1 What Is the M&A Formula?

Everyone thinks that at least 50% of M&A deals end in failure. But nobody really seems to care, as long as they believe that everyone else is working with the same odds.

This is not OK. Every M&A failure costs time and money, but more importantly, by chasing bad deals you are standing in the way of your own company's value-adding growth. Done properly, M&A can be a successful way to efficiently grow a business. Done poorly, it will destroy shareholder value while making your external advisors rich, and at the very least it will make you look foolish, and may even harm your career opportunities.

This at least 50% failure rule has allowed investment banks and M&A advisors to encourage any kind of deal—whether it is appropriate or not—for decades. After all, they get paid either way, so what do they care if the deal goes bust?

This is particularly true when you agree to pay external advisors a success-based fee, as this only encourages them to attempt any deal whatsoever, thereby continuing the high global M&A failure rate. Meanwhile, CEOs, CFOs, and small-business owners are left unable to reach their true potential. If we are going to reduce the M&A failure rate, then someone has to stop doing deals. And the deals they have to stop doing are the ones that will end in failure.

The truth is that M&A doesn't have to be this risky. The best M&A dealmakers in the world have achieved M&A success by following three rules:

- Every single deal has to be business model driven.
- They involve the whole organization through great leadership.
- They do not rely on external advisors for their own M&A success.

It doesn't matter whether you are a corporate executive, an SME owner, a new employee, or a student, if you can understand business model-driven M&A, then you are on the path to success.

The late Robert Merton coined the phrase 'self-fulfilling prophecy' way back in 1948, and it is still used today. If you go into a deal believing in the at least 50% rule, then you are already accepting the possibility of failure. It will be obvious in everything you do—your attitude towards the deal, your attention to detail, and your preparation. But if you believe in M&A success right from the very beginning, then you will radiate the confidence that you need to inspire your team and drive the deal forward. This is strong leadership, but it all starts with one transformative decision: you have to decide that you are going to be an M&A success. Make that decision and this book will give you all the tools you need to make the right deals, avoid the wrong deals, and make you look like a deal-making genius. But it all starts with you.

Before the M&A Formula …

If you can sum up the purpose of your business in one sentence, then you have already taken your first steps toward M&A success. Before you start to look at the M&A Formula itself, you have to know what your company does—in other words, what are the key drivers of your business?

Maybe you are driven by creating the cheapest possible product in the market? Or maybe your key driver is to provide an increasing range of customer services?

As soon as you have identified the one or two key drivers of your business, you will be ready to start growing your business.

Information is coming online so fast, and new sectors are popping up everywhere. Some of the biggest companies in the world (Amazon, Facebook, Google, Netflix, Tesla) were hardly known some 10 to 15 years ago, and who knows what new sector will dominate the global marketplace 10 years from now.

Now, you're probably thinking, Apple does very little M&A; didn't they do pretty OK?

Absolutely: Apple's total return to shareholders in our research period is a whopping 940.8%, which dwarfs the total return of the M&A Elite.

There are two ways to grow a business: through organic growth, and through M&A activity. Build or buy. Apple is the ultimate example of an organic growth success story, as it has used its own innovation to create the sort of technology hardware which is craved by the world.

But Apple is unusual in its success. So we started to look for other firms with a high total return to shareholders over the same 10-year research period to challenge our M&A Elite. We got inspired by a publication from Heidrick & Struggles called *Accelerating performance*.[1] These so-called 'super-accelerators' are actually a fascinating mix of 'build' and 'buy' corporates (plus a couple who do both), which have increased their TRA dramatically over 10 years. The report was probably not intended as an M&A study, but we turned it into one for two reasons. Firstly, and most importantly, we wanted to compare the world's most successful firms to our M&A elite. Was build better than buy? (No) Secondly, did any of these firms actually rely on corporate M&A to become successful? (Yes)

TRA on super-accelerator firms:

- Apple 940.8%
- Google (Alphabet shares) 243.9%
- Comcast* 183.3%
- Softbank Group 252.12%
- Cigna 206.7%
- Gilead Sciences 358.3%
- Starbucks 242.2%
- Danaher* 191.8%
- VISA 526.8%
- Biogen* 476.5%
- Shire* 360.7%
- HDFC Bank* 504.5%
- Intercontinental Exchange 171.5%
- Illumina 551.4%
- Cerner* 316.4%

