

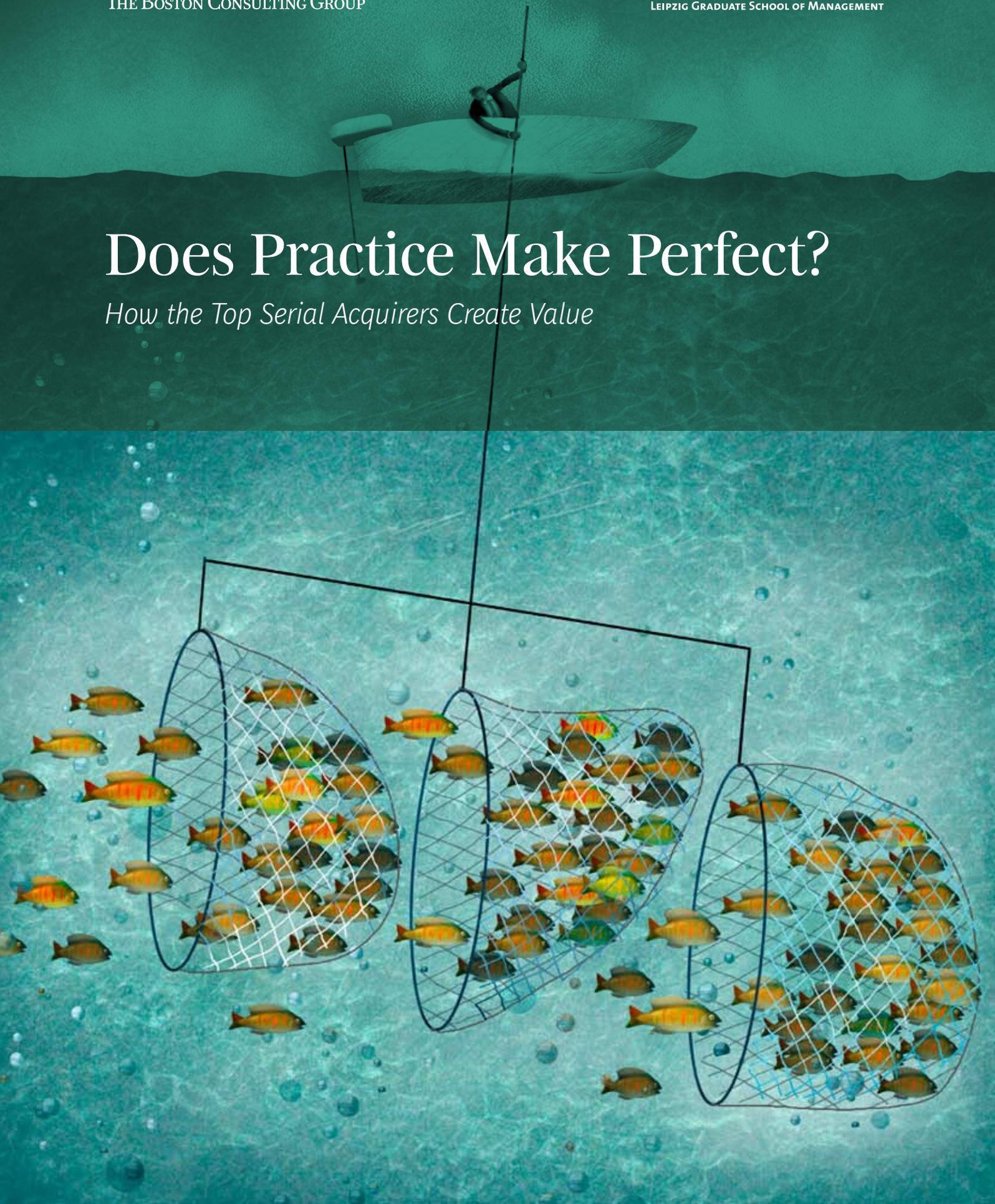
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# Does Practice Make Perfect?

*How the Top Serial Acquirers Create Value*



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# Does Practice Make Perfect?

*How the Top Serial Acquirers Create Value*

**Jens Kengelbach, Dominic C. Klemmer, Bernhard Schwetzler, Marco O. Sperling,  
and Alexander Roos**

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## AT A GLANCE

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Nearly a quarter of all mergers and acquisitions are made by “serial acquirers”—companies that regularly buy businesses. As the M&A market starts to heat up again, what can we learn from these acquirers?

