Invest in a Few, Grow into New: Why “One and Done” M&A is No Longer Effective

By Thomas J. Herd and Gregg Albert
Introduction

Growth should not be a gamble, particularly for large global companies. With responsibilities to legions of shareholders, employees, customers, and suppliers, major corporations should ensure steady, reliable growth, regardless of the vagaries of the global marketplace. This is particularly important in today's volatile, post-recession world, in which capital can be more tightly constrained and returns are more closely scrutinized.

Yet many companies have adopted growth strategies that are risky, consume a number of resources, and do not generate sufficient returns. In particular, the "one and done" approach to inorganic growth focuses almost exclusively on mega-deals that—if executed and integrated successfully—promise major gains in market share, the acquisition of cutting-edge new technologies, and plenty of headlines.

Unfortunately, however, these deals do not always pan out. Markets change, opportunities evaporate, and strategies shift. In such instances, the one and done approach can leave companies heavily vested in failed ideas, wrong turns, and dead ends.

In the pages that follow, Accenture describes a better approach: By complementing major M&A transactions with a "string of pearls" strategy comprising smaller, more tactical investments and venture initiatives, companies can support growth while increasing strategic agility and responsiveness to an unpredictable global environment.
In today’s rapidly changing and intensely competitive environment, companies must continually build on their strengths and develop new ones. Of course, many companies keep up with fast-moving opportunities and threats through inorganic growth, which can allow them to gain new capabilities and enter growing markets more rapidly than they could on their own. Yet the way many large companies approach inorganic growth actually can limit their ability to adapt to new market needs and changing paradigms in technology, and can inhibit their capacity to compete in the dynamic global marketplace.

In particular, what is sometimes termed the “one and done” approach—in which a few large M&A deals dominate an organization’s inorganic growth agenda—can be both risky and costly. History shows that big bets do not always pay off, particularly when the pace of change in markets is fast and accelerating. Plus, buying large, established businesses by definition requires plenty of capital, which may or may not generate a positive return. And because of its tendency to direct large portions of the company’s capital to a few major plays, an exclusive focus on large M&A transactions can limit a company’s ability to move from one strategy to another, thus reducing its agility. This is particularly relevant to emerging markets, new products and technology.

However, this outdated approach often is encouraged and preserved by large companies’ organizational structures. Typically, an internal group is dedicated to M&A and corporate development, and focuses on large, fully-integrated transactions tied to the core business. Separately, a venture capital group may be tasked with smaller, more targeted investments in peripheral and adjacent start-up businesses and ideas. The essential problem is that in many major corporations, these organizations operate on different agendas and in different ways, with no coordination to their approach to transactions. They also are misaligned in terms of capital, time horizons, or risk management, and the ways in which these disparate groups are linked to organic plans to grow the business are haphazard at best.

For instance, the split between M&A, organic growth initiatives and venture often takes the form of different performance metrics for investments and acquisitions, as well as uneven resource allocation. This can lead to the inefficient use of scarce resources, to competing interests, and to scattered, less-productive pursuit of multiple goals. Indeed, while the venture capital team often hopes for positive returns within a few years, the M&A group may expect results within months. This, in turn, can cause friction when scarce financial and human resources are being allocated.

Additionally, the source of funds to support these two different growth engines can vary, which causes issues of its own. While venture capital may come from individual business units that stand to benefit from specific projects and investments, the M&A and corporate development teams may have their own budget or draw funds from finance. With no single sponsor responsible for the use of growth-related capital, both the M&A and venture capital teams may tend to act unilaterally and not in strict alignment with larger corporate goals. This misalignment of funding sources also can allow governance over valuation to erode which, in turn, creates the potential for acquisitions that consume too much capital.

