Reap exceptional value from M&A: manage it as a core competence

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ABSTRACT

Mergers and acquisitions (M&As) have become the preferred growth strategy for many executives. However, simply "doing deals" is not enough to create a competitive advantage for their companies. Only focusing on M&A as a financial transaction is too narrow of an approach, which is easily duplicated across firms. Using Woodward, Inc. as a case example, this article shows how using an actionable, end-to-end process model – a ten-stage Deal Flow Model – and embedding integrated capabilities within the organization across the entire process, managers can make M&A a core competence to provide a valuable, rare, and inimitable advantage for their firms. The Deal Flow Model is unique as it is designed to be actionable by managers, who can apply the process to build the M&A competence of their organization. Likewise, researchers will find the model useful as a structure to examine the M&A process as a whole or to frame single-stage, single-discipline research in the broader context of the overall M&A process.

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In his classic book *Competitive Strategy*, Harvard's Michael Porter observed, "It is difficult to win at the acquisition game." [1] Since Professor Porter's trenchant insight almost four decades ago, there has been ample evidence demonstrating that M&A creates significant post-deal performance issues for firms. For example, a landmark analysis of 2,500 deals found that more than 60 percent destroyed shareholder value. [2] The poor results from M&A have been attributed to a variety of management missteps across the process -- in M&A strategy, target identification, due diligence, negotiation, integration and measurement. [3] In the current era of transient competitive advantage, digital transformation and disruptive innovation, M&A is certain to be increasingly challenging.

While mergers and acquisitions are a multi-staged and cross-disciplinary process, too often corporate leaders approach M&A as a financial exercise to facilitate their growth strategy. This increases the likelihood that confounding implementation problems will arise in the subsequent, post-transaction stages. Although analyzing, planning and assessing value prior to transaction close is important, any seasoned CEO who has been through at least one M&A will recognize -- and has likely learned the hard way -- that value is only realized after deal close through effective implementation. What is needed then is a management-oriented model providing an integrated and actionable end-to-end view of the M&A process.

The foundation of an M&A core competence – a comprehensive Deal Flow Model

Combining M&A experience with a systemized and documented M&A process has been found to improve success. An analysis of 228 bank mergers found that combining two key factors, experience and a clear M&A methodology, enhances deal performance. The first factor, which the researchers call "tacit knowledge," consists of M&A experience and exists largely in the minds of executives, managers and employees. The second factor, which they term "codified knowledge," consists of written procedures that a company articulates in the form of routines or norms which guide actions and decision-making throughout the M&A process, both pre- and post-transaction close.[4]

Despite evidence that a systematized M&A process improves deal success, other research has found that almost two-thirds -- 60 percent -- of surveyed executives indicated their firms do not have a comprehensive end-to-end M&A process model.[5]

A tested M&A model for managers
The Deal Flow Model offers a cross-disciplinary, end-to-end view of the M&A process consisting of ten stages across three phases (see Exhibit 1).

INSERT EXHIBIT 1 ABOUT HERE

The Deal Flow Model is linear, but in reality M&A is not
As veteran dealmakers know, M&A is not a simple sequential process. For the sake of clarity the Deal Flow Model is arranged as ten distinct stages across three-phases. M&A language -- "pre-deal," "deal" and "post-deal" – as used among M&A professionals and researchers also implies a chronological approach to M&As. In practice, however, there are no clear lines between many of the stages identified in the model. The stages actually involve multiple overlapping activities. While each deal may be sequenced a bit differently, firms learning to build their M&A competence can use the model to record and catalog their M&A process tools, templates and talent in an organized fashion across the ten-stages (see box "Dealmakers can adapt the Deal Flow Model to specific circumstances"**).**