### **SMART TARGETING HOLDS THE KEY TO SUCCESS**

Although serial acquirers produce lower returns, on average, than infrequent acquirers, the top serial players generate superior returns by targeting small, distressed private businesses.

### **TIMING IS CRITICAL—AND HERE SERIAL ACQUIRERS EXCEL**

Serial acquirers are more likely to do deals at the start of an M&A wave and just before an economic upturn, when deal premiums are low and the choice of targets is greatest.

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**N**EARLY A QUARTER OF all mergers and acquisitions are made by “serial acquirers”—companies that regularly buy businesses. As the M&A market starts to heat up again, what can we learn from these acquirers? Does practice make perfect? And, more critically, what distinguishes the serial acquirers that outperform from those that underperform?

This report addresses these questions, drawing on a worldwide analysis carried out by The Boston Consulting Group (BCG) and the Leipzig Graduate School of Management (HHL) of more than 26,000 deals executed from 1988 through 2010.<sup>1</sup> The proprietary database of deals and M&A success factors jointly created by BCG and HHL, and believed to be the largest of its kind, provides fresh insights into the patterns and behaviors of the world’s most successful acquirers.

One of the surprising findings is that serial acquirers, on average, generate significantly lower shareholder returns from deals than single acquirers. They are also less likely to create value from their transactions. However, deeper analysis reveals that serial acquirers outperform single acquirers by a substantial margin in four main types of deals: when the target is distressed, when the target is relatively small, when the target is a private business, or when the target is on another continent.

Our research also reveals that serial acquirers excel at timing their transactions. Specifically, we found that serial acquirers, compared with single acquirers, do a higher proportion of their deals at the start of an M&A wave, when deal premiums are low and the choice of targets is greatest.

Given that previous BCG research has shown that downturn deals produce substantially higher long-term returns than transactions executed during economic upturns, it would seem that now is the ideal time for serial acquirers to strike. But as BCG has also demonstrated in its last six annual reports on M&A, success is by no means guaranteed. On average, 60 percent of deals destroy shareholder value for the acquirer in public-to-public transactions. Although timely transactions can increase the chance of success, selecting the most appropriate target is also essential. Our analysis indicates that successful serial acquirers are particularly adept at picking targets, which provides valuable lessons for all acquirers.

## Serial Acquirers’ Hidden Influence

One of the striking yet often overlooked features of the M&A market is that most deals worth more than \$25 million are done by frequent acquirers. Thirty-seven

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Serial acquirers are less likely than single acquirers to create value from their transactions.

percent of such transactions are carried out by moderate acquirers that buy two to three businesses every three years, while 23 percent are done by serial acquirers that buy at least four companies every three years. On average, serial acquirers do 5.2 transactions worth more than \$25 million every three years, although a significant number of these companies do more than 20 such deals over that period.<sup>2</sup>

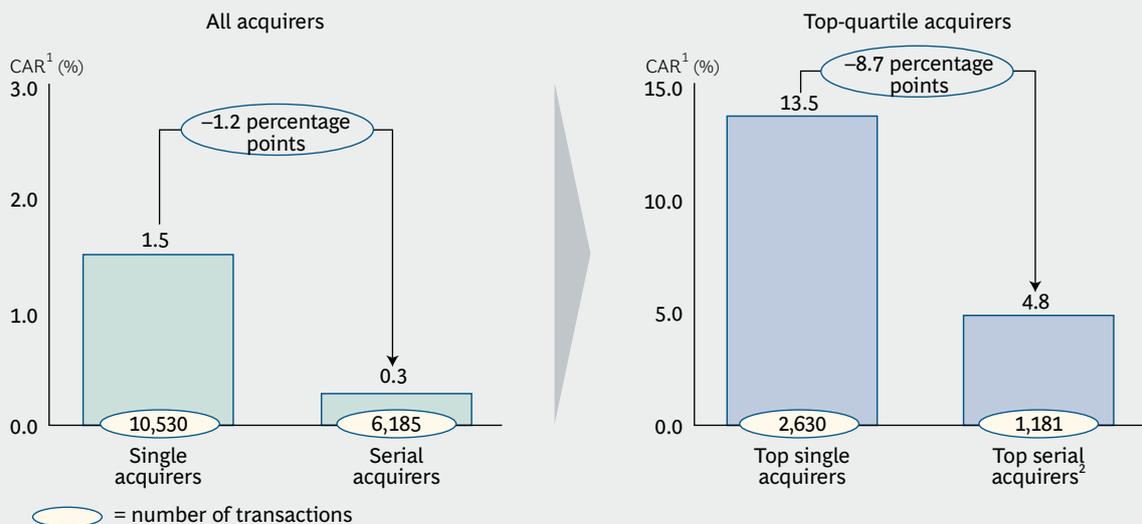
Typically, serial acquirers are four times larger than single acquirers (measured by mean total assets) and have superior profitability, as well as significantly higher leverage and capital expenditures. However, although serial acquirers' transactions are 52 percent larger than those of single acquirers in terms of absolute size, their targets' size is 76 percent smaller than their own (measured on the basis of sales)—an important source of value, as we discuss below.

