Global M&A Report 2021

As the world locked down and masked up, M&A endured.

Acknowledgments

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Letter from the Bain M&A Team: How Did You Deal?

Deals got trickier and more critical for growth in 2020.

Dear friends,

Welcome to the third annual edition of our Global M&A Report. Our mission remains constant: Use our unique position in the M&A world to connect what we see in our clients' executive suites with the larger trends happening across the globe. The result, we hope, is to make all of us a little better at the craft of M&A.

We were humbled in our efforts to assess all that happened in 2020, and we believe that it will be several years before we fully understand the long-term ramifications of a year during which every aspect of the corporate M&A process was disrupted. In this year's report, we untangle the jumbled trends, distinguishing between the outcomes that were temporary by-products of the historic moment and those that signify longer-term changes.

As in previous crises, companies that were nimble and prepared to quickly adjust seized the opportunities in 2020. A lot of M&A got done last year, more than 28,500 deals, but it was not easy. For example, as almost 70% of our M&A practitioner survey respondents pointed out, doing diligence remotely was particularly difficult.

How did you, our readers, do it? We saw many of you embrace digital collaboration tools and creatively employ locally stationed talent to get high-quality deals done. Many teams similarly adapted in-flight integration programs and successfully transitioned to the virtual working environment. While technology will never fully replace the in-person elements of dealmaking, many of the new virtual ways of working for M&A processes are here to stay.

The year 2020 saw the continuation and, in many cases, the hastening of longer-terms trends. Overall M&A was down in 2020. Certainly, the pandemic played a big role in this, but the truth is that M&A appears to have peaked in 2018. One question now is: Will M&A activity accelerate out of this trough as the world recovers?

Capability-driven deals have grown over the past five years to 15% of all large deals, a near-sevenfold increase. We think this is in response to the ongoing business model disruptions across several sectors. The crisis in 2020 made it even more expedient for companies to bring in-house critical capabilities in areas such as online delivery, telemedicine, and teleconferencing (to name a few), thereby strengthening their value proposition. And we note that corporate venture capital activity, another route for companies to acquire capabilities at an early stage, hit a new all-time high in 2020.

Other ongoing trends that accelerated include increased regulatory involvement and scrutiny of deals. The superabundance of capital continued to drive high valuations and a favorable deal financing environment.

Corporate divestitures declined more than the overall market, and this was a bit of a surprise to us. In our executive conversations, we kept hearing that optimizing company portfolios was the key to unlocking growth strategies. In retrospect, it was just too hard to carve out assets in 2020. The high valuation levels, however, may make it an opportune time for business leaders to take hard looks at their portfolios and undertake long-pending divestitures in 2021.

We should note that a decline in inter-regional M&A was particularly true between the West and Asia-Pacific. This long-term shift has roots in regulatory issues such as national security concerns as well as a rethinking of the commercial implications of localized supply chains.

Digging deeper, any comprehensive assessment of M&A in 2020 really needs to be performed on an industry-by-industry basis. More so than in the past, the external environment in each particular industry set the boundaries for how much M&A companies could do. Technology, media, and telecommunications all saw strong market capitalization increases, while energy and financial services saw the biggest declines. Because of these large differences in industry performance, much of our report is organized to capture industry-specific themes and implications for M&A teams.

Looking forward, the executives we talk to are optimistic. They are entering 2021 with an expectation that M&A activity will experience an uptick and become more important for meeting growth goals and for developing new capabilities to compete in an increasingly disruptive environment.

That said, the outlook varies greatly by industry, and we expect to see a wide range of M&A theses playing out, from the focus on consolidation and divestitures in the most impacted sectors to a continuing capabilities gold rush in the sectors within which competition is mostly driven by innovation. In that regard, 2021 promises to be a very interesting year.

We look forward to working with many of you on these profound questions, and we are eager to hear your feedback on all aspects of our report.

Thank you for reading, and enjoy.

Sincerely,
The Bain Global M&A Team

Section 1: State of the Market

2020 Year in Review: The Surprising Resilience of M&A

Strong second-half recovery

As the world locked down and masked up, M&A endured.

Similar to every other area of business, deal activity was heavily affected by Covid-19. In the earliest months of the pandemic, M&A virtually ground to a halt. Shareholders and management teams shifted their attention to the priorities of just keeping employees safe and businesses running amid a historic disruption that nobody could have predicted. Companies put deals in progress on the shelf or canceled them outright. Lacking both the bandwidth and a clear view of the future, they paused pursuing new deals.

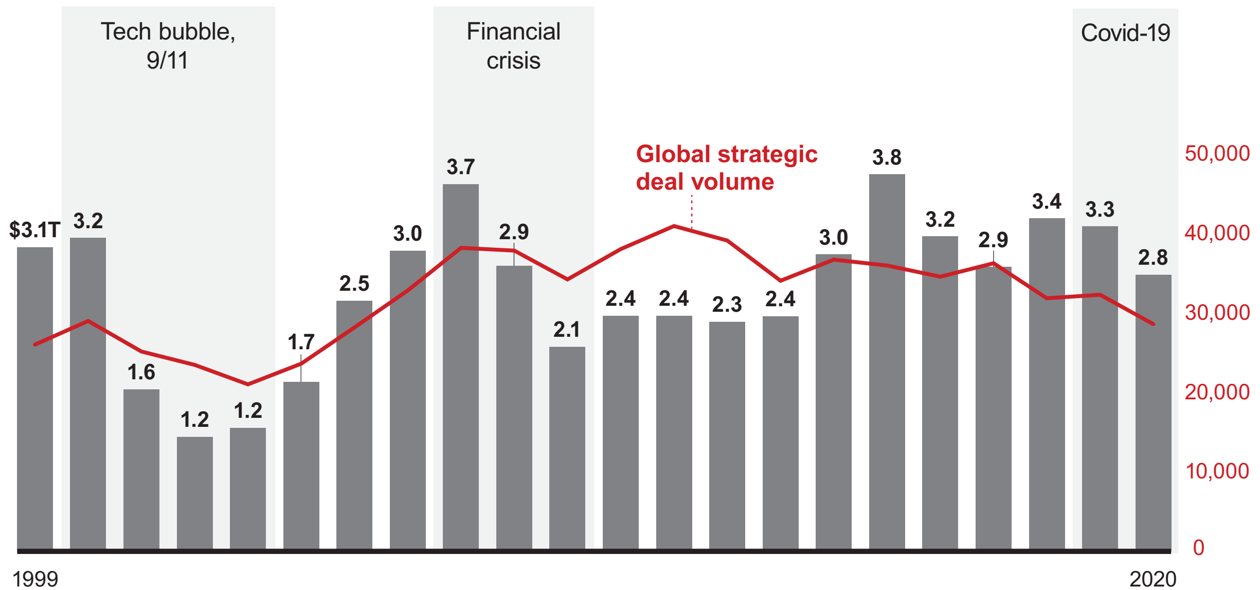
During the second half of the year, decision makers began to recognize how the world and consumer preferences were changing and the importance of acting fast to buy the newly critical capabilities that would help their businesses adapt to the changing realities and emerge out of the downturn as winners. Deals on the shelf were put back into action as the future direction of each industry came into clearer focus and as governments pumped stimulus funding, keeping deal financing accessible. Deal value rose by more than 30% in both the third and fourth quarters. In the end, more than 28,500 deals were inked by corporate acquirers in 2020, for a total value of $2.8 trillion.

