Standing Out from The Crowd:

How the World's Most Successful Acquirers Manage A Portfolio

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Over $2.3 trillion in M&A activity has been recorded globally in 2018, up 57% from the same period a year earlier, according to Dealogic research. The flurry of deal-making has happened against a backdrop of booming economies, rapidly evolving industries, wide-scale technological innovation and healthy stock valuations. These have boosted corporate confidence and invited record-breaking deal sizes and pace.

According to a 2018 M&A trends report by Deloitte, 68% of executives in the U.S. say that their deal flow will increase in the next 12 months. The close of 2018 and opening of 2019 are expected to remain ripe periods for deals. But in the midst of deal fever, companies may start to slip with respect to deal rigor and scrutiny and fall into a pattern of aggressively pursuing M&A with less and less purposefulness. Today, it's not enough to simply be an acquirer. As deal competition grows and new innovation makes existing technologies and incumbent leaders outdated in months – rather than years – it is crucial to become an advantaged acquirer. **This is the designation of companies that focus less on news cycle headlines and more on the structural framework that underpins every M&A decision.**

All companies –regardless of industry or size– can tap into the benefits of being an advantaged acquirer. For these companies, their deal portfolios will look distinctively different than those simply caught up in the rush of deal fever. Deloitte organizes this idea into nine points, below, and offers insight into how forward-thinking companies can add intention in their portfolios and deals to become advantaged acquirers.

Portfolio distinctives of advantaged acquirers

Strategically Sound	Value-Creating	Resilient
Competitively Positioned	Maximizes Intrinsic Value	Survives Scenarios
Balances Innovation	Addresses Market Value	Builds Optionality
Creates Synergies	Finds the Right Owner	Weighs Feasibility and Risk

Companies operating in this framework take an offensive position in M&A by selectively pursuing deals that contribute to an overall strategic mission, rather than simply reacting to every shiny opportunity that comes their way.

Building an Advantaged Portfolio

Before any M&A activity can take place, an advantaged acquirer must be **strategically sound.** Healthy examination of values and vision helps create the lens that all M&A activity is viewed through. What's more, strategic soundness is the underlying foundation for each of the other strategies employed by advantaged acquirers. To be strategically sound, a company must position itself in the market competitively, it must emphasize innovation and it must establish people and processes such that it creates synergies to maximize value extraction.

Sound companies can honestly assess and wholeheartedly embrace their **competitive position**. This means that the organization focuses on the markets that it can successfully compete in – that is, the markets where it has some inherent advantage or can quickly create one. For these companies, the goal is not to win in every market or, by default, try to expand to every adjacent market for expansion's sake. Their goal is to win in the market in which they have carved a strong position and defensible competency.

Microsoft has been one of the most prolific dealmakers in history, acquiring mega-companies such as LinkedIn, GitHub and Skype. These deals may seem expensive and distinctively different, but they are entirely driven by Microsoft's competitive agenda within its target market. CFO Amy Hood explains in an interview at the 2018 Fortune Most Powerful Women Summit in Laguna Niguel, California:

> "For the past five years, we've been incredibly consistent — buy communities, look for networked assets, look for growing markets, and look for where we're a better owner."

By understanding their strategic competencies and existing portfolio dynamics – and recognizing where they have strategic advantages to build on community/user model assets – Microsoft is able to more easily focus on deals that fit within the framework of their M&A mission.

To ensure strategic soundness, an advantaged acquirer should maintain a plan that **balances innovation.** A portfolio that values future innovation will sow seeds for growth across a variety of opportunities (short, mid, and long term) and various levels of risk and reward. According to a JP Morgan Chase study, companies in nearly every sector generated, on average, positive corporate returns from M&A activity in 2017. The only way to continue this momentum is strategic planning for today and into the future. While emerging technology and future industry winners will never be certain bets, targeting highly innovative opportunities will provide healthy portfolio diversification and upside exposure.

Finally, a strategically sound organization will **create and pursue synergy opportunities,** understanding that the value of the whole should be greater than the sum of its parts. Synergy is not just a corporate buzzword – companies need to be able to clearly define how prospective deals will be additive to existing operations – and accretive to the bottom-line. They must be able to convey to stakeholders how a deal will create an environment where disproportionate value is introduced relative to the cost of acquisition.

The second primary characteristic of an advantaged portfolio is that it should always **create more value** than alternative portfolio options. That is, for the same level of risk and cash, there are no better value generating paths to be pursued. While research suggests that there are a variety of reasons to pursue deal-making – including acquiring a disruptive competitor or building a digital strategy – value creation must be front-and-center. And to do this, companies must understand value types and pursue the right kind of deals: maximizing intrinsic value, addressing market value and questioning whether they are indeed the best owner.