Core activities across the ten M&A stages
Key objectives and core activities of the ten-stages of the Deal Flow Model are identified in Exhibit 2. The objectives and activities were developed and refined through a combination of the author's experience gained by applying the model and also by incorporating best practices found throughout empirical and practice M&A literature. Over the past several decades, both M&A researchers and professionals have written much about the various pitfalls and best practices during each of the ten stages. Several comprehensive reviews of M&A research exist, summarizing empirical findings regarding "pre- and post-deal" success factors. [6] The M&A practice literature also has reported the pitfalls and best practices within various stages of the Deal Flow Model. [7]

INSERT EXHIBIT 2 ABOUT HERE

Lessons learned in industry and private equity
Lessons can also be learned from companies that have built an integrated end-to-end M&A expertise. Best practices applied by GE, for instance, include assessing cultural fit early in the deal process during the "Investigate" stage, selecting an integration manager before deal close during the "Negotiate" stage, providing necessary resources and assigning accountabilities for implementation during the "Integrate" stage and continual updating of M&A tools and templates for application on future deals. [8] Another experienced deal maker, Cisco develops a well-defined acquisition strategy for their transactions during the "Formulate" stage, implements clear retention plans during the "Motivate" stage, visibly measures success of each deal during the "Evaluate" stage, and, like GE, refines the firm's M&A tools and process for use on subsequent transactions. [9]

In addition to these high profile industry examples, even in the financially focused domain of private equity a shift from approaching M&A solely as a financial exercise to conducting M&A instead as an integrated process of value creation, spanning transaction through implementation, is occurring. Now that borrowing costs are low and M&A activity is booming, hedge funds, sovereign wealth funds and pension funds are competing for deals, thus elevating the importance of creating long-term value over short-term financial victories or losses. During a recent interview with the *Financial Times*, the Managing Director of private equity firm Carlyle Europe Partners, Marco De Benedetti, noted that he believes the industry can counter that threat by having "superior" value creation plans for the companies they buy, stressing, "Private equity is no longer able to generate returns by simply relying on financial engineering. Today it is about hard work and building something." [10]

Applying the Deal Flow Model – M&A as a core competence at Woodward, Inc.
Woodward, Inc. is a publicly traded, designer, manufacturer and service provider of control solutions for the aerospace and industrial markets, with annual revenue in excess of $2B US. Over the past decade Woodward completed more than ten transactions of various sizes, representing more than $1B US in aggregate transaction value. As the firm's strategy combines organic growth supplemented by potential acquisitions, the executive team at Woodward wanted to be sure any future transactions they may undertake would result in maximum value creation for the firm and its shareholders. To that end, Woodward's Strategy and Business Development Group, initiated a multifaceted effort to strengthen the company's M&A competence.

To begin the process, Ted Papenthien, Corporate Director of the group and his team examined the company's approach to a number of recent deals they had conducted. He explained, "When we assessed the performance of our past acquisitions, we found a lot of things we did well, but as with any complex activity such as M&A transactions, we found opportunities for improvement." The team concluded that future deals should be approached as an integrated, end-to-end process, from transaction through implementation.

After reviewing recent transactions, Ted and his team then identified Woodward-specific M&A tools and templates throughout the entire M&A process. For example, potential target analysis and prioritization tools (Locate), functional due diligence checklists and a cultural comparison and integration template (Investigate), project tracking and management tools (Integrate), communications planning and key talent retention matrices (Motivate), and transaction success measurement tools (Evaluate) among others were identified or developed and stored on the firm's intranet. The tools and templates analysis was designed to ensure the company possesses an optimal M&A toolkit, across the various organizational functions and M&A stages for any future transactions (i.e. codified knowledge).

The next task was to identify M&A talent across the organization that possess the knowledge and skills to work on different aspects of future pre- and post-deal activities (i.e. tacit knowledge). These staff members comprised a cross-functional representation

of the company from -- Finance, HR, IT, Legal, Operations, Communications and Marketing. Concurrently, external advisors with specialized M&A capabilities were also identified that would partner with Woodward to assist internal talent on tasks such as legal and other transaction documents, financial analysis and tax treatment.