Serial acquirers are most active in the telecommunications sector, where 31 percent of transactions are done by serial acquirers, followed by the finance and business equipment sectors, with 29 percent each; the consumer durables and chemicals sectors account for the lowest proportions of serial deals, at 15 percent and 13 percent, respectively.

### Empire Builders or Value Creators?

Despite the fact that serial acquirers have considerably more M&A experience, our research indicates that practice does not necessarily make perfect. Serial acquirers' average returns of 0.3 percent are one-fifth those of single acquirers (1.5 percent).<sup>3</sup> (See Exhibit 1.) Their deals are also somewhat less likely to succeed. For example,

**EXHIBIT 1 | On Average, Single Acquirers Outperform Serial Acquirers**



**Sources:** Thomson Reuters Datastream; Thomson Reuters Worldscope; BCG analysis.

**Note:** Results are based on a sample of 26,444 transactions with announcements over the period 1988 to 2010. The serial-acquirer classification is based on a backward-looking, three-year rolling-window approach; companies acquiring more than three targets are classified as serial acquirers. The top single and top serial acquirers are those companies in the top quartile of their respective performance (CAR) distribution.

<sup>1</sup>Average cumulative abnormal return was calculated over a seven-day window centered around announcement day (+3/-3).

<sup>2</sup>The top-serial-acquirer classification is based on the average deal performance of one company; the top serial acquirers account for nearly one-quarter of all serial acquirers.

41 percent of serial acquirers' public-to-public transactions create value, compared with 43 percent of single acquirers' public-to-public deals. One popular explanation for the relatively poor performance of serial acquirers is that they tend to be more interested in empire building than in creating value—often fueled by overconfident CEOs and overvalued stock.<sup>4</sup> However, a closer analysis of the data not only casts doubt on this claim but also demonstrates that many serial acquirers do, in fact, create significant value.

Although serial acquirers' average returns are only 0.3 percent, 52 percent of them generate average returns of 2.3 percent, and returns can rise to more than 40 percent in individual cases. The remaining 48 percent of serial acquirers destroy roughly 2 percent of value, on average.

Successful, value-creating serial acquirers are typically half the size of their unsuccessful, value-destroying peers, and they have more highly valued stock, suggesting that empire building is not their motivation. Nevertheless, the returns of top-quartile serial acquirers (4.8 percent) are still significantly less than the returns of top-quartile single acquirers (13.5 percent). This raises the question: Where, if anywhere, do serial players truly excel?

## Five Key Ingredients of Successful M&A

Our research indicates that serial acquirers produce superior returns when they focus on four types of targets and when they time their deals at the right moment, notably, when premiums and competition are low.

**Target distressed businesses.** The experience of serial acquirers gives them a particularly strong edge when buying distressed assets. Although all acquisitions are complex, especially during the critical post-merger integration (PMI) stage, purchasing a distressed business makes the exercise much more complex because there is often an urgent need to restructure the target, as well as limited access to information during the due diligence process.