First, an advantaged acquirer is one who pursues deals where the **intrinsic value is maximized**, all other factors being equal. Any long-term value created over time is had by improving the intrinsic value of holdings; that is, increasing returns on existing capital, reinvesting new capital to generate new returns, and releasing unproductive capital. These get to the basics of intrinsic value definition and development: the level of risk-adjusted cash flows the portfolio (or deal) offers. Companies must assess where value is being created or destroyed by considering revenue growth and return on invested capital. These will be guideposts on the path to defining levels of intrinsic value and determine whether more money should be put toward a deal, or whether performance can't be assumed, and losses should be cut. While this pursuit can look different depending on deal type, intrinsic value is more likely to be realized over time if the portfolio is consistently calibrated to company-wide, long-term strategic goals.

Intrinsic value should be a primary factor in evaluating portfolios. However, **addressing current market value** must not be ignored as an important diagnostic tool alongside intrinsic value review. Focusing on just one value metric (intrinsic value) while avoiding others (current market value) could mean that companies are blind to potential threats or opportunities stemming from the markets' assessed value of the target company or existing business portfolio.

In some cases, a current owner may not be creating as much value as another owner could. In that case, the owner should **find the right owner**, and consider selling to a value-maximizing party (eBay's divestment of Skype to Microsoft is a great example). Again, what is unique about the advantage acquirer's portfolio is that they may not have the most value-creating businesses but have the best value-creating businesses. 70% of respondents to Deloitte's 2018 M&A trends survey report that they will divest a business interest in the next 12 months due to financing needs or strategy shifts. Top companies do not feel compelled to keep a business solely because it generates cash. In fact, generating cash by selling an underperforming asset may in fact be the best way to maximize value. Furthermore, these proceeds could be paid out to investors or reinvested in other businesses via further M&A activity - where maximum value could be reached – and which may help narrow a strategic portfolio focus.

Finally, **an advantaged acquirer has a resilient portfolio**. While markets have been generally kind to acquirers in the latest bull cycle, disruptive geo-political, economic and other macro and micro factors are becoming more pronounced. To maintain standing as an advantaged acquirer, companies need to put standards in place that encourage portfolio-wide resilience in the face of unknowns. This can show up as resilience to stick to a defined strategy when others are on a buying-spree, resilience to cut losses on underperforming or poor bets and resilience to allocate capital prudently when markets and technology change rapidly.

Alongside resilience, an advantaged acquirer will have the ability to navigate the future and create or optimize value in a variety of uncertain future realities. One of the best ways to ensure this is to **create and test scenarios** for different, plausible, futures. In this, leaders stress test performance and risk. They go beyond basic sensitivity testing and build stories around how macro shifts may unfold and how relevant environmental impacts will affect existing portfolio companies or targets. They model evolutions five, 10 or 15 years away and illustrate potential consequences for industry dynamics and boundaries, customer interactions, or the winning business models

In planning for the future, an advantaged acquirer **builds optionality** into its business choices, enabling multiple potential routes to value in the future. A recent Deloitte report explains three tools to create optionality:

- Stage-gating: Planning choices that will need to be made as certain strategic events happen or fail to occur (ex., "if-then" scenarios);
- Defining transaction pathways: Planning deal sequences to pursue contingencies based on the success or failure of planned M&A activity;
- Identifying trend triggers: Identifying the indicators of certain trends in order to observe the macro-level market changes that may affect success.

Ultimately, the value of optionality is achieved when it keeps a company on one path at a time, preventing it from pursuing different forked paths and bearing the cost of trying to focus on all possibilities.

Finally, an advantaged acquirer **weighs feasibility and risk** within its portfolio. Feasibility focuses on the ability of a company to pursue, build and then maintain their goal portfolio, e.g. – is it possible with the people, process, existing priorities and structures currently in place? Risk, on the other hand, focuses on potential unfavorable developments that come from the choices made. These can include competitive reactions, technology or integration risks, capital markets reactions or macroeconomic unknowns. Companies should consider the level of risks in aggregate and question whether they can all be managed in totality? This requires close examination and a deep understanding of the portfolio or target business innerworkings.

Good business strategy is about making the right decisions – with the value framework that informs these decisions being one of the most telling features of future success. The nine values summarized in this article, broken out under the core ideas of being **strategically sound, value creating, and resilient,** summarize the qualities that an advantaged acquirer should reflect. Of course, these attributes are not always easy or clear to pursue. But they should remain targets as companies apply their framework criteria for improving how they do deals.