Rapid digitalization has underpinned the M&A recovery by enabling M&A processes to be conducted virtually, even as the world was in lockdown. Until last year, digitalization of the M&A process was a discussion topic for the future. Covid-19 accelerated M&A digitalization, however, by many years. Corporate M&A and private equity (PE) teams found themselves quickly adapting to the world of virtual due diligence, deal closing, and integration. They learned just how much could be done with digital tools. While digital collaboration tools and ways of working replaced many of the traditional methods, M&A practitioners also ran into the limitations of technology in the softer aspects of deal-making, such as relationship building or assessing cultural fit. Roughly 70% of respondents in our November M&A practitioners' survey said that diligence in 2020 was challenging.

In terms of overall deal volume and value, the recovery was not enough to compensate fully for the lean first half of the year. Full year 2020 delivered meaningful declines both in value (down 15%) and volume (down 11%) vs. the previous year *(see Figure 1.1)*. By region, the Americas was down 25%, the sharpest regional decline; Asia-Pacific and Europe, the Middle East, and Africa ended the year relatively better, with deal value declines of 4% and 6%, respectively.

The pandemic has also accelerated the importance of environmental, social, and governance (ESG) considerations. In fact, the year 2020 will be remembered as the one in which ESG assumed a prominent place among M&A criteria, requiring the extension of target screening, the development of new diligence capabilities, as well as the use of new sources of data.

Figure 1.1: Covid-19 slowed down global deal momentum



Source: Dealogic

Governments play a growing role in M&A

As we wrote in last year's report, regulation has steadily expanded well beyond the traditional mandate of assessing the impact of a deal on market power and consumer benefit. Regulatory powers have moved into concerns such as national interest, data privacy, and the impact on future competition.

In 2020, governments around the world continued to expand their scrutiny of M&A. For example, in May 2020, the German government approved new powers to veto hostile foreign takeover bids for healthcare companies, citing the Covid-19 crisis. The new regulation would apply to non-EU bids for German manufacturers of vaccines, protective equipment, ventilators, medicines, or other supplies. Similarly, the UK government initiated a major upgrade of the takeover law that would allow for extensive scrutiny of cross-border deals in 17 sensitive industries.

The extension of government powers and scrutiny is not limited to healthcare, technology, defense, and other sensitive industries. For example, China Mengniu Dairy was forced to withdraw from its plans to buy Lion Dairy, an Australian beverage business, after getting clear indications that the government would oppose the deal. In the US, the Trump administration mandated that TikTok's US operations be sold to a US buyer on grounds of national interest, with concerns that user data could be compromised.

In France, LVMH attempted to call off its deal with Tiffany when it received a letter from the French foreign ministry requesting LVMH to delay the purchase. The deal is now completed.

At the same time, however, Europe is lending regulatory support for domestic M&A in some sectors. Recent statements from the European Commission support further domestic consolidation among telecom providers, and the growing regulatory support across regions is encouraging further domestic banking consolidation.

The European regulators also are more open to pan-European deals, which led to announcements such as the Nexi and Nets deal in payments.

As the M&A regulatory landscape continues to evolve, M&A practitioners need to keep up with the latest regulations, both locally and in the addressable markets.

The extension of government powers and scrutiny is not limited to healthcare, technology, defense, and other sensitive industries.

Deals continue to get more local

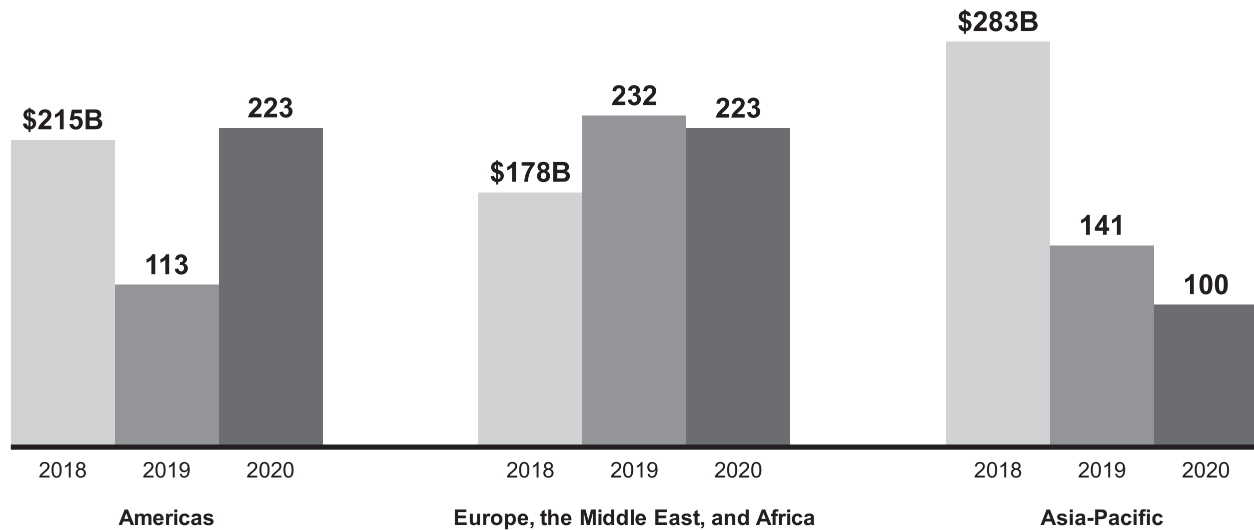
The rising scrutiny on cross-border deals and ongoing US-China trade tensions have already been slowing down cross-regional trade for a few years now. This trend is decisively accelerated by supply chain concerns exposed by the Covid-19 crisis. Nearly 60% of our survey respondents report that the need to localize supply chains will be a significant factor in evaluating deals going forward.

As an indication of the localization, the number of Asian outbound deals into the Americas and Europe fell by 29% year over year in 2020. With overall deal value down only 2.5%, Greater China acquirers directed 93% of their deal spending toward domestic companies, with only around 5% going to deals in the Americas and Europe, the Middle East, and Africa. This represents a sharp drop from around 11% in 2019 and roughly 25% in 2016, the peak of Chinese outbound M&A.