Once various tools, templates and talent -- both internal and external -- were identified, Ted and his team arranged for a two-day training session to be conducted by company and external experts for key Woodward M&A talent from across all organizational functions. The purpose of the training was to facilitate both awareness and future application of an integrated Woodward M&A competency across the deal stages. The training agenda was organized and delivered based on the various components of the Deal Flow Model, with session topics including Woodward's approach to and tools for M&A: strategy (Formulate), potential target identification and funnel management (Locate), due diligence (Investigate), valuation (Valuate), negotiations (Negotiate), deal close (Consummate), integration management and coordination (Integrate), communication and organizational culture (Motivate), product and service enhancement (Innovate) and deal success measurement and reporting (Evaluate).

In his remarks to the participants during the close of the training session, Ted noted, "We know we did a lot of good things during our previous deals. After this session, Woodward is now even better positioned for future deals with an integrated, cross-functional approach across the entire process." Since the training, Ted and his team have updated and refined key tools and templates that form the Woodward M&A knowledge repository housed on the firm' s intranet, for each stage of the process. Moving forward, the team will conduct regular reviews of the firm's M&A tools, templates and talent, and revise the repository as needed.

Based on the lessons learned from GE, Cisco, Woodward and many others, Exhibit 3 identifies seven key steps that companies can work through to build their M&A competence.

INSERT EXHIBIT 3 ABOUT HERE

Addressing M&A as an integrated core competence provides competitive advantage
The concept of core competencies suggests that firms can differentiate themselves from their competition by developing an integrated set of unique and valuable capabilities that are difficult for other firms to imitate. Besides being a differentiator, how a firm organizes around a unified set of activities provides a source of strategic competitive advantage. Separately, each capability is valuable. But, the principal competitive advantage is found in the integrated combination of capabilities a firm employs in a particular area, making them hard to separate and difficult for other firms to duplicate. [11] How then does a firm know if a particular core competence provides competitive advantage?

The VRIO -- Valuable, Rare, Inimitable, Organizational -- framework [12] has become a standard test of how well a particular core competence does or does not provide competitive advantage to a firm. [13] The VRIO framework consists of four key criteria about a resource or capability to determine its competitive potential:

1. **Value**: Does the resource/capability enable the firm to improve its efficiency or effectiveness?
2. **Rarity**: Is control of the resource/capability in the hands of a relative few?
3. **Imitability**: Is it difficult to imitate, and will there be significant cost disadvantage to a firm trying to obtain, develop, or duplicate the resource/capability?
4. **Organizational**: Is the firm organized in such a way that it is ready and able to exploit the resource/capability?

As mergers and acquisitions have become ubiquitous globally, firms that can execute only the transactional elements of deals well -- sourcing, financially analyzing, valuing and closing deals -- do not satisfy the VRIO criteria for M&A competence as a competitive advantage. Whereas, firms that are able to skillfully execute an integrated M&A competence, across the full process from transaction through implementation, do realize each of the VRIO criteria -- see Exhibit 4. Therefore, simply "doing deals" does not provide firms with competitive advantage, but doing and implementing deals strategically through a value-enhancing M&A process, does.

INSERT EXHIBIT 4 ABOUT HERE

Developing M&A as an integrated set of capabilities across the process, a core competence that meets the criteria of the VRIO framework provides four key advantages for firms. First, establishing an M&A process within a firm makes the practice repeatable. Second, management can identify and build M&A talent strength across each process stage. Third, a set of M&A tools and templates can be applied during each stage. Fourth, once a high level of integrated M&A competence is established in the firm, other firms will find it difficult to match the same combination of M&A talent, tools and execution.

Takeaways
Now that mergers and acquisitions have become the preferred growth strategy for many executives, success depends on the realization that the most valuable deals are those that create a competitive advantage for their companies. Only focusing on M&A as a financial transaction is too narrow of an approach. Instead, using an actionable, end-to-end process model and mobilizing the diverse talents of the organization and integrating its capabilities across the entire M&A process will provide a valuable, rare and inimitable advantage for firms, enabling them to "win at the acquisition game."