The Global M&A Elite has delivered TRA varying in the range of about 200–300% (with the exception of ASSA ABLOY at 327.9%). These TRAs are partly driven by M&A transactions, whereas a TRA from the likes of Google (at 243.9%) is the result of a rather genius search machine. The TRA can be expressed in another way—if you had invested $100 in Google 1st January 2007 you would have your TRA+initial investment 1st January 2017 $343.9 (100+243.9)—a similar investment in ASSA ABLOY would have grown to Skr 427.90 if Skr 100 had been invested 1 Jan 2007. What is perhaps even more impressive—the Global M&A Elite has delivered almost the same value (331.4)[2] to an investor as Google (343.9) in the 10 year research period.

Should You Build or Buy?

If you want to grow your business, you have to either 'build or buy.' This is the big conundrum for any CEO, big or small. Do you always have the time (and the resources) to build, and will your company always be more efficient for building as opposed to buying? For most people, the answer is no. That's why M&A is so popular at every level. No one has the time or knowledge to build themselves, so a lot of companies are buying, and it's only going to accelerate.

The highest identified TRA we measured over this period of 10 years belongs to a 'build' business model. Still, how many Apples are there in the world? Do we ever hear about what happened to all the companies who didn't succeed like Apple? Do you remember Nokia, Kodak, Xerox? Together with high-fashion clothing, technology firms and biotech represent some of the highest-risk business models, often with a binary outcome: live or die.

We have no long-term measure for all companies in the technology hardware sector, which is Apple's subsector, but in the past 3 years the TRA has been only 85%.

Another highly successful 'build' company is VISA, which has a similar monopoly over its sector and a TRA of 526.8%. But over the past 10 years the subsector 'data processing and outsourcing' has returned 'just' 207.7%.

Many of the high performers in the survey are pharma and biotech firms, and they have really made their stockholders happy; but the total pharma+bio index has only returned 130% to shareholders.

There is no evidence that 'build' is better than 'buy' or vice versa. Still, the jury is always out on corporate M&A, where a 50% or more failure rate prevails. Or so they say. Why don't you go and count the 'build' failure rate in biotech, technology firms, or high-fashion clothing? 'Build' doesn't promise better risk-adjusted returns than 'buy.' Furthermore, 'build' does not mean you are home safe, even with the best possible business model. Just as many failures prevail in 'build' as in 'buy'; you just don't hear about them so often.

Moreover, why would you ever limit yourself? M&A is about creating options, and so is running a business. Why not do both? Take a look at the companies in the super-accelerator group above marked *. These companies have seen huge success from using both the 'build' and 'buy' models. Besides, all of our Global M&A Elite companies are no strangers to creating shareholder value by 'building' up the business. Essentially what they do is just invite others to the party through business model-driven M&A.

The opportunity is huge for people and companies who can move fast and show that they are great corporate acquirers. Perhaps you realize right now that you should have started building online channels 4 or 5 years ago, and you think you've missed the moment. Think again. Corporate M&A allows you to travel in time. You can partner up or buy people and companies with the competencies that you need in your existing business model. It is that easy.

Deciding to Buy: Growing Your Business with M&A

This book won't tell you how to 'build,' but it will make you a successful corporate acquirer. You can avoid M&A failures with immediate effect and gradually build M&A competencies into your business model, moving from a defensive stage to an offensive stage, and elevating your competencies to the level of the Global M&A Elite.

While you were setting out your business model drivers, you will have set a number of stretch goals for your company. Now is the time to revisit them.

With these stretch goals in mind, you will be better able to create your M&A target list, and begin the crucial process of running these targets through the Goldman Gates.

Don't be alarmed if your long list of target companies is whittled down to just one or two by the end of this process. That's kind of the whole point. Stopping your company from doing the wrong deal is the first step towards reducing your M&A failure rate. When you stop doing the wrong deals, your failure rate will become much lower and your company will become 'anti-fragile,' as you learn from your anti-portfolio.