Without a cohesive portfolio approach that considers the different engines of corporate growth, friction leads to lost energy in the form of capital, resources and time. Such disconnects and misalignments can hinder a company’s ability to execute its core strategy with enough speed to stay competitive in today’s fast-changing environment, and can limit value from both large and small transactions. For example, when the M&A and venture capital groups have differing objectives, companies may make oversized acquisitions that do not align with their strategy, as well as venture capital investments that are similarly unrelated to core strategy and result in little or no long-term value.

In short, by allowing walls to exist between M&A and venture capital—and by focusing the former on large, infrequent deals—companies are compromising their returns on growth investments, providing insufficient support for their core strategies, and ultimately, holding back their pursuit of high performance.
A Better Way: Strategy-Driven, Portfolio-Based Growth

Instead of addressing their best growth opportunities with a variety of misaligned investments and activities, major companies should ensure that their overarching strategy is deeply ingrained in both large M&A transactions and smaller venture capital investments. Just as important, companies should take steps to integrate and align both types of growth with each other.

Four best practices can help organizations unlock the benefits of this more balanced approach to growth:

- Adopting a portfolio perspective
- Establishing the right criteria for growth opportunities
- Using stress testing and scenario planning
- Ensuring senior leaders play an active role in framing inorganic growth strategies

Viewing inorganic growth as a portfolio of activities and opportunities is essential: Companies must integrate large M&A transactions with smaller, peripheral investments into one core growth strategy. By pursuing a series of smaller, tactical investments—which can be viewed as a "string of pearls"—companies can mitigate market risks and capital outlays while boosting their ability to react quickly to the dynamic environment. In particular, smaller deals and investments are easier to reverse when conditions and strategic goals change. At the same time, carefully planned and executed large deals can be "game changers" that bring powerful competitive advantage and market strength in a short period of time.

Besides helping companies optimize risk, reward and agility, a balanced portfolio of larger and smaller investments provides the opportunity to align historically competitive parts of the business, thus boosting productivity. To take advantage of this opportunity, however, companies must make organizational adjustments, including removing barriers between the different teams pursuing growth and agreeing on which performance metrics they will use to appraise acquisitions.

Furthermore, organizations should build this portfolio using the right criteria, thus ensuring each acquisition and investment aligns with its overall growth strategy. These criteria include the amount of money the company wants to spend and the target’s relative maturity versus growth potential. The acquiring company’s risk tolerance and desired debt-to-equity ratio also should be reflected in its selection criteria. For some companies, adding significant debt could impact both its valuation and the strength of its brand.

Scenario planning and stress testing also can help ensure the portfolio includes the right growth opportunities. More specifically, companies should cultivate an understanding of current and future market dynamics and competitors to help it define and communicate action plans to address likely scenarios. While commonly referred to as "war gaming" sessions, these intense internal interventions can yield a multitude of outcomes that align and focus the organization. For example, a daylong session with executives charged with steering the business enterprise, business segment or geographic expansion puts assumptions to the test against possible market events that could shift the underlying current.

Another powerful exercise commonly used in financial or engineering vernacular is to engage in a "stress test" session to gauge and understand the point at which sensitivities in the financial or business model “fail” to meet the internal risk appetite. This type of exercise is extremely helpful in illustrating when the overall risk of a particular venture or growth strategy exceeds the amount of risk the organization can actually manage without breaking—and in some cases, can cause the organization to even rethink their overall growth targets. Likewise, firms should independently stress-test their overall inorganic growth strategy, and understand how the results apply to the M&A and venture capital departments.
Finally, companies must ensure that senior leadership—particularly C-level executives and the board of directors—play a leading role in framing inorganic growth strategies. This role and ultimate responsibility would include the overall M&A strategy program, the targeting and screening process (including knock-out criteria), and a dynamic business case effort to reflect the eagerness of the overall organizational aims. For instance, senior leaders must ensure that the objectives of the M&A, corporate development, partnership development and venture capital teams are aligned with the company’s overarching strategy, and they should drive cooperation between these different approaches to inorganic growth. Indeed, by definition M&A and venture capital teams have different objectives, management goals, and skills.