The Covid-19 travel restrictions have intensified this localization trend. Global cross-regional deal volume declined for the fifth consecutive year, falling by 20% in 2020, mainly out of Asia-Pacific *(see Figure 1.2)*.

Almost 75% of surveyed M&A practitioners based in Asia-Pacific and Europe, the Middle East, and Africa expect an increased focus on domestic or intra-regional deals. Among US respondents, 44% anticipate concentrating domestically and within the region while 40% expect no significant change from prior years.

Figure 1.2: Cross-regional deals increased out of the Americas but declined out of Asia-Pacific



Source: Dealogic

The surprising strength in deal valuations across many industries

With the pandemic taking its toll on the economy, it was natural to assume that deal valuations would weaken amid scale consolidation and distressed asset M&A. Indeed, that is what transpired following the global financial crisis, when deal multiples dropped by about 30% over two years.

But in the unpredictable year of 2020, the opposite has happened. Globally, median enterprise value to earnings before interest, taxes, depreciation, and amortization deal multiples increased to 14 times from 13 times in 2019, underpinned by faster-growing industries, where multiples either held steady or increased. In the current low-growth environment, the premium for growth remains high. As a rule, when the cost of capital is low, the value of growth goes up exponentially—and we're in this super-abundant capital market now. So, in industries such as technology, telecommunications, digital media, and pharmaceuticals, which had bright futures that were made even brighter by changes hastened by Covid-19, valuations increased. The opposite was the case in industries such as retail and energy, where valuations weakened.

Companies in industries with Covid-19 tailwinds were acquired at exceptional premiums. For example, in telemedicine, Teladoc acquired Livongo for $18.5 billion, implying an expensive sales multiple, with expectations that the strong sales growth would continue into the future. If Covid-19–inspired consumer behavior continues—that is, if consumers maintain their preference for food delivery, telemedicine, online gaming, and the like—those valuations are likely to continue to remain healthy.

Another big factor in strong valuations: the unprecedented government economic stimulus packages. Overall, most developed country governments stepped up their economic support, ranging from 5% of GDP (France) to 12% of GDP (US), both of which are much higher than the level of stimulus provided after the global financial crisis.

Government stimulus, combined with continuing low interest rates, a spike in household savings rates, record PE dry powder, and accessible debt capital markets, contributed to sustained asset prices in 2020. The longer-term impact of government stimulus, however, is unclear. Will it fizzle away, or will it continue, ultimately providing enough support to restart the global economy growth engine?

A year like no other

Putting it all together, 2020 was a year that brought us the deepest decline and the strongest rebound in M&A activity, when digital M&A became the new norm, and when both regional decoupling and the strengthening role of regulators continued their momentum.

Based on the resilience of the M&A market in 2020 and the more than 28,500 deals announced, it is hard not to feel positive about the future of M&A. Our M&A practitioners' survey shows that the appetite for M&A remains robust, with about half of the respondents expecting higher M&A activity in their industries in 2021, although almost the same number cite the uncertain economic outlook as the main hindrance to dealmaking. The survey also shows that M&A will continue to be a key strategic pillar—survey respondents expect M&A to contribute to 45% of their future growth compared with about 30% over the past three years.

Lessons from the past show that leaders use downturns as an opportunity to outinvest competitors to increase the performance gap. M&A and divestitures have played a significant role in past downturns, as leaders both streamlined their portfolios and acquired scale or new capabilities to improve their competitive position—moves that enabled them to benefit from this strategic repositioning for years to come. We expect more of this as winners pursue deals that will help them emerge stronger out of the downturn.

Next, we will discuss how deal rationales are diverging in different industries. We'll also detail the continued momentum of capability-driven M&A and how companies are adopting creative tactics to lower M&A risk in this unpredictable economic environment.

Expanding M&A Options for New Capabilities

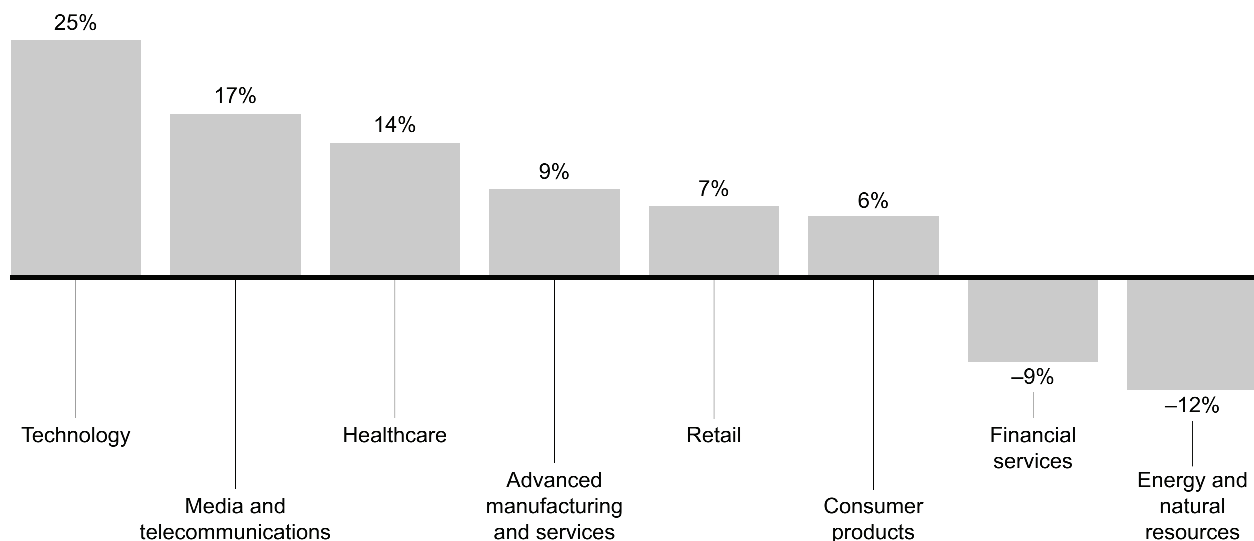
Diverging fortunes across industries

Diverging fortunes across industries is nothing new. For years, disruptive trends such as technological innovations or changing consumer preferences have upended existing business models in retail, media, consumer products, automotive, and payments, among other industries.

In 2020, we witnessed further separation, however, between winning industries and losing industries. Technology, media, and telecommunications, which rode strong growth tailwinds as a result of Covid-19, clearly outperformed, while energy companies suffered the most *(see Figure 1.3)*.