Every time you run a target through the Goldman Gates, you will be able to allocate an M&A score, which tells you whether the target is a 'go,' a 'no go,' or a 'maybe.'

'Go' Targets
These are the firms which are going to be the best fit for your company. Move forward now before someone else beats you to it!

'Maybe' Targets
You need to do more research into these companies, so you can identify the blockages and work out whether or not they will be a good fit. Don't move forward unless you are satisfied that your due diligence efforts can promote these companies to 'go' targets.

'No Go' Targets
These are the firms that you should avoid at all costs. However, this doesn't mean that you have wasted your time. These names will form the basis of your anti-portfolio—a vital document which will keep you and your colleagues from making the same mistake in the future. Saying no is not as easy as saying yes. However, you must learn to say no a lot more because that's the only way to avoid doing the wrong deals. Besides, being absolutely clear about what M&A deals you don't want to pursue only sharpens your own M&A formula, and makes your team much more directional and decisive on future M&A deals.

Once you have identified the 'go' and 'no go' deals, you move them to the M&A Launchpad. 'Go' deals get onto your Launchpad, and 'no go' deals are added to your anti-portfolio. Think of this as a big bin beneath the rocket-launch platform—occasionally you can take a look at it and remind yourself why it never became airborne.

Look at your company's stretch goals and business model drivers, and create a version of the M&A Launchpad which is unique to your company. Then all you have to do is follow the rules. Follow the M&A Formula and run each deal through the Goldman Gates.

The Three Steps

The M&A Formula is a simple, three-point plan that will ensure you are in the best possible position for M&A success before you even know what your next deal will be.

Whether you are the head of a multinational industry behemoth, or a small-business owner mulling your first acquisition, the M&A Formula will keep you and your team on track and immediately reduce your risk of failure.

The Three-Step M&A Formula

1. Follow business model-driven M&A.
2. Exercise strong leadership and communication.
3. Take ownership.

Follow Business Model-Driven M&A. Focus on a few key, high-impact drivers for your business. They must be long-term drivers over at least 2 or 3 years, and preferably over a longer period of 5 to 10 years. This isn't something you have to do every time you begin a new deal; it should be part of your long-term corporate strategy.

Every company will approach this in a different way. For DSV, the main driver is cost, and due to the company's reputation for operational excellence, it is well placed to achieve this goal. When they buy other firms, it is because they aren't as operationally good as DSV, so there is an opportunity to save money by bringing them into the fold.

Your company's main driver might be completely different; it all depends on the results of a deep dive into your business model. What building blocks can you turn into M&A drivers? Choose only one—or at most two—as you want to stay focused and drive hard on a few metrics rather than spreading yourself too thin. Any building block can do it, as you will see later. No specific country or region applies. It's not about branded products or intellectual property rights either. It's about choosing the right business model driver for your company, getting your own organization behind it, and making sure that you secure your long-term M&A funds for the projects.

Exercise Strong Leadership and Communication. Communicative leadership in corporate M&A doesn't happen overnight. It is a skill which you have to work on, and embed in your company. Still, the formula itself will kick-start clear communication with its no-bullshit focus on business model drivers. It is about creating a winning mindset in your organization through a sense of belonging. Every person in the company should be able to say: "I know why we do M&A and I know what is expected of me."

Take Ownership. No external advisor will ever make you a successful corporate acquirer.

The reason that you have to take ownership is not because you're better than anyone else in all M&A disciplines, it is because no one else will know your business model as well as you. You are at the front line. Your own organization knows your business better than anyone.

Understanding Business Model-Driven M&A

The M&A Formula (see blogs on this subject on www.fixcorp.co + other references) requires some basic knowledge about your firm's as-is business model.

The Business Model Canvas is a useful tool for this conversation, as it is basically a corporate diagnostic drill which must be based on the common knowledge of your firm (see Figure 1.1).

Never underestimate the negative consequences that you could experience if your team is not aligned in the mutual understanding of your business model.

