M&A Strategy and Integration:
Adapting to Today's Disruptive Business Models and the Changing Mechanics of Value Creation

By Nitin Kumar

The rules of business continue to be redefined by highly disruptive technologies on a global scale that are altering business models, value propositions, customer demands, interaction models, the economic logic for transacting, profits measurement and the evolution of new interconnected ecosystems.

These changes are much more prevalent in the last few years. There is disruption everywhere, with technologies such as cloud, software-defined everything, open source, artificial intelligence, IoT, blockchain and augmented/virtual reality starting to go mainstream and creating new business models across industries. Established players have to adapt and perhaps reinvent themselves or risk being displaced.

All of this is changing the thinking behind how M&A strategy is conceptualized and executed. The very questions around the definition of value and how to maximize it are undergoing transformation as well (e.g., areas to focus on during due diligence, synergies to exploit and value creation itself). But M&A integration often has not kept pace with these changes and must rapidly adapt as well.

Business strategy in the technology sector is difficult; M&A strategy is harder

The technology sector was the primary disruptor in the early part of this century and continues to be disrupted today. Lots of legacy technology companies missed the new paradigms and are seeking to acquire their way out of disrupted business models by purchasing newer technologies and enabling business models. The number of control points that companies must deal with today is substantial, and these changing control points are at times conflicting, hence making strategy definition and formulation a lot more difficult than in prior years. Some examples of business model technology shifts are:

- Hardware to software
- License to cloud
- Product to cloud
- Cloud to edge
- Centralized to decentralized
- Decentralized to centralized
• Closed to open
• Enterprise to ecosystem
• Real to virtual
• Human to machine
• Data to voice
• Voice to data

(More on these technology shifts will be forthcoming in a future article.)

Which tech strategy should we back? What is a winning business model for us? What capabilities do we need to acquire? Where is our primary business risk? Such questions are all the more difficult to answer in today’s dynamic environment.

Impact on M&A strategy and due diligence
These pattern shifts have impacted the very thinking behind M&A strategy and integration. Here’s a quick look at some key considerations:

• It is more challenging for companies to take on a new business model, as it is likely to be outside of their traditional way of doing business. For example, selling licensed software vs. SaaS presents very different economics, key performance indicators and go-to-market approaches.
• Typically, the older (or new) model tends to cannibalize the new (or older) model, making go-to-market decisions a lot harder.
• There are few conventional synergies to realize from back office operations of smaller target companies; success is about product and revenue synergies for the most part.
• Disruptive technologies or capabilities are not the only factors; putting clear definitions on an array of required capabilities and their impact requires closer alignment between corporate strategy and development.
• Cultural due diligence and technology (not IT) diligence. Ascertaining the source and sustainability of value becomes critical.
• Single acquisitions rarely transform business models; developing a view of assets in combination with acquisitions to foster a pipeline with an invigorated level of engagement with target companies is more important than ever.
• Defensive vs. offensive transactions need to be differentiated; the former tends to be more dilutive.

Impact on valuation
Traditional valuation metrics based on multiples of EBITDA or DCF have lost relevance, with valuations trending much higher, thereby making it harder to justify acquisitions to boards of directors and investors.
Many clients now feel that acquiring disruptive assets is not only expensive and harder to justify from a valuation perspective, but will also have a direct impact on the acquirer’s equity profile or stock price. Markets would take better to an acquisition strategy that is cohesive and signals a series of acquisitions that will lead to a superior business model.

In our experience, we have seen four types of value-additive deals, which have been well received by markets:

- **Catalyst transactions**: The first acquisition signals the acquirer’s intent to embrace change and embark on transformative change going forward.
- **Strengthen the stack**: Specific capabilities such as AI, cyber and analytics that enhance the positioning of the existing value chain can lay the foundation for future acquisitions.
- **Creating competitive advantage**: Adding more capabilities across the stack to differentiate from competitors and becoming a disruptor.
- **Attaining scale**: Gaining customer and market momentum at scale, displacing competitors and bulletproofing the acquirer for the near term while creating the runway for more game-changing acquisitions.

### Impact on M&A integration

It is ironic that the changing rules of business have not altered the general mindset during integration, which still revolves around two distinct schools of thought—either leaving the target alone or fully and quickly absorbing it using a playbook from 2012 or 2013, which does not generally create value in 2017.

*In our experience, the M&A integration process must undergo the following shifts to orient itself towards value creation:*

#### Degree of integration

The scope of M&A integrations are defined when specific products, customers, channels and brands are added, which are different from the current model; scale integrations when similar products and customers are added to attain scale. Arguably all disruptive technology integrations are scope category, but the degree of integration may vary by situation, as outlined below.

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<tr>
<th>Level of Integration</th>
<th>Situation</th>
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<tr>
<td><strong>No integration</strong></td>
<td>• No prior experience with acquiring disruptive technologies; the first deal to catalyze transition to new business model</td>
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<td><strong>Limited integration</strong></td>
<td>• Scope integration rather than scale integration, i.e. investing where both companies can benefit from synergies</td>
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<tr>
<td><strong>Partial integration</strong></td>
<td>• Enhancing existing value chain in very specific areas, functions, processes or value drivers – be more surgical</td>
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<tr>
<td><strong>Full integration</strong></td>
<td>• Prior experience with integration of multiple disruptive technologies • Major disruption to existing business models due to disruptive technologies</td>
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Function to business model
M&A integration has traditionally had two ways of creating value:

- **Functional integration**: Enhancing the organization’s ability to compete by aligning and integrating functional assets and capabilities into bundles of competitive advantage through lowering costs and increasing efficiency.