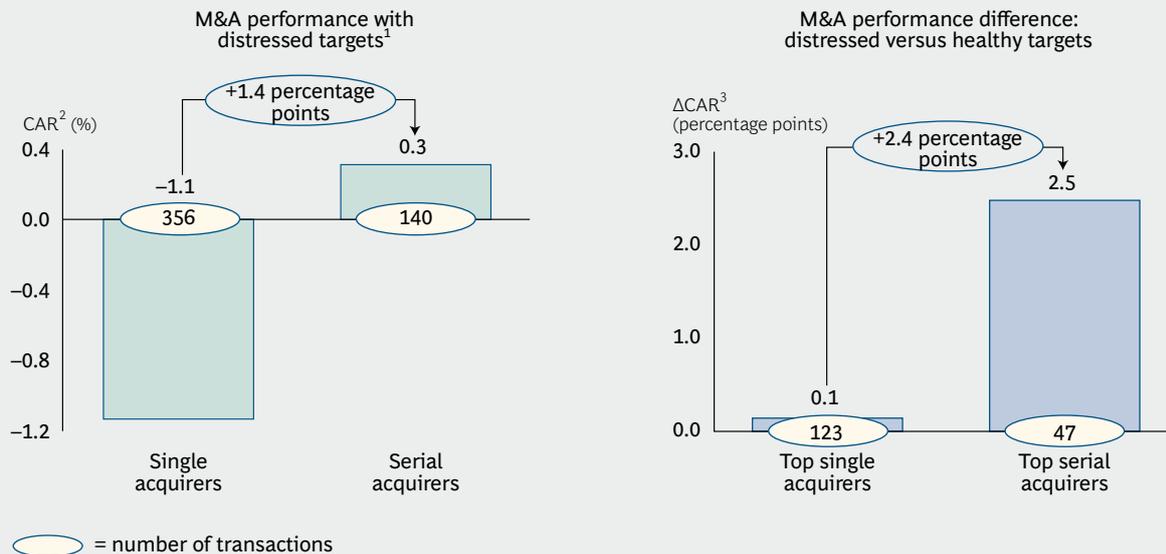
Serial acquirers appear to excel at turning this complexity into value. On average, their returns from distressed assets are 1.4 percentage points higher than those of single acquirers. (See Exhibit 2.) In fact, top-quartile serial acquirers produce substantially higher returns (2.5 percent) than top-quartile single acquirers (0.1 percent) when they concentrate on distressed targets instead of on healthy businesses. Targeting distressed assets also, of course, enables buyers to enjoy lower deal premiums and less competition for these targets.

**Keep transactions relatively small.** As noted earlier, serial acquirers mainly target businesses with significantly smaller sales than their own, enabling them to limit their risks and build up knowledge and experience as they go along. Eighty-four percent of their deals are small, compared with 58 percent of those of single acquirers; large-scale deals are rare. (See Exhibit 3.) More significant, this concentration on relatively small targets produces substantially higher returns. The performance difference between small transactions and very large transactions for serial acquirers is 1.5 percentage points greater than the difference in returns between

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Although serial acquirers have average returns of only 0.3 percent, versus 1.5 percent for single acquirers, 52 percent of them generate average returns of 2.3 percent.

## EXHIBIT 2 | The Top Serial Acquirers Produce Superior Returns from Distressed Assets



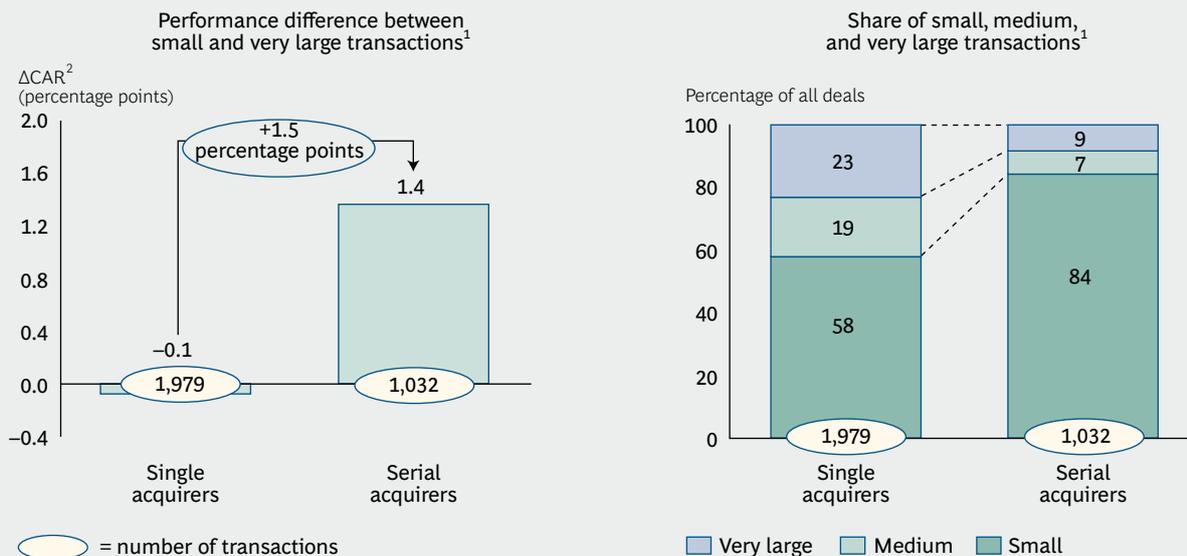
**Sources:** Thomson Reuters Datastream; Thomson Reuters Worldscope; BCG analysis.