Most businesses have reacted. Almost 80% of the M&A practitioners we surveyed confirm that their companies have revised their short- and/or long-term corporate strategies, with M&A and divestitures playing a major role. Our survey respondents expect M&A to account for 45% of revenue growth over the next three years vs. 31% over the prior three years. More than 90% of respondents believe that the level of divestiture activity will increase or stay the same in their industries.

Figure 1.3: The Covid-19 crisis had varying impact across industries



Sources: Capital IQ; Bain analysis

Continuous appetite for growth and new capability assets

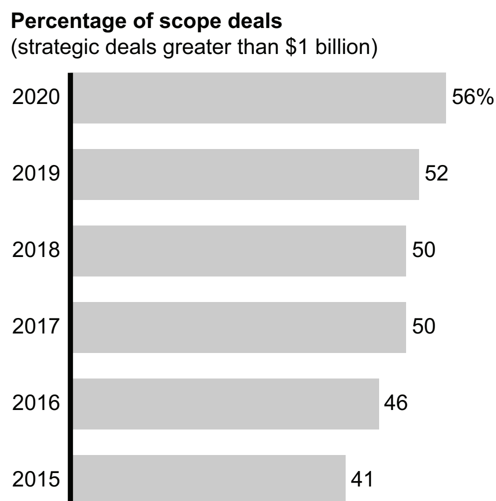
A few years ago, we identified an increase in the share of scope deals aimed at helping companies expand into fast-growing markets or gain new capabilities. This trend continued in 2020, with scope deals further increasing volume share to 56% of all large deals (more than $1 billion) compared with 41% in 2015. Not surprisingly, the picture varies by industry, with healthcare, technology, and consumer products standing out with the highest share of scope deals *(see Figure 1.4)*.

The need for new critical capabilities was at the heart of many recent scope deals. For example, growing consumer demand for direct delivery was the impetus behind US retailer Target's acquisition of delivery services business Deliv; Nestlé's acquisition of healthy meals delivery company Freshly and Ahold Delhaize's acquisition of a majority share in FreshDirect (with Centerbridge Partners taking 20%) are other examples of capability scope deals.

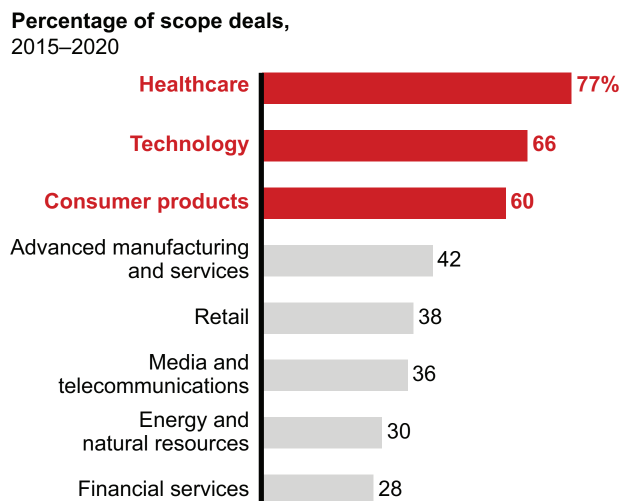
Scale M&A continues to be relevant as well, especially in industries that are watching the pandemic hasten the disruption of their business models. Traditional media and retail will experience more consolidation as scale becomes increasingly necessary to compete with and outinvest digital competitors. In banking and telecommunications, consolidation is also encouraged by regulator support. For example, in banking, the US and Europe are already witnessing the start of domestic consolidation, with deals such as PNC and BBVA in the US, Bankia and Caixa in Spain, and Intesa Sanpaolo and UBI in Italy.

Figure 1.4: Momentum continued for scope deals in 2020 as leaders outinvest in growth and capabilities despite the economic environment

Rising share of scope deals over the past five years …



… driven mainly by healthcare, technology, and consumer products



Notes: Top 250 strategic deals of the year from 2015 to 2019 and top 131 deals from 2020 (January–September) identified by excluding nonstrategic deals, such as asset or property acquisitions, financial investment deals, government acquisitions, internal reorganizations, or minority stake acquisitions; deals classified by rationale using a proprietary classification framework, as per stated strategic rationale at the time of announcement
Source: Bain M&A deal database, 2020

Expanding the options to access new capabilities

Scope M&A will remain relevant across all sectors as companies refocus on growth and the new capabilities that are gaining in importance as disruption mounts. "New world" companies are scarce, though, and buying them typically is expensive, with deal multiples based on revenue instead of earnings before interest, taxes, depreciation, and amortization. Moreover, the acquirers, from "old world" industries, generally have little experience in the new world.

That is why more companies are weaning off the idea that outright acquisition is the only path to bring in new capabilities. They are open to forging alliances and partnerships as well as doing venture or minority investing so that they can share capabilities and minimize M&A risk.

Sometimes competing companies independently invest in a promising technology. Volkswagen and BMW both invested in Northvolt, Europe's largest battery cell producer, as a way to secure battery supply in the coming years. Northvolt expects to start production at the end of 2023, and it will also supply other automotive original equipment manufacturers and industrial companies. The investments are partly inspired by a need to develop and share a common standard for electric vehicles and charging stations, but they are also to share the massive capital requirements of getting these new technologies into production.

Similarly, multiple partnerships were formed to develop vaccines for Covid-19. Partnerships between Pfizer and BioNTech, Sanofi and GlaxoSmithKline, and AstraZeneca and Oxford University enabled both capability sharing and an accelerated timeline to vaccine development.

Our survey of M&A practitioners found that the preferred alternatives to outright M&A differ by industry. For example, partnerships were prominently mentioned by respondents in the healthcare, technology, media, and telecom industries, while joint ventures (JVs) were more commonly cited in the energy and natural resources industries.