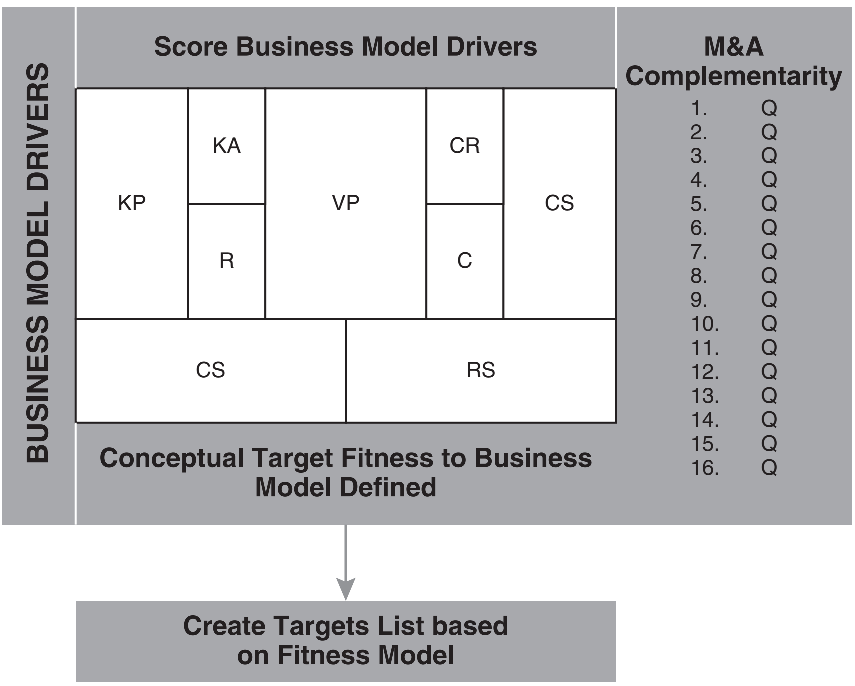

Figure 1.1 Business model drivers

CS: customers; CR: customer relationships; C: channels; VP: value proposition; KR: key resources; KA: key activities; KP: key partners; CS: cost; RS: revenue

Applying the M&A Formula

#1 The business model and the M&A drivers (Business Model-Driven M&A)

To quote Lewis Carroll's *Alice in Wonderland*: "If you don't know where you are going any road can take you there," and this is particularly true in business model-driven M&A. Thanks Erik (Elgersma).

We encourage you to discuss your business model drivers *before* moving on to the M&A Formula itself, where the first step is to choose one or two M&A drivers in your business model on which you can leverage and create value with M&A.

Case Insight

The global car firm, the 'missing alignment,' and how a Business Model Canvas discussion got the team back on track …

The top 50 management team of Toyota Financial Services (TFS) was gathered in one huge meeting room with their advisor Business Models Inc. (CEO Patrick van der Pijl).

Read the full story on: https://www.businessmodelsinc.com/client-story/toyota/

Julia Wada, group vice president of HR and technology recalls how many different opinions were out there on fundamental issues such as "who is the customer?"

On the one hand you can argue, that any car OEM (Original Equipment Manufacturer) must consider the person behind the wheel, "the customer" (a person driving a Toyota).

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On the other hand you can argue, that any OEM supporting car-finance (to increase their car sales) must consider the OEM re-seller network as "the customer" (Toyota dealer selling a car to a person or a company perhaps).

Finally the former CEO of TFS, George Borst said: "We can agree to disagree but I believe these are both our customer."

The most interesting point from this book's perspective is really, that the M&A Formula will not work if your own organization is not aligned on your own business model. Adding a new business to an existing, but blurred business model really compares to building a house on a shaky or muddy foundation. Make sure your groundwork is solid before using the M&A Formula. More often than not companies, or more precisely their organization, are not ready to do Corporate M&A simply because of this single issue. No post integration plan, due diligence whatever any M&A sellside will sell from their tool box will ever fix this problem. Never.

Most discussions based on the Business Model Canvas actually start with "who is our customer". And almost as many times, according to Mr. Pijl, there are actually different views on something so fundamental as who is our client really?

Kindly remember there are a total of nine building blocks in the Business Model Canvas presented in the book Business Model Generation, produced by Mr. Pijl.

Our point is really this. Make sure your whole organization is fully (and truly) aligned with all building blocks before you start using the M&A Formula itself. Not only the customer discussion which is crucial in itself though.

This is a real life experience and it is definitely not an unusual occurrence at all.

