McKinsey&Company

Knowledge *Bulletin* OCTOBER 2006

TEN HABITS OF HIGHLY EFFECTIVE ACQUIRERS

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■ Big Picture

Although the risk of failure is high, companies continue to embrace M&A as a way to create value. The Strategy practice has studied the winners and come up with guidelines for getting M&A right.

It is well documented that companies often fail to generate value through M&A. Studies published by Ernst & Young, Coopers & Lybrand, A.T. Kearney, and McKinsey all claim that 50% to 80% of deals fail to create value.[1]

Yet such well-publicized evidence has done little to slow the torrid pace of M&A. Perhaps the pace is spurred on by the belief that many companies still manage to create shareholder value through M&A – which is, of course, true: The risk of failure may be high, but some companies do well time and again.

To understand what the winners do right, the Strategy practice conducted a series of interviews with executives responsible for M&A at highly acquisitive companies in the U.S. and in emerging markets.[2] We identified a group of successful acquirers: acquisitive companies that outperformed their sector peer group on a 10-year (1994-2004) TRS basis. Their business practices suggest 10 powerful guidelines that can help companies conduct M&A successfully, regardless of their size or situation.

1. **Strategic fit.** Outperforming acquirers typically use M&A to fill specific capability gaps. Rather than merely buy additional top-line growth, they use acquisitions to support the company's strategic goals. In contrast, companies making acquisitions under pressure to fill revenue gaps or bolster earnings often make poor decisions.
2. **Experience.** Successful deal teams are staffed with experienced executives who clearly understand their company's culture and values. On average, the heads of these teams have three times more experience within their companies than the heads of teams that underperform their sector peer group.
3. **Business unit involvement.** Many acquisitions fail because the people who analyze their viability are not those responsible for their implementation. Successful acquirers avoid this trap by forming ad hoc teams that supplement the group responsible for M&A with the BU members who will be responsible for implementation. At Mittal Steel, for example, all line and staff functions are represented on a typical due diligence team, which is usually made up of about 20 managers chosen from various plants. Teams are divided into sub-units that review specific areas (e.g., finance, marketing, management, and costs).
4. **Small deals first.** Outperforming acquirers start with small deals[3] and work their way up to larger acquisitions. This enables them to limit their risk exposure while they learn how to conduct deals successfully. Teva, an Israeli pharmaceutical company, exemplifies this approach. Only after completing a number of small acquisitions did it embark on its first large deal, the value-generating acquisition of IVAX.
5. **Long-term focus.** Companies that provide long-term incentives for senior management are less susceptible to the "herd mentality" and are therefore less likely to pursue bad deals. On average, outperforming acquirers measure CEO performance over a period of three years in their long-term incentive plans; underperforming acquirers measure only one year on average.

1 Alexandra Reed-Lajoux, *The Art of M&A Integration: A Guide to Merging Resources, Processes, and Responsibilities,* New York: McGraw-Hill, 2005, second edition.

2 *The growth service line of the Strategy practice interviewed 20 companies in the U.S., which served as the basis for a* McKinsey on Finance *article published by Robert Palter and Dev Srinivasan in June 2006 entitled "Habits of the Busiest Acquirers" (ID# 719658). This bulletin combines the insights gained from the growth service line interviews with the insights gained from about 100 interviews conducted by the globalization research initiative with companies in China, India, and Latin America.*

3 *A small deal is a deal whose value is less than 30% of the company's market value.*

6. **Friendly stance.** Successful acquirers position themselves as "friendly" acquirers. This helps them avoid getting into competitive auctions. As a result, they pay less for their acquisitions than underperforming acquirers.
7. **Realistic synergy estimates.** Underperforming acquirers tend to overemphasize synergy potential, because they are often overly confident about their ability to capture these synergies, even when presented with considerable evidence to the contrary. Successful acquirers are more likely to downplay synergy estimates.
8. **Standardized integration.** An overwhelming majority of interviewees said that integration is the make-or-break stage in the M&A process. The key to success is to develop standardized approaches that can be used each time an acquisition is made. Mexican-based cement producer Cemex, which has become the world's third-largest cement producer through a series of successful acquisitions, is widely recognized for its world-class integration system, which consists of a set of codified, standard integration processes known as the "Cemex Way."[4] One proviso: While it is critical to develop a standard approach, the approach should not be so rigid that companies are unable to tailor it – without changing the core elements – to meet the unique requirements of each M&A deal.
9. **Customer focus.** Successful acquirers consider their customers to be their biggest stakeholders. They offer customers incentives to stay with the company and try to address the issues that the deal might raise even before the deal is closed.
10. **Constant and transparent communication**. Outperforming acquirers communicate clearly and often with both internal and external stakeholders. Management develops a communication "rhythm" using e-mail and newsletters and by speaking to employees and customers in person to ensure that the process and management's intentions are transparent to all.

Teams can use these guidelines as a checklist to ensure that their clients not only understand the factors that can help them succeed but also avoid the pitfalls that can cause inadvertent value destruction as they engage in M&A deals. Indeed, these guidelines might be distributed to clients that are actively pursuing inorganic growth.

To read more, see "Building a Rewarded M&A Machine: Lessons from the Most Acquisitive Companies" (ID# 718951)

4 *"The Globalization of Cemex," HBR Case Study, 2002*