**Note:** Results are based on a sample of 26,444 transactions over the period 1988 to 2010. The serial-acquirer classification is based on a backward-looking, three-year rolling-window approach; companies acquiring more than three targets are classified as serial acquirers. The top single and top serial acquirers are those companies in the top quartile of their respective performance (CAR) distribution.

<sup>1</sup>Distressed companies are those in the bottom quartile of interest coverage ratios for all companies (1988–2010).

<sup>2</sup>Average cumulative abnormal return was calculated over a seven-day window centered around announcement day (+3/-3).

## EXHIBIT 3 | Serial Acquirers Focus More Strongly on Smaller Deals and Reap the Benefits



**Sources:** Thomson Reuters Datastream; Thomson Reuters Worldscope; BCG analysis.

**Note:** The serial-acquirer classification is based on a backward looking, three-year rolling-window approach; companies acquiring more than three targets are classified as serial acquirers.

<sup>1</sup>Definitions of transaction size are based on the ratio of the target's sales to the acquirer's sales (t-1): small = <0.5; medium = 0.5–1; very large = >1.

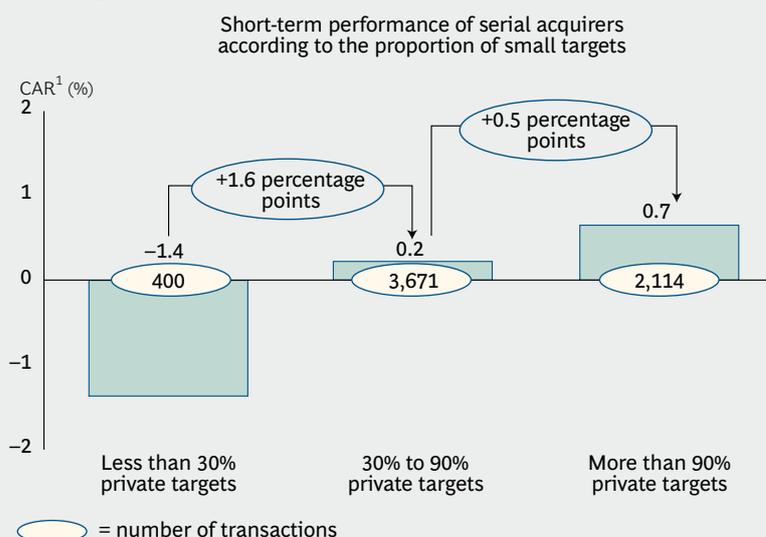
<sup>2</sup>Average cumulative abnormal return was calculated over a seven-day window centered around announcement day (+3/-3).

small and large deals for single acquirers. In fact, transactions exceeding \$1 billion destroy value for serial acquirers; for single acquirers, they produce approximately half as much value as small deals.

GlaxoSmithKline illustrates the value of leaning toward smaller transactions. Since 2007, the pharmaceutical giant has had a vigorous acquisition strategy—doing 17 deals in just 30 months at one point—with a focus on high-growth, low-risk targets. Acquisitions included one large deal, five medium-size transactions, and a continuous flow of smaller acquisitions. But it was the smaller deals that produced the highest returns. Moreover, GlaxoSmithKline’s M&A strategy is clearly focused on creating superior value rather than on expansion for its own sake. For example, all its potential deals are carefully picked on the basis of strategic and financial criteria (internal rate of return and return on invested capital) and have to compete for funding with R&D licensing, capital expenditures, and other investments. The board of directors’ explicit focus on PMI also ensures that planned synergies are captured.