Oversight from the C-suite ensures these teams are pulling in the same direction and at the same pace, thus promoting organizational effectiveness and minimizing operational risks and costs. For example, cross-border and business strategic alignment reduces the friction mentioned earlier and minimizes lost capital, market position and time. Ensuring organizational alignment, complementary employee mindsets and clear accountability down and across the organization will mitigate systemic risk, increase overall organizational capability and prepare for changing strategic aims. These are the essential building blocks required to fully implement an overall inorganic growth plan that includes the elements and approach discussed in this paper. Furthermore, clear communication from executive leadership provides growth teams with valuable guiding principles, and can help close the gaps that often exist between them.
Balanced Growth in the Real World

Several innovative organizations have used the full portfolio of inorganic growth activities to execute their overall strategies more effectively. Google is a prime example. The tech giant has used small purchases to accelerate its overall goals and achieve greater agility, particularly in areas such as the consumer Internet, software and mobile technologies. Examples include its acquisition of Keyhole (which became Google Earth), Zagat, Aptune, Clever Sense and, perhaps most notably, Motorola Mobility. In this particular case, the acquisition of the Motorola Mobility business gives Google the rights to a treasure trove of critical patents and IP. Since Google is a relatively young firm, their patent portfolio isn’t as robust as compared to more seasoned competitors. By bundling Google’s existing technology prowess with the acquired patent protection, growth synergies and market penetration acceleration is possible with reduced capital risk. The similarly innovative, flexible, and engineering-driven cultures between the two entities fueled one another and played a large part in the deal’s success.¹

eBay also has made several notable yet modest acquisitions that have enabled it to play a larger role in electronic commerce, such as its purchases of Magento, mobile carrier billing provider Zong, and Milo.com. The Milo acquisition, while relatively small at an estimated $75 million, has furthered eBay’s retail strategy by expanding its reach within a range of sales channels, helping make it “the first place a consumer goes every time she shops.”²

However, some of these same companies also have acquired larger businesses that, together with smaller investments, have provided an optimized balance of risk, value, and growth. Google, for example, made several larger plays to boost its participation in key markets between 2006 and 2010, including acquisitions of YouTube, DoubleClick, ITA, and AdMob. For its part, eBay spent several billion dollars on Bill Me Later and PayPal. In contrast to its investment in Milo, PayPal alone cost eBay $1.5 billion. At the time of the acquisition, PayPal already serviced roughly one in every four eBay transactions. Considering the complementary nature of their services and overlapping customer base, both entities were able to successfully integrate, leverage each other’s strategic positioning and ultimately make the lives of their customers more convenient.³

In Asia, Petrochina has purchased a number of small- to medium-sized shale gas companies that also typify this “smaller is better” approach, while Disney has developed a specialty in small, targeted acquisitions to help it enter specific markets—an example of which is its 2009 acquisition of Playdom, which enabled the entertainment icon to become a player in the online social gaming universe.³

In all, these companies demonstrate the real-world power of a more balanced, strategy-driven approach to inorganic growth.
Conclusion

In a rapidly changing, unpredictable global environment, staking growth on just a few big bets is a risky move. Business journals are littered with stories of acquisitions gone wrong, of shareholders demanding retrenchment to core strategies, and major corporations making dramatic course adjustments.

That doesn’t mean M&A is a de facto mistake; carefully vetted major deals still play an important role in inorganic growth. However, companies increasingly are seeing the value in a more balanced approach. By complementing large M&A transactions with a continuous stream of smaller, more targeted venture capital investments, joint ventures, and smaller bolt-on acquisitions, companies can accelerate growth, boost agility and achieve alignment with their overall strategy, derive more value from invested capital, and manage risk more effectively.

Doing so, however, will require many large global companies to change the ways in which they operate, boosting alignment between M&A and venture capital teams, building a balanced portfolio of large and small deals, putting in place the right criteria and metrics, and ensuring senior executives lead the way. By taking these steps now, major global companies can move ahead in the race toward high performance.
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References


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