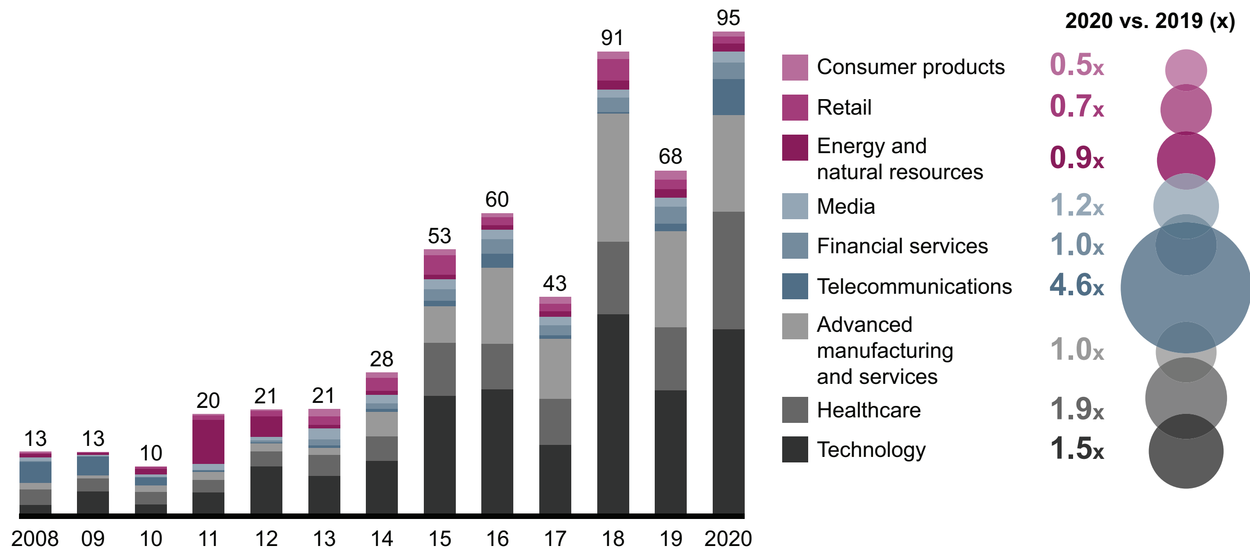
As companies expand into these alternatives to traditional M&A, they need to build M&A teams that are nimble and able to develop the skills for selecting and executing various deal types. By updating their traditional M&A playbooks for new types of investments or partnerships, companies can minimize the risks associated with bringing in new capabilities.

Corporate venture capital is here to stay

Another alternative to traditional M&A is corporate venture capital, which requires an entirely different set of talents and capabilities.

When we first wrote about corporate venture capital in 2018, it was still quite nascent, albeit with almost fourfold growth over the previous five years. Since then, corporate venture capital has expanded significantly, and it has proven its resilience in the tumultuous year of 2020, with $95 billion invested. That sum represents the highest annual deal value invested by corporate venture capital firms ever.

Figure 1.5: 2020 was a record year for corporate venture capital investing



Note: Includes full transactions completed, announced, and in progress
Source: Pitchbook

Technology and healthcare account for more than 60% of corporate venture capital deal value, but financial services, telecommunications, and advanced manufacturing and services are swiftly catching up *(see Figure 1.5)*.

Corporate venture capital is still quite a new space for many companies, and success requires patience as venture capital bets typically take several years to pay off. Our own research shows that winners manage their corporate venture capital investments differently than the typical ways they manage investments with their traditional M&A teams. For example, they ensure adequate corporate venture capital autonomy, but they also build in mechanisms for bringing the new ideas and innovations back into the base business. They also learn to provide patient capital and measure the success of corporate venture capital differently than more traditional investments.

Four ways to de-risk deals in a volatile environment

In today's world, the premium for growth and quality assets is higher than ever. Deal multiples have stayed the same or increased in sectors such as technology and healthcare. In addition, scope deals come with higher multiples (greater than 30%), but they offer lower assurance of cost synergies, which typically are easier to achieve than revenue synergies.

Companies can take many steps to de-risk deals in this economic environment. We'll look at four of them.

First, they can get sharper at estimating, planning, and executing their way to generating near-term revenue synergies; they can also accelerate the target's growth plan and enable faster capability transfer across the organizations. The successful approach to diligence and integration in scope deals is remarkably different from scale deals.

Also, dealmakers can hedge the downside potential by getting creative with earn-outs and other results-driven incentives. Almost 45% of our survey respondents expect the use of earn-outs to increase for carve-out transactions, enabling firms to defer payments and make them dependent on future business success.

Another de-risking approach is to start with a minority stake before plunging into full ownership. Minority stakes allow for greater flexibility, with opportunities to learn about each other, work together, and plan for joint growth. Flexibility comes with a lower level of control, however, so careful planning and meticulous governance are required to align the objectives of both parties and ensure joint decision making for all critical decisions.

Finally, savvy corporate acquirers continue to forge partnerships with financial investors. About 65% of our survey respondents expect to partner with private equity (PE) firms, and almost 80% of them say they would do it to share investment risks. Our conversations with PE firm partners, however, show that the mutual benefits go beyond financing. PE firms are now more open to taking minority stakes, especially as they see corporate partnerships as another source of finding future deals. With their significant diligence and transaction experience, PE firms also bring unique capabilities to corporate partners—namely, a stamp of quality to deal execution and a value creation focus, among others.

The Covid-19 crisis has reinforced our view that winners use M&A in downturns to widen the gap with competitors. They acquire new capabilities to reshape their business model to adapt to the changing business environment, and they divest to streamline their portfolios for better focus.

Given the scarcity and cost of fully acquiring companies with "new world" capabilities, companies are creatively expanding their options beyond traditional M&A. Some are cocreating future growth strategies with JV partners. Some are trying before buying with minority stakes. Some are using corporate venture capital to invest in future growth at early stages. Whichever path they choose, winners will continue to build new skills and reshape their businesses while minimizing M&A risks.

Section 2: Hot Topics

Rebuilding M&A Capabilities for the Post–Covid-19 World

The new challenge: M&A has changed, forcing a capability rethink

Over the past few years, M&A has gone from something akin to chess, in which players can pick a strategy and plan many moves ahead, to an open battlefield video game, with players entering and exiting in a constantly shifting landscape. Three major changes are afoot.

First, Covid-19 has hastened preexisting disruptive trends across industries, providing an even clearer view of the business models that will win in the future as well as those that will be outmoded. Deal rationales have evolved from creating scale and cost synergies within an industry to expanding the business scope and adding new capabilities. These capabilities often involve technology, proprietary data, or scarce talent.

The number of capability deals has grown steadily in recent years. In 2020, we saw US telecom major Verizon's acquisition of BlueJeans in the videoconferencing space, US retailer Target's acquisition of Deliv as a follow-on to its earlier purchase of Shipt in the home delivery space, and global food and beverage major Nestlé's acquisition of Freshly in healthy meals delivery. All of these deals are aimed at serving rapidly growing consumer needs, and they involved the acquisition of capabilities that likely were not even on the radar a couple of years ago. The acquirers are betting on the value of bringing these capabilities in-house, not on potential cost synergies. No longer something to handle at the back end of an integration, technology has become both an enabler of deals as well as a source of opportunities and value creation. To make these deals succeed, acquirers need a tailored approach to screening, diligence, and integration.

Second, the M&A process has become faster and more complex. While corporate acquirers have an advantage in that they can create proprietary deal flow, they often face stiffer competition from private equity (PE) players. Every deal is now an auction process. And PE funds, sitting on $2.8 trillion of dry powder, look a lot like corporate acquirers. They are starting to hold their assets longer and use buy-and-build strategies. As we mentioned earlier in this report, access to debt capital has been a nonissue during this crisis, so the premium and the competition for attractive high-growth assets are higher than ever. Among the consequences of these trends: M&A may not be the best participation model, so M&A teams need to consider the broader option space of partnerships (with or without equity), joint ventures (JVs), and corporate venture capital, depending on their situation.