Firstly, go rigidly through all building blocks with your team, be it 2 people or top-250 and make sure you discuss all options.

Secondly, the Business Model Canvas is a highly useful tool for this discussion as all participants can easily engage in the discussion that becomes very structured.

Thirdly, and perhaps the best result, with this approach you avoid personal beliefs or people having a special position in your company (read later "what you don't know about biases will harm you").

If you do not feel confident enough, then you should consider hiring an external advisor who can take you and your team through this discussion before you move on to the M&A Formula itself. I have seen Business Models Inc. in action, and I can really recommend their methodology based on the Business Model Canvas itself.[3] As a team, you need to have a common understanding of where you add value in your business model. If not, you will have a hard time narrowing it down to one or two business model drivers in the first step of the M&A Formula.

Say you are running a gadget firm, where your greatest strength lies in making items at a very low unit cost. You discuss your company goals and try to narrow your business down to one or two building blocks, which you will leverage on in terms of M&A. In this case there is only one building block: *cost*.

Now comes the question: "Do we have to be the leading gadget-making firm in the world to become successful in M&A?" No. You just have to be better than your closest competitor.

Imagine two people on an outback trip in Canada. A very hungry grizzly bear suddenly approaches. One guy quickly straps his running shoes on, but the other one tells him "you idiot, no human being can possibly outrun a grizzly bear! You don't have a chance." The first guy replies: "Actually, I only have to run faster than you …"

If you run faster, if your firm is better than the company down the road, then you have a chance of creating value in M&A. You don't have to be the world's best in your category, as long as you are better than the company you are planning to buy. Just make sure you know what business model driver you want to apply.

Leadership and Role Models. Once you have chosen one or two business model drivers, it is time to find a role model, perhaps from the Global M&A Elite or an SME firm with proven M&A success. Discuss with your team what your role model is doing. Could you do the same, and why? We have provided you with seven possible role models from the Global M&A Elite, but there are several hundred firms in the world who have seen repeated success in M&A. The best role model for low unit costs is probably DSV, although the company would probably describe its strength as 'operational excellence,' as it always gives its clients an excellent service in bringing stuff from A to B. This company started out with ten trucks and has grown to almost €10 billion in revenues by making acquisition after acquisition whilst delivering, like the rest of M&A Elite, a high total return to shareholders.

M&A is about doing; it is not like building a firm. Buying growth must be clearly articulated in terms of why you do M&A, what you expect, when, and why. Without this clear mission statement, you cannot lead an organization in M&A and you will not be able to follow up on your transactions.

Taking Ownership. Your team is aligned on your business model and you have chosen one or two business model drivers in M&A. You have chosen a role model from the M&A Elite companies, perhaps a combination, and you have also chosen one or two key metrics to align with your shareholders. Now, you just have to apply the rest of the ingredients and you have baked-in the M&A Formula for future successful growth.

The Goldman Gates will help you validate various targets and see if there is a business model fit. Once you have identified the M&A complementarities, you can go directly to the M&A Launchpad (more on this later).

If you are an SME business owner, you are the boss and you have majority shareholdings, you can start right away. If you are CEO, you could probably also start this transformation straight away and become business model driven.

It gets more problematic if you are a business student or a junior employee. Just remember this: the common knowledge of your organization is greater than the knowledge of any individual. The M&A Formula is based on your organization's common knowledge and it has been proven to reduce the M&A failure rate and, when organizational learning starts to kick in, you will be able to repeat M&A success. You will be right in the long run. If you seriously think, as a young and promising employee, that your company is not prepared to take its M&A activities seriously, then it may be time for you to change the company you are working for. If you spend too many years working for a company with a normal M&A failure rate, that doesn't bode well for your career.

When you buy with your heart, you are leaving yourself vulnerable to a million unknowns. When you buy with your head, it's a lot less romantic, but you are minimizing your risk of failure.

Break your decision-making into smaller pieces and thoroughly analyze each one of the building blocks. That's what we do through business model-driven M&A, and it works.