Dealmakers can adapt the Deal Flow Model to specific circumstances

In practice, the model's process stages illustrated in Exhibit 1 are often implemented in a different sequence. For example, beginning the "post-deal" integration planning of organizational cultures, people, processes and systems prior to transaction close -- "pre-deal" – can be best practice in some circumstances. Likewise, while often identified as a "post-deal" activity, M&A communications to various stakeholders -- investors, employees and communities -- should begin in the "pre-deal" phase. In addition to the "Investigate" stage, due diligence information about a partner company is regularly collected and analyzed during various other "pre-deal" -- "Locate," "Valuate" and "Negotiate" -- stages. Finally, the tracking and reporting of integration activities and milestones, along with various success measures -- cost and revenue synergy capture, cultural integration and key talent retention – can begin as early as the "Investigate" stage, and continue throughout the subsequent stages culminating with the "Evaluate" stage.

Notes

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6. For example see Barkema, H.G. and Schijven, M. (2008), "How do firms learn to make acquisitions?: a review of past research and an agenda for the future," *Journal Of Management*, Vol. 34 No. 3, pp. 594-634; Caiazza, R. and Volpe, T. (2015), "M&A process: a literature review and research agenda", *Business Process Management Journal*, Vol. 21 No. 1, pp. 205-220; Steigenberger, N. (2017), "The challenge of integration: a review of the M&A integration literature", *International Journal of Management Reviews*, Vol. 19 No.

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7. For example see Cascio, W.F. (2010), "Done deal: now manage post-merger integration," *HR Magazine*, Vol. 55 No. 10, pp. 42-46; Kullman, E. (2012), "DuPont's CEO on executing a complex cross-border acquisition," *Harvard Business Review*, Vol. 90 No. 7/8, pp. 43-46.

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10. Espinoza, J. (2017), "Private equity is about hard work and building something," *Financial Times*, available at: https://www.ft.com/content/05374d3c-a8e4-11e7-ab55-27219df83c97 (accessed 21 May 2018).

11. Prahalad, C.K. and Hamel, G. (1990), "The core competence of the corporation," *Harvard Business Review*, Vol. 68 No. 3, pp. 79-91.

12. Barney, J.B. (1995), "Looking inside for competitive advantage," *Academy of Management Executive*, Vol. 9 No. 4, pp. 49-61.

13. Knott, P.J. (2015), "Does VRIO help managers evaluate a firm's resources?" *Management Decision*, Vol. 53 No. 8, pp. 1806-1822.

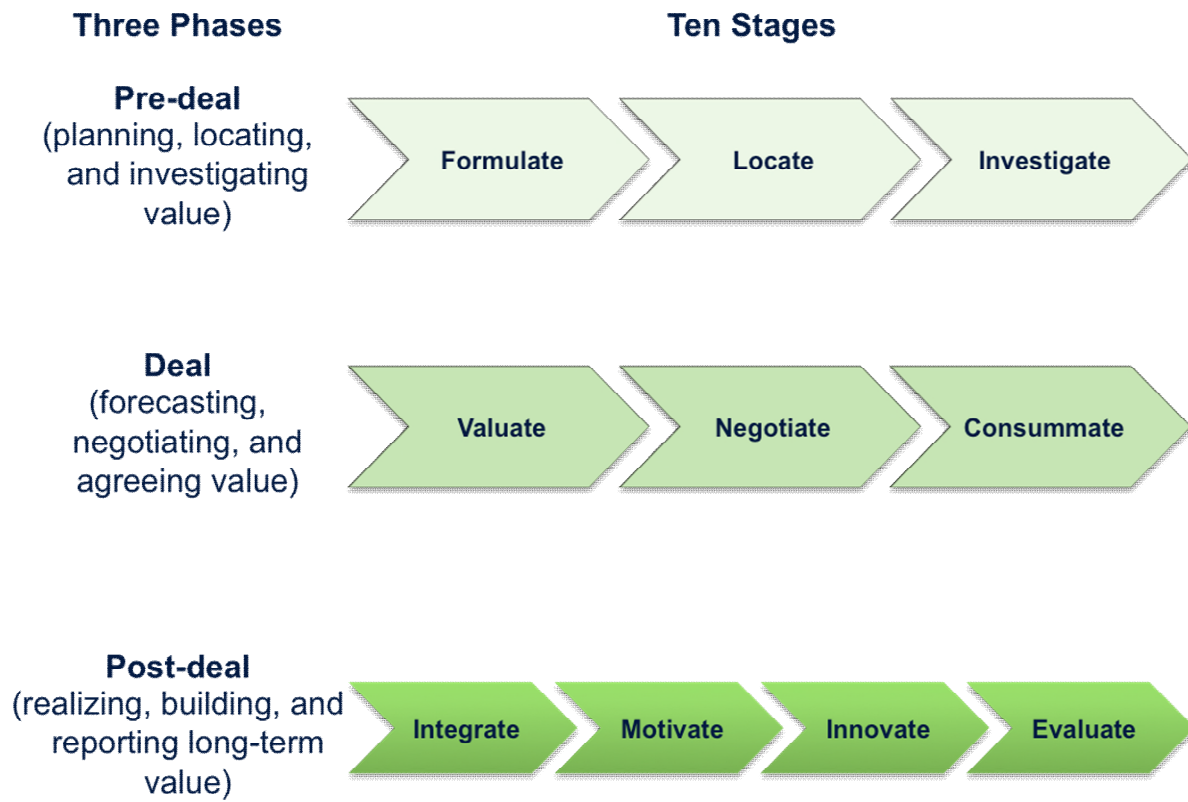**Exhibit 1: The Deal Flow Model – Ten stages across three-phases**

Three Phases	Ten Stages

Pre-deal
(planning, locating, and investigating value)

Formulate	Locate	Investigate

Deal
(forecasting, negotiating, and agreeing value)

Valuate	Negotiate	Consummate

Post-deal
(realizing, building, and reporting long-term value)

Integrate	Motivate	Innovate	Evaluate

Exhibit 2: Ten stages of the Deal Flow Model – Key objectives and core activities

	Stage	Key Objective	Core Activities
Pre-deal	**Formulate**	Clear M&A strategy	• Define the business strategy. • Define an M&A strategy to support the business strategy.
	Locate	Targets that fit the M&A strategy	• Identify potential targets. • Assess strategic and organizational "fit" of potential targets.
	Investigate	No surprises after deal close	• Conduct financial, operational, legal, technological, and organizational due diligence. • Draft operational and cultural integration plans. • Draft communications plan. • Draft key talent retention plan. • Draft key customer retention plan.
Deal	**Valuate**	Realistic bidding range	• Determine cost and revenue assumptions. • Develop valuation models using multiple techniques.
	Negotiate	Agreed deal terms	• Meet with target's negotiating team. • Discuss and agree deal terms. • Submit bid (in an auction transaction).
	Consummate	Transaction close	• Draft transaction documentation. • Sign documentation. • Gain regulatory approval. • Transfer transaction funding.
Post-deal	**Integrate**	Synergy capture	• Execute integration plans. • Adjust implementation as needed. • Implement key customer retention and "re-recruitment" plan.
	Motivate	Maximum workforce productivity	• Implement communications plan. • Implement key talent retention and "re-recruitment" plan. • Implement cultural integration plan.
	Innovate	Additional revenue growth	• Transfer knowledge between firms. • Develop and implement new or enhanced products, services, and/or processes.
	Evaluate	Measured and reported deal success	• Track and report operational integration activities and milestones. • Track and report cultural integration activities and milestones. • Track and report key talent retention activities and milestones. • Track and report synergy capture (cost reduction and revenue enhancement).