Add to this mix data access, the broadening regulatory scrutiny of deals on grounds of national interest, and the abundance of major technology players. Consider the involvement of Amnesty International in the Google and Fitbit deal. The organization wrote a letter to EU regulators, arguing that the acquirer must address human rights issues more expansively via remedies—the human rights in question

being the right to privacy and nondiscrimination. Evaluating the environmental, social, and governance (ESG) impact of targets is fast becoming an integral part of the diligence process as there are both risks and opportunities related to ESG. For many acquirers, this is all brand-new territory to navigate.

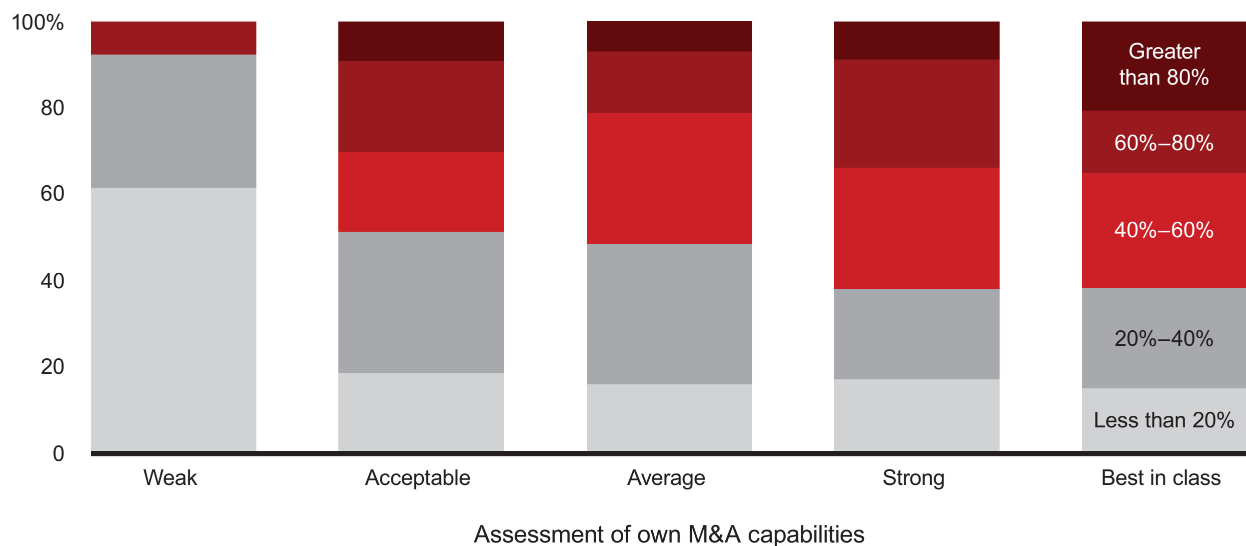
Finally, Covid-19 brought new challenges to the deal process. In our 2020 M&A practitioners' survey, 70% of respondents reported that diligence was more challenging during Covid-19, and more than 50% found it harder to close deals. Digitalization of the M&A process has been building gradually over the past few years, but similar to other trends, Covid-19 has hastened it. Companies that adapted quickly, developing capabilities in areas such as virtual diligence and virtual integration, made great strides even during the toughest phase of the Covid-19 crisis. The use of data in the M&A process is another emerging differentiator. Leaders are harnessing data (and sometimes artificial intelligence) to screen for targets and create profiles, often before they come to market. In diligence, companies are using digital platforms for risk analytics and to generate customer insights and other differentiated insights to get an edge.

As companies rewrite their corporate strategies for the post–Covid-19 world, M&A will gain further prominence. In fact, the M&A practitioners we surveyed expect M&A to account for nearly half of revenue growth over the next three years—that's up from 30% over the past three years. What's more telling is that practitioners with higher confidence in their firms' M&A capabilities expect M&A to contribute to a higher share of revenue growth *(see Figure 2.1)*.

Figure 2.1: Companies with greater confidence in their M&A capabilities expect a higher contribution from M&A to revenue growth

Assessment of M&A capabilities vs. expected inorganic revenue growth

Expected M&A contribution to revenue growth over the next three years



Source: Bain M&A Practitioners' Survey, 2021 (N=291)

Some of the time-tested principles of what good M&A looks like still hold true. The best players have a clear M&A mandate aligned to the corporate strategy. They focus on creating value and reducing risk through every step of the M&A value chain, tailoring their approach by deal type. They also proactively divest. Yet, with the broader changes afoot, even the most astute M&A teams are busy refreshing and rebuilding capabilities. Otherwise, they risk losing deal opportunities and finding themselves leap-frogged by the competition.

What to do *now*: Five imperatives to equip your capability for the future

We see five things that companies need to do to respond to today's challenges.

Reevaluate M&A's link to strategy. As business models change and companies revise their top-level corporate strategies, the M&A team's mandate should be updated. Among the biggest issues: With evolving ecosystems and digitalization redefining industries, companies need to take a new tack on where to buy vs. build to remain competitive in the years ahead.

Embrace nontraditional M&A. The best companies will expand their options beyond outright M&A and divestitures. Leaders will use JVs, partnerships (with or without equity, with or without financial sponsor partners), and corporate venture capital to deliver value in ways that are easier on the balance sheet and company cultures, tailoring integration to the deal type. Most M&A practitioners surveyed expect to see more partnerships, JVs, and corporate venture capital in the coming year, but expectations differ by industry.

Companies can take an ecosystem approach by partnering with other companies to explore new opportunities, reserving the option to accelerate if the promising trend takes off. This increases the likelihood of selecting the right deals. For example, a major financial services company has built a portfolio of ecosystem partners aligned with emerging trends. It monitors market developments and regularly reevaluates these partnerships to decide in which areas the company should become more active through either additional investment or full acquisition. This approach will become increasingly necessary in a future defined by ecosystems, especially for those industries that have already started facing rapidly evolving ecosystems.

Bring expertise into the process early. Given the growth in scope and capability deals, specialized expertise is required early on to understand the business fit. This often means making a deeper connection to the business unit during the diligence process or expanding the set of external partners to bring in the appropriate expertise. While this can be especially challenging in a world of virtual meetings, it also broadens the opportunity to match up experts from any company location. As we explain later, virtual collaboration tools now are more essential than ever.