**Concentrate on private companies.** While keeping transactions relatively small offers one of the most promising routes to successful M&A, targeting private companies gives serial acquirers a further competitive advantage. Privately owned targets are not only less liquid, which can often result in lower prices, they also require a different due-diligence process from that applied to publicly listed companies. In addition, they demand different negotiation skills and, frequently, different industry expertise. This specialized knowledge is quite rare and can usually be developed only through the serial experience of an industrial buyer, limiting the competition

#### EXHIBIT 4 | Acquirers with a Larger Proportion of Private Targets Generate Higher Returns



**Sources:** Thomson Reuters Datastream; Thomson Reuters Worldscope; BCG analysis.

**Note:** The serial-acquirer classification is based on a backward-looking, three-year rolling-window approach; companies acquiring more than three targets are classified as serial acquirers.

<sup>1</sup>Average cumulative abnormal return was calculated over a seven-day window centered around announcement day (+3/-3).

for private targets. Exhibit 4 illustrates this point: the larger the proportion of private companies purchased, the higher the serial acquirer's returns.

In general, strategic acquirers (as opposed to private-equity acquirers) are more likely to be approached by sellers of private businesses, giving them a head start and leading to higher deal flows. Additionally, such acquirers are more likely to be familiar with the targets, which often are former competitors.

**Search for targets on other continents.** Serial acquirers seem to thrive in any situation that other companies consider too complex or too far outside their normal experience, including intercontinental M&A. Although serial and single acquirers do similar proportions of intercontinental deals, capital markets reward serial acquirers with three times higher returns for global acquisitions than for local acquisitions (0.6 percent compared with 0.2 percent), reflecting investors' confidence in the ability of serial acquirers to manage geographic complexity.

The retailer Tesco is a case in point. Since the late 1990s, the company has overcome low growth in its home market by expanding gradually into key emerging markets such as Poland, Turkey, and Thailand through a succession of relatively small, step-by-step acquisitions. While the company's goal is to gain scale in its target markets, it learns as it goes along—for example, by initially forging joint ventures and later purchasing its partners. This strategy helped Tesco outperform the World Retail Index by 5 percent per year between 1995 and 2010.

**Ask yourself: Is now the right time?** Regardless of whether the target is small or private, distressed or located on another continent, timing is one of the most critical factors in any M&A deal. And here serial acquirers excel, providing valuable lessons for all acquirers.

Generally, serial acquirers execute a significantly larger proportion of their M&A (59 percent) in low-premium environments than do single acquirers (51 percent), enabling them to retain a bigger share of the deals' synergies. Specifically, serial acquirers are particularly adept at entering the M&A market at two optimal moments: at the start of an industry M&A wave and just before an upturn, which may coincide with the start of a wave, as is the case today.

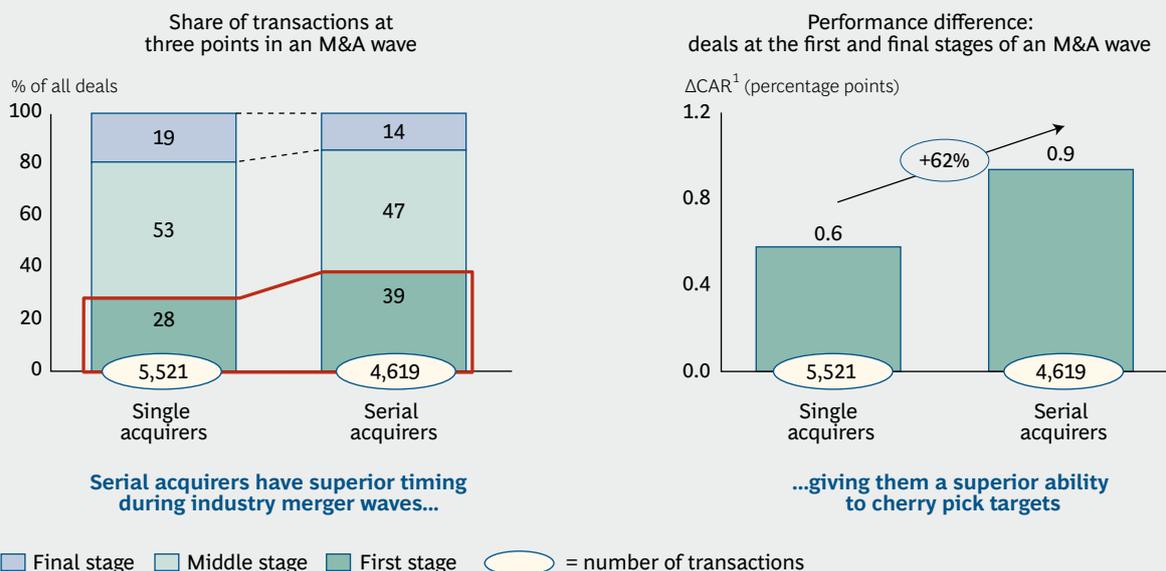
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Serial acquirers excel at entering the market at the start of an industry M&A wave and just before an upturn.

- *Deals at the Start of an M&A Wave.* As Exhibit 5 illustrates, serial acquirers tend to enter the M&A market at an earlier stage of an industry M&A wave than single acquirers, enabling these early birds to cherry pick the best targets. On average, 39 percent of serial acquirers' deals occur in the first stage of an M&A wave, compared with just 28 percent of single acquirers' transactions.<sup>5</sup> Correspondingly, a smaller proportion of serial players' deals occur in the final, more barren stage of the wave. The net result—the difference in returns between deals in a wave's first and last stages—is that serial acquirers gain a 62 percent higher return than single acquirers by stepping into an M&A wave at its start.

Not surprisingly, successful, value-creating serial acquirers are more likely to do deals in the first stage of a wave than their unsuccessful, value-destroying peers.

## EXHIBIT 5 | Serial Acquirers Have Superior Timing and Exploit Their First-Mover Advantage During M&A Waves



**Sources:** Thomson Reuters Datastream; Thomson Reuters Worldscope; BCG analysis.

**Note:** Results are based on a sample of 26,444 transactions over the period 1988 to 2010. The serial-acquirer classification is based on a backward-looking, three-year rolling-window approach; companies acquiring more than three targets are classified as serial acquirers.

<sup>1</sup>Average cumulative abnormal return was calculated over a seven-day window centered around announcement day (+3/-3).

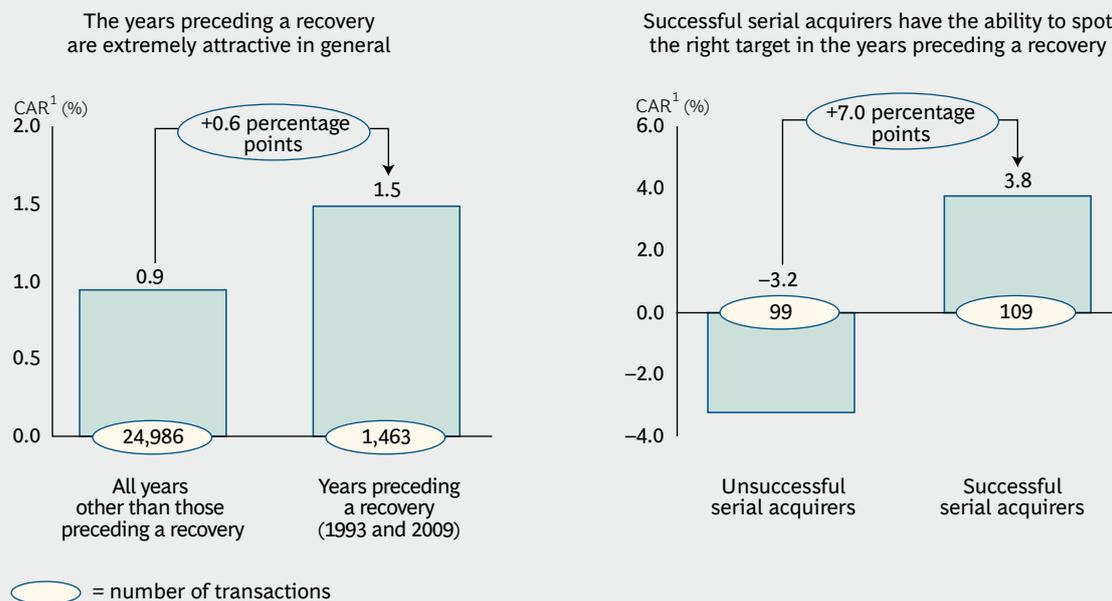
More crucially, successful first-mover acquirers generate substantially higher returns (3.1 percent) than unsuccessful first movers (-2.7 percent).

- *Deals at the Start of an Upturn.* As BCG research has consistently shown, deals done in downturns produce substantially higher long-term returns than those executed during upturns.<sup>6</sup> Our latest research shows that the timing of deals *within* a downturn is important as well. Specifically, acquisitions made just before an upturn—following a recession—produce significantly higher returns. Transactions executed in the pre-recovery years of 2003 and 2009, for example, produced returns of 1.5 percent, compared with 0.9 percent for all other years. (See Exhibit 6.)

Although there is no evidence that serial acquirers are better than single acquirers at spotting an upturn, our research suggests that successful serial acquirers are better than their unsuccessful peers at spotting and executing value-creating deals before a recovery. On average, the returns of successful serial acquirers from pre-upturn deals are 7.0 percentage points higher than those of unsuccessful serial acquirers.

These insights indicate that now might still be a good time to buy. Indeed, many recent acquirers have already reaped the benefits. In 2010, for instance, average acquirer returns in public-to-public transactions were positive (0.7 percent) for the first time in more than a decade. Likewise, the shareholder returns of target companies reached an all-time high in the period 1996 through 2010. This window of

## EXHIBIT 6 | Deals Executed Before a Recovery Produce the Best Results During Downturns



Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; BCG analysis.

Note: Results are based on a sample of 26,444 transactions over the period 1988 to 2010. The serial-acquirer classification is based on a backward-looking, three-year rolling-window approach; companies acquiring more than three targets are classified as serial acquirers.

<sup>1</sup>Average cumulative abnormal return was calculated over a seven-day window centered around announcement day (+3/-3).

opportunity is unlikely to last much longer, however. In order for prospective acquirers to benefit from the latest M&A wave, which is rapidly gaining pace as private-equity firms and other players enter the market, they should heed the lessons of the most successful serial acquirers in terms of both timing and, in particular, the choice of targets.

### Learning from the Best

A multivariate analysis of the relationship between value creation and the five key ingredients of M&A success for serial acquirers suggests that focusing on private targets and small deals is likely to have the biggest impact. International M&A appears to have an important but less significant effect. Other factors also affect the relative success of a deal, whether done by a single or a serial acquirer, such as the method of payment. For example, in the acquisition of publicly listed targets, the “disciplining” power of cash makes cash payments superior to using the acquiring company’s stock as the takeover currency. Conversely, in the acquisition of private targets, capital markets react positively to an announcement of transactions involving stock or mixed considerations.

However, proper timing and target selection alone will not win the day. BCG’s extensive experience advising clients on M&A suggests that the critical difference between winners and losers is that successful serial acquirers treat M&A as an industrial process. They establish dedicated deal teams of internal staff and external advisors with clear lines of responsibility; standardize their M&A processes;

strive for efficiency and effectiveness; and establish robust measures of performance. Above all, they systematically align their transactions with their strategic priorities, buying what they know at a time when they know it will deliver the optimum returns.

All of this can be learned, but it takes practice. Practice won't necessarily make perfect, but if acquirers follow the five key lessons of the top serial acquirers, which have had more practice than most, their chances of success will significantly increase.

#### NOTES

1. The database includes 26,444 public-to-public, public-to-private, and public-to-subsidiary transactions larger than \$25 million.
2. The size hurdle of \$25 million per transaction, plus the fact that smaller transactions often have undisclosed deal values, explains the relatively small average number of transactions by serial acquirers. Additional analyses of certain high-frequency acquirers have shown that the average number of transactions per year can be well above 20 when all closed transactions without size and disclosure requirements are included.
3. We measure short-term shareholder value creation as the cumulative abnormal return (CAR) over a seven-day event window. See Stephen Brown and Jerold B. Warner, "Using Daily Stock Returns: The Case of Event Studies," *Journal of Financial Economics*, 1985.
4. See, for example, Robert C. Conn et al., "Why Must All Good Things Come to an End? The Performance of Multiple Acquirers," EFMA 2004 Basel Meetings Paper, February 2004, and Andrei Shleifer and Robert W. Vishny, "Stock Market Driven Acquisitions," *Journal of Financial Economics*, 2003.
5. An industry M&A wave is defined as above-average, clustered M&A activity with an identifiable peak lasting at least three years. The first stage comprises the first two years of such a cycle.
6. See *Accelerating Out of the Great Recession: Seize the Opportunities in M&A*, BCG report, June 2010.

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