Ask yourself: is your business listening carefully enough to the people on the front line—the ones who are actually selling your products and services? Do you thoroughly consider your client segments and observe their behavior? Do you match this with your clearly defined value proposition? It is extremely important to do this on *both sides* of a potential deal before determining a fit. A good fit is the first step, but there must also be willingness, on both sides, to pursue one 'business model.' Create transparency and do not be afraid of over-communicating. There is no such thing in M&A.

Listen to the naysayers in your organization, the ones saying "why on earth would you expect that to work?" Then let them sketch other business models and create new options.

Our mission is to lower the failure rate in M&A, and we strongly recommend that you use the M&A Formula before doing anything else.

Success and Failure in M&A

There are a few different ways to 'fail' in M&A, and not all of them are bad. In fact, we would categorize failed deals as 'Really Bad,' 'Bad,' 'Bad-ish,' and 'Good.'

Failed Deals

Really Bad

Deals that were done where the outcome drastically under-delivered on expectations. Maybe the synergies were not realized, teams did not align, or governance issues killed the gains. These deals did not use the M&A Formula, instead relying on sheer monkey business!

This sort of failure is really bad; it destroys careers and loses shareholder value.

Bad

Deals that were lost because the buy-side was unprepared in some way, and the opportunity to gain was lost. There was an M&A Formula fit, but no supporting M&A Launchpad.

These failures are bad, annoying, and symptomatic of poor M&A practice.

Bad-ish

Highly desirable deals which met with the M&A Formula and were Launchpad ready, but failed because of externalities.

This usually means that you were able to expose a previously unrecognized and totally unexpected issue that would have hurt you later, so you got lucky. This is not a bad deal, it's just bad-ish.

It has to be a really big event, such as Brexit or the Swiss Central Bank removing the cap on its currency, causing a 20% immediate appreciation. We sometimes refer to these events as material adverse changes (MACs) in a deal. MACs can even be built into your M&A Launchpad, protecting your firm even during binding offer stage!

Good

Deals that were in line with your M&A Formula, and therefore had to be attempted. However, factors that would have

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eventually turned the deal were identified early on (e.g. the seller disabling your business model drivers, culture, governance, Ts&Cs, due diligence, price, or an interloper risk). These deals are usually stopped due to Launchpad or governance issues.

This is a good failure, as you were able to fail deliberately.

If anyone tells you that you will fail in at least 50% of your M&A deals, tell them they are dead wrong, because you are simply not going to make the same mistakes as so many others.

In this book, we have shown you that 56.1% of companies in an SME survey found that their M&A activities in the past 5 years had contributed 'significantly' to corporate success. So, we know it is actually not that hard to immediately lower your (expected) failure rate of at least 50% if you start doing the right things.

But is 56.1% so much of a difference from 50% or less? Well, yes!

If we compare this 56.1% score with fund managers in the stock-picking business, we get a good comparison. The term 'monkey business' may have been invented by the economist Burton Malkiel in his 1973 book *A random walk down Wall Street*, where he proclaimed that a blindfolded monkey throwing darts at a newspaper's financial pages would do just as well as any equity fund manager.

Many years later, the *Wall Street Journal* decided to test Malkiel's theory in real life.

It turns out that it wasn't actually that easy to use monkeys, so they used blindfolded *WSJ* personnel to throw the darts instead. After 100 tests, the result was that the professional investors won 61 times out of 100, or 61% of the time. So, the world's top fund managers are only about 10% better than flipping a coin. Really?

In M&A and the capital markets, this is actually a big difference. If you get it right 40–50% of the time, you are a monkey. But get it right 60–65% of the time, and you could be one of the world's best fund managers or an M&A rainmaker.

Success in M&A is something completely different from just avoiding failure. That's why we invented the M&A Formula. If you had invested €100 in Google 10 years ago, you would have received an annual return of about 13%, equal to the average total return of our Global M&A Elite. Google is a fantastic firm, and so are the Global Elite firms. They create value for their shareholders. They also create value for our societies in paying taxes, creating jobs, securing pensions, making great products- and services for their customers.

Notes

1. Price, C., Toye, S., Hillar, R., & Turnbull, D. (2017) *Accelerating performance*, Heidrick & Struggles, London.
2. FrieslandCampina not stocklisted + local currency the rest.
3. www.businessmodelsinc.com; their CEO was the producer of Business Model Canvas.