- **Structural integration**: Enhancing the organization’s structural advantage (offensive play) or shielding the organization (defensive play) from structural forces that would damage profitability.

In a survey we conducted with 100 M&A integration leaders, their responses indicated that functional integration approaches were not scaling to deals focused on new business models. Today’s M&A integration tends to drive structural transformation that could impact competitor behavior or industry dynamics.

Synergies
Traditionally, companies have thought of synergies as either cost-based or revenue-driven and have approached it that way. Given there are typically few cost synergies (and probably negative synergies due to underinvestment in back office) when acquiring smaller disruptive companies, technologies or business models, one needs to think about this differently.

An approach frequently used is to look at synergies in a couple of ways.

- **Sequential synergies**: If acquirer (or target) does activity A, then target (or acquirer) is now enabled to do activity B (sequential to A), which was previously not possible on the value chain.

- **Reciprocal synergies**: Acquirer brings X, enabling Y for target and vice versa (i.e., what can they both add to each other).

With this framework, cost and revenue synergies are byproducts rather than a starting point, unlike traditional M&A integrations.

Another place to pay attention to is BETA synergies (i.e., the collection of those reciprocal and sequential synergies that have direct bearing on the acquirer’s equity profile or stock price). Isolate these value drivers upfront and track, measure, monitor and report them rigorously while building them into investor messaging.

Integration management office (“IMO”) configuration
The IMO is the center of gravity during a M&A integration, and the way the IMO is configured matters to how value is captured. When cost synergies were integral to value creation, a functional approach was adopted and costs from specific functions, such as headcount, assets and contracts, could be addressed quickly. Hence it made sense to have functional work streams. Today, it is all about revenue synergies, and a functional approach to integration is not capable of delivering full value. The coordination between sales, marketing, products, pricing and customer service needs to be in perfect sync in order to create value. Thus the IMO needs to be configured by value drivers not by function.
Given the dynamics of M&A integration and synergies, there is an obvious impact on the IMO design and configuration, including:

- Lack of conventional synergies leads to a breakdown of the rigid functional configuration of the IMO. It is now all about having value drivers be the work streams instead of the functions. Gone are the days when six functional boxes were solid-lined into an IMO!
- M&A integration professionals increasingly will need specific understanding of the economics of these new technologies, rather than relying on a generalist skill set often associated with traditional M&A integration that focused on managing redundancies and overlaps.
- Many M&A professionals need to separate value creation from merely protecting value for Day One or focusing on the IMO process (e.g., governance, reporting, tracking, playbook and checklists). While the IMO can turn the cranks, provide structure, rigor and reporting and is still important, it is the value driver work streams (and applicable functions), which create shareholder value when acquiring disruptive technologies or business models.

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<th>Conventional M&amp;A Integration</th>
<th>Modern M&amp;A Integration</th>
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<td>Heavy focus on structure, discipline and rigor of M&amp;A processes</td>
<td>More focus on value creation while maintaining the M&amp;A process discipline</td>
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<tr>
<td>Integrate fully or leave target alone – two extreme views</td>
<td>Integrate for value (i.e., scope integration where specific value drivers are aligned and integrated in a specific manner)</td>
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<td>Primary objectives centered around cost synergies and, at times, revenue synergies</td>
<td>Primary objectives are reciprocal and sequential synergies with cost and revenue synergies being outcomes</td>
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<td>Promise the status quo to employees, customers and other stakeholders</td>
<td>Promise and commit change to employees, customers and stakeholders</td>
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<tr>
<td>IMO configured by functions</td>
<td>IMO configured by value drivers</td>
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<tr>
<td>Integrate cultures</td>
<td>Align key behaviors with desired results</td>
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<tr>
<td>Linear and structured M&amp;A integration strategy</td>
<td>Flexible and adaptable M&amp;A integration strategy</td>
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<tr>
<td>Generalist, cross-industry M&amp;A professionals – mostly back office synergy focused</td>
<td>Industry and sector-focused specialist M&amp;A professionals – creating value from products, customers and new business models</td>
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Leading practices and insights from our experience and client network

Many of the transactions we have been part of and some insights from our network in Silicon Valley revealed five success factors when acquiring disruptive business model-changing technologies.

The entire M&A continuum needs to adapt to these changes. Our recommendations include:

- Building in-house capabilities on the disruptive technologies and around targets in the acquisition pipeline.
- Conducting rigorous technology diligence and going across the stack to evaluate for scalability, stability, interoperability, security, extensibility and performance.
- Proactively developing a range of new valuation models.
- Developing an engaged board of directors, investor messaging and education during M&A strategy development; the initial set of transactions can be less accretive.
- Developing specific integration approaches; don’t run the traditional playbook.

Author’s note: There are industries and sectors consolidating with conventional approaches that are still very much applicable. This article is focused on the new deal types and the industry sectors at the forefront of change.
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