Know the battlefield, and be ready to move quickly. Given the fierce competition for deals, companies can no longer wait for bankers to come to them or rely on just one source of deal intelligence. Firms must constantly track the industry landscape and how it evolves, and know how to focus very quickly

when opportunities arise. To move with speed, leaders establish an ecosystem of external partners (namely, bankers, tax and legal advisers, PE players in the industry, and so on) for swift access to the appropriate data sources and connections.

Add new lenses to diligence. In capability deals, it is not sufficient just to understand the standalone value of a target and joint value creation potential; dimensions such as culture, sustainability, and consumer sentiment should also be evaluated at the diligence stage. And, as we mentioned in last year's report, sources of value creation and risk are less predictable in scope deals. We also see consumers and regulators alike presenting new challenges to getting deals approved. One example is ESG, which has been brought to the fore by both consumers and investors. ESG was the driving force for several deals over the past year, and the initiative will influence many more in the future.

How to do it: Set up an operating model to deliver on these new imperatives

Building these M&A capabilities requires the appropriate operating model, and even the most successful acquirers need to ensure that theirs is up to the new task. In addition, such operating models need to evolve over time, quickly reflecting changing requirements, which demands constant and accurate observation as well as a solid understanding of market developments and related competitor movements. Many companies struggle to get this correct. In our survey, executives cited finding the right people, coordinating with business units, setting up effective processes, and establishing clear decision rights as top challenges to building M&A capabilities *(see Figure 2.2)*.

Here's how M&A leaders are revamping their approach to people, processes, and tech to meet the challenges of today's rapidly evolving landscape.

People: The best acquirers are rethinking roles across the M&A process. As scope and capability deals gain share, companies are bringing in more expertise from internal networks (business units) and partner ecosystems. One e-commerce firm uses a central M&A team to source a pipeline of deals, business unit leadership to assess attractiveness, and a team of internal and external experts to evaluate technical intellectual property. This mix of a core team, business unit leadership, and technical experts ensures that opportunities are evaluated from transaction, business need, and technical standpoints before they even go to diligence. Companies also are finding that experts on other deal structures (such as JVs, partnerships, licensing, divestitures) are essential to articulate the trade-offs of each and to help with execution.

Processes: The rapidly evolving landscape calls for more frequent and better-defined interactions and decision forums. In some ways, acquirers need to operate more like a PE fund. Well-defined decision rights and regular forums for updates (for instance, to the investment committee) are key, especially during the beginning of the process. For example, a leader in grocery has developed an M&A guidebook to articulate decision rights and processes at each stage of the M&A life cycle and under a host of scenarios, such as different deal types and sizes. This company regularly deploys a complete portfolio and market scan process that identifies markets for M&A, limited investment, or divestitures. Companies

Figure 2.2: Finding the right talent is seen as the biggest challenge to building M&A capabilities

Source: Bain M&A Practitioners' Survey, 2021 (N=291)

also need specific processes in place to actively manage JVs, alliances, and other partnership models. This is particularly important as failed JVs, alliances, or partnerships have the potential to reduce a company's reputation within its ecosystem, damaging its ability to attract new partners down the road.

While defined procedures are essential, it pays to be agile in parts of the process. That's especially the case in sourcing and screening; the best companies have teams available to swarm on potential targets as soon as there is a chance that they will be up for grabs. The same is true for integration. Although most integration is a well-outlined process, we see lots of value in leaving some capacity to cover the inevitable unplanned issues that arise in the integration management office.

Technology and tools: Companies need to invest in the right technology to mine the gold that is data. It is essential. Harnessing new insights from data not only provides a better view of risks but also a cleaner picture of the deal's upside potential. For example, one medtech provider developed a tool to perform a market data scan of thousands of targets on a regular basis. The M&A team then builds one-page models of short-listed targets for quick decision making when they come to market. Leaders are combining alternative data via web scraping and other techniques to build insights that give them differentiated results in screening and diligence. In the new virtual environment, picking and rapidly adopting the appropriate collaboration tools can spell the difference between maintaining a deal's momentum or losing it.

Divesting during Covid-19

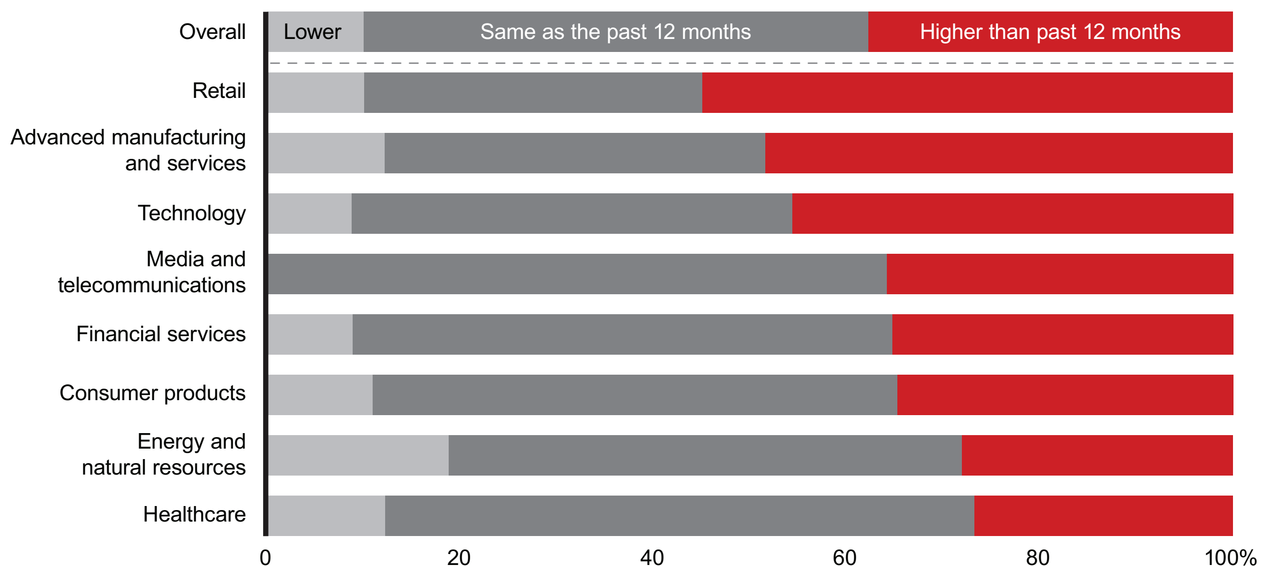
There's greater urgency to divest noncore assets, and it's harder than ever

Covid-19 has placed unprecedented demands on management bandwidth, resulting in divestiture activity being put on the back burner. Divestiture volume was down 15% in 2020, and value dropped by 21%. The easy excuses are economic uncertainty and the demands of conducting a virtual sales process. This is a missed opportunity as superior returns arise from taking action when others are timid.