Exhibit 3: Seven steps to build the firm's M&A competence

Component	Key Activities
1. **M&A performance assessment**	• Identify recent M&A transactions. • Identify what went well and what could have been done better across the entire M&A process -- the ten stages of the Deal Flow Model. • Catalog key learnings to apply to future M&As during each M&A stage.
2. **M&A internal talent inventory**	• Identify key M&A talent across functions. • Identify roles each person has performed during past M&A efforts, and will be able to perform during future efforts throughout each stage of the Deal Flow Model. • Catalog key M&A talent identified.
3. **M&A external talent inventory**	• Identify key service providers used in prior M&As -- legal, financial, tax. • Identify potential other service providers and determine how each could support talent on future M&As. • Conduct analysis of current and potential M&A service providers to determine "best fit" with the company. • Select future M&A service providers.
4. **M&A tools and templates inventory**	• Conduct M&A tools and templates inventory across functions and M&A stages -- due diligence checklists, valuation templates, communications planning matrix, cultural analysis and integration matrix, integration project management tools. • Identify M&A tools overlaps and gaps. • Rationalize tools overlaps and gaps. • Catalog future M&A tools and templates.
5. **M&A training**	• Identify M&A training needs/objectives, based on the recent M&A performance and key M&A talent capabilities assessments above. • Develop training content for each stage of the Deal Flow Model, designed to achieve each training objective identified. • Identify training participants based on the M&A talent inventory above. • Schedule and conduct cross-functional M&A training.
6. **M&A knowledge repository**	• Establish an M&A knowledge repository, housed on the firm's intranet, for each stage of the Deal Flow Model. • Populate the repository with M&A tools and templates across each of the ten M&A stages.
7. **M&A competence maintenance**	• Conduct regular reviews of M&A tools, templates and talent. • Update tools, templates and talent in the M&A repository as needed.

Exhibit 4: VRIO – M&A as a transaction versus an integrated process

M&A as a Transaction		
VRIO Criteria	**Fulfills VRIO?**	**Rationale**
Value: Does the resource/capability enable the firm to improve its efficiency or effectiveness?	**NO**	• Completing a transaction only provides the firm with an opportunity to improve its efficiency or effectiveness, while value is realized through implementation.
Rarity: Is control of the resource/capability in the hands of a relative few?	**NO**	• Numerous companies possess transaction capabilities.
Inimitability: Is it difficult to imitate, and will there be significant cost and/or time disadvantage to a firm trying to obtain, develop, or duplicate the resource/capability?	**NO**	• Firms can easily source -- through hiring or contracting -- financial and legal transaction capability on a full- or part-time basis.
Organization: Is the firm organized in such a way that it is ready and able to exploit the resource/capability?	**YES**	• Many companies employ in-house teams able to source, analyze, value and consummate the financial and legal elements of their M&A transactions.
M&A as an Integrated Process of Activities From Transaction Through Implementation		
VRIO Criteria	**Fulfills VRIO?**	**Rationale**
Value: Does the resource/capability enable the firm to improve its efficiency or effectiveness?	**YES**	• Projected deal synergies -- improved firm efficiency and effectiveness -- are realized through effective implementation.
Rarity: Is control of the resource/capability in the hands of a relative few?	**YES**	• Most firms only focus on the transaction, rather than an integrated M&A approach spanning pre- and post-transaction capabilities.
Inimitability: Is it difficult to imitate, and will there be significant cost and/or time disadvantage to a firm trying to obtain, develop, or duplicate the resource/capability?	**YES**	• An integrated M&A competency is hard to duplicate because of the effort, time and cost involved.
Organization: Is the firm organized in such a way that it is ready and able to exploit the resource/capability?	**YES**	• An integrated approach to M&A requires a firm to organize around an integrated end-to-end process, applying all the relevant skills, knowledge, tools and talent required for transaction completion and post-transaction value creation.