000 comprises companies that are among the top 1,000 by market capitalization; excludes companies headquartered in Africa and Latin America. Figures may not sum to 100%, because of rounding.
[2] Companies in Global 1,000 on Dec 31, 2007, but not on Dec 31, 2017 (n = 178).
[3] Companies in Global 1,000 on both Dec 31, 2007, and Dec 31, 2017 (n = 686).
[4] Companies among top 250 companies in Global 1,000 on both Dec 31, 2007, and Dec 31, 2017 (n = 157).
[5] Companies among top 100 companies in Global 1,000 on both Dec 31, 2007, and Dec 31, 2017 (n = 65).

Source: Global 1,000, 2017; Thomson Reuters; Corporate Performance Analytics by McKinsey

by the time we performed our latest analysis. And by 2017, more than a quarter of those companies had dropped out of the Global 1,000 altogether because of takeovers and other factors. The story was similar among those companies we deemed selective acquirers (Exhibit 2).

When we looked even closer at the data, we saw some striking differences in what high-volume deal makers do relative to peers. For example, the programmatic acquirers were twice as likely as peers to estimate revenue and cost synergies at various stages of the deal-making process, and they were 1.4 times more likely than peers to have designated clear owners for each stage.[4]

These findings are consistent with our experience in the field, in which we see that programmatic acquirers have built up organizational infrastructures and established best practices across *all* stages of the M&A process—from strategy and sourcing to due diligence and integration planning to establishing the operating model. In this article, we will consider how programmatic acquirers typically manage each of these stages.

The programmatic model may not be the right fit for every company, of course. Some businesses may contend with organizational limitations or industry-specific obstacles (consolidation trends and regulatory concerns, for instance). Regardless, it can be instructive for companies with *any* type of M&A program to understand how some companies are taking advantage of the programmatic approach.

Strategy and sourcing

Most of the programmatic acquirers we interviewed said they work hard to connect their strategies with their M&A priorities. The hard work starts with

[4] 2019 McKinsey Global M&A Capabilities Survey.

a return to first principles: the development of a blueprint for bringing strategic goals into deal-sourcing discussions. An effective M&A blueprint delineates the limitations of pursuing certain deals and provides a realistic snapshot of market trends—for instance, “Which market-shaping forces are the most promising within our sector, and how are our competitors likely to evolve?” Additionally, the M&A blueprint can help programmatic acquirers identify whether or not they may be the best owner in any deal or transfer of assets—for instance, “What are our sources of competitive advantage, and what capabilities are we trying to acquire?” Finally, the blueprint can help companies assess how realistic it may be to expect success from a deal—for instance, “Are assets readily available, or are they overpriced? Do we have the relationships required to carry out this transaction? Are regulatory constraints too much to overcome?”

These were the kinds of questions senior leaders at one consumer-products company asked themselves as part of a recent deal. The leadership team strongly believed the company needed to expand its presence in China and asked the M&A organization to identify potential acquisition targets. The debate over which regions to focus on went on for several weeks, until senior leaders and the M&A team realized they needed to revisit the base strategy. In a series of fact-finding meetings that took place over an eight-week

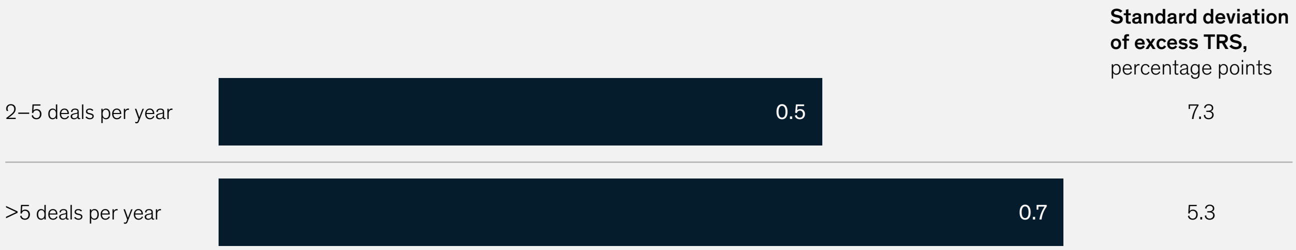
The staying power of programmatic acquisition

In our ongoing research, we track the largest (by market capitalization) 1,000 global companies, measure excess total shareholder returns they created compared with industry peers, and look at the type of acquisition strategy these companies deployed. The data confirm that programmatic acquirers continue to perform better than industry peers; indeed, the more deals a company did, the higher the probability that it would earn excess returns (exhibit). Precisely because these companies are doing deals systematically, we believe they are building lasting, distinctive capabilities in M&A.

Exhibit

Among programmatic acquirers, making more than five deals a year raised the probability of earning excess returns.

Median excess TRS for programmatic acquirers that remained in Global 1,000 from Dec 2007 to Dec 2017,[1] %



[1] TRS = total returns to shareholders. Global 1,000 comprises companies that are among top 1,000 by market capitalization; excludes companies headquartered in Africa and Latin America.

Source: Global 1,000, 2017; Thomson Reuters; Corporate Performance Analytics by McKinsey

A programmatic approach won't work if you don't define the program and don't treat M&A as an enduring capability rather than a project or occasional event.

period—and referring back to their M&A blueprint—the senior leaders and the M&A organization identified the amount of capital required to meet their goals, specific market trends and customer segments in China, and the potential advantages the company could confer to a target (primarily, its global distribution network). Once senior leaders at the consumer-products company had systematically explored such questions, they were able to gain quick agreement on a handful of potential targets in specific regions, several of which had not even been mentioned during the initial discussions.

Due diligence and integration planning

The programmatic acquirers we interviewed said they often tackle due diligence and integration planning simultaneously—holding discussions far ahead of closing about how to redefine roles, combine processes, or adopt new technologies. Having the right resources at the ready seems to be a key tenet for these companies. It was for one consumer-products company that, at the outset of its merger with a target, modeled the optimal sequence for migrating general and administrative tasks from both companies to a centralized shared-services group, thereby jump-starting the overall integration process.

Corporate culture and organizational health—both their own and that of the target companies—also seem to be important concerns for programmatic acquirers. Our research shows that programmatic acquirers are more likely than peers to pay close attention to cultural factors during both diligence and integration processes.[5] For instance, the integration team at one technology company closely tracked the balance of employees who would be selected for the combined entity from across both the parent company and the target. If any area of the business was not achieving a balance that matched the relative scale of the merger, team leaders intervened. Additionally, employee selections could not be approved without ratification from the integration team. If two candidates were deemed equally suitable for a role, the team tilted its selection to the target-company candidate, recognizing that managers in the acquiring company likely already had a built-in unconscious bias in favor of the homegrown employee. If neither candidate was considered suitable, the team moved quickly to recruit externally.[6]

M&A operating model

A programmatic approach won't work if you don't define the program and don't treat M&A as an enduring capability rather than a project or occasional event. Our research shows that, compared with peers, programmatic acquirers often focus on building end-to-end M&A operating models with clear performance measures, incentives, and governance processes. For these companies, the devil is in the details. Potential acquisitions are not evaluated ad hoc, for

[5] Ibid.
[6] Becky Kaetzler, Kameron Kordestani, and Andy MacLean, "The secret ingredient of successful big deals: Organizational health," *McKinsey Quarterly*, July 2019, McKinsey.com.

instance. Instead all the decision makers and the criteria they are using are clearly defined and made transparent to all stakeholders. “If it’s truly a program, then for each type of opportunity, you need to say, here are the targets that would constitute a doubling down, here are the targets or products we’d like to have, and here are the targets for the distribution we want,” one partner at a private-equity company explained to us. “It has to be systematic.”

To that end, one technology company treats M&A in much the same way it does customer acquisitions: it uses a customer-relationship-management-like tool to manage its M&A program. The tool is an online database of hundreds of companies that the technology company actively monitors as potential targets. Using a series of customizable dashboards, the corporate-development team updates the database and tracks statistics about acquired companies and which targets are in which phases of acquisition. (Business-unit leaders are also tasked with keeping this information up to date.) The corporate-development team generates reports, and the head of M&A analyzes the data and tracks progress on deals. The tool enables accountability across all phases of M&A; it is even invoked during executives’ performance reviews.

A clear takeaway from our research is that practice still makes perfect. By building a dedicated M&A function, codifying learnings from past deals, and taking an end-to-end perspective on transactions, businesses can emulate the success of programmatic acquirers—becoming as capable in M&A as they are in sales, R&D, and other disciplines that create outperformance relative to competitors.

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