The crisis has added an urgency to divest as companies need to divert their scarce resources to the best opportunities amid increasing industry disruption.

Depending on how the pandemic unfolds, we anticipate a possible sharp increase in corporate divestiture activity to make a comeback in 2021 and beyond. Roughly 40% of the nearly 300 M&A practitioners we surveyed expect a rise in divestitures over the next 12 months; only 10% of respondents felt that it would be lower *(see Figure 2.3)*. Some of the increase in divestitures will be a resumption of decisions made prior to the pandemic, especially situations in which businesses have been disrupted by new technologies or no longer factor into long-term growth plans. Additionally, the pandemic itself has raised liquidity concerns for many companies that took on debt to survive the downturn. Selling assets will help many companies pay down their debt burden. Finally, some businesses that may have been

Figure 2.3: 40% of survey respondents expect divesture activity to increase over the next 12 months



Source: Bain M&A Practitioners' Survey, 2021 (N=291)

marginally attractive in pre-pandemic portfolios will not earn their keep as new consumer behaviors continue post the great lockdown. The industries that were hardest hit during the pandemic, such as retail, energy, and hospitality, will likely see the highest level of divestiture activity.

Our research shows that winners from past downturns used the opportunity to outinvest competitors, with M&A and divestitures playing a prominent role. In May 2020, Sanofi divested $5 billion worth of its minority equity stake in Regeneron, with the expectation to use the proceeds to speed its strategic repositioning toward specialty pharma. Three months later, Sanofi announced a $3.7 billion acquisition of US-based biotech company Principia BioPharma.

While divestitures are more important than ever, they also are harder than ever. Management has never been more distracted. Covid-19 has made diligence remote and more digital, and it is increasingly challenging for buyer and seller to agree on valuations in heavily disrupted industries facing unpredictable futures. This comes on top of common divestiture issues such as the difficulty in negotiating asset perimeters, entanglements, and the critical transition service agreements (TSAs) required to make deals happen.

Fortunately, there is willing buy-side demand for divested assets. About 80% of surveyed M&A practitioners expect to revisit their short- and long-term strategies over the next 12 months, and 62% expect more interest in acquiring carved-out assets in their industries than they experienced over the previous 12 months. Meanwhile, private equity (PE) interest in carved-out assets is expected to remain high in the year ahead, with limited partners under pressure to continue to put dry powder to use. Across industries, 30% of respondents anticipate PE to increase its interest in buying divested assets, with the biggest anticipated rise in advanced manufacturing.

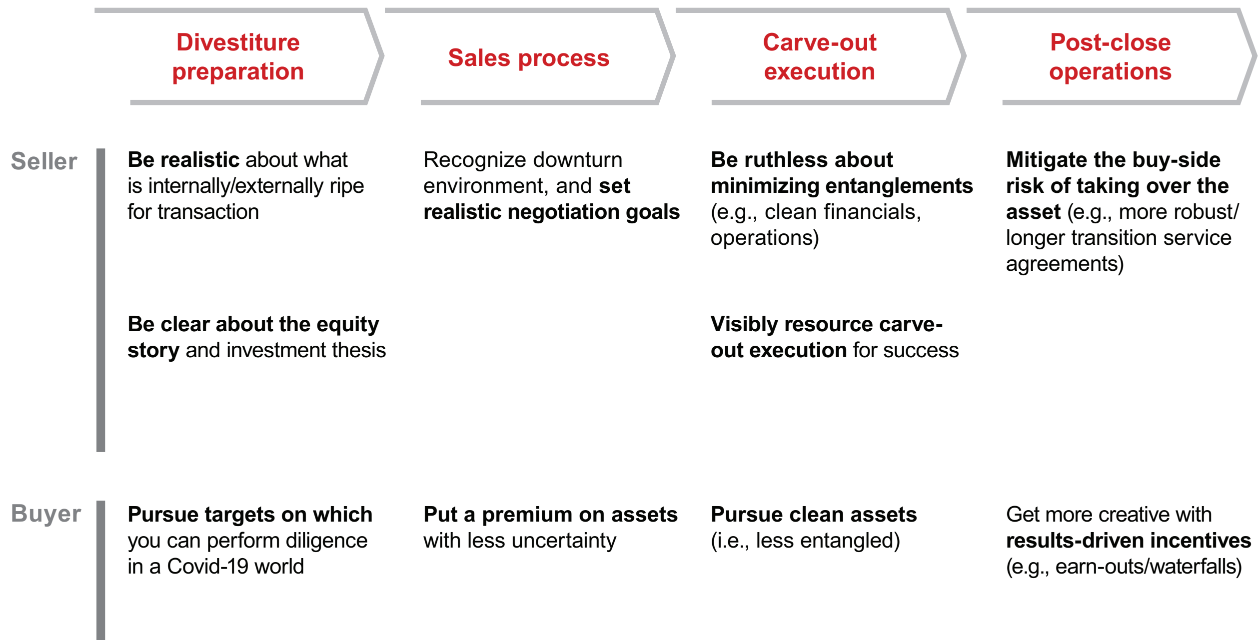
Flexibility can bridge the gap between seller and buyer

Companies that move quickly and creatively to overcome the obstacles to divesting will outpace competitors out of the downturn. There are proven approaches to bridging the gap between seller and buyer *(see Figure 2.4)*.

For example, with many industries facing uncertain futures, it is critical to develop clear equity stories and investment theses that address multiple possible scenarios. Divesting companies also need to be ruthless about minimizing entanglements, with deal perimeters that lead to clean financials and clean operations, and they visibly need to resource the separation program for success. They need to acknowledge that the more complex divestiture processes will require more resources and more time than usual. In the downturn environment, sellers also must set realistic negotiation goals and mitigate the risk for buyers by offering longer-term or more robust TSAs.

As they hunt for deals in this uncertain economic environment, buyers can minimize their risk by going after clean assets in which they can perform diligence from a distance and in which there is less entanglement. They can focus their efforts on assets with greater certainty, acknowledging the

Figure 2.4: How to bridge the gap between the need to divest and the added challenges



Source: Bain analysis

premium for such assets. They can structure deals to share the risk and upside potential with the seller. That means getting more creative with earn-outs, waterfalls, use of equity, and other results-driven incentives.

In our survey, 45% of respondents expect to see more earn-out deals as a way to hedge risk in divestitures.

Bouygues Telecom struck such a deal in June, when it agreed to purchase Euro-Information Telecom, a subsidiary of Crédit Mutuel group's Euro-Information. The acquisition price included a fixed part of €530 million to be paid on the closing of the deal and an additional part of between €140 million and €325 million contingent on the achievement of certain business performance criteria and payable over several years. In another instance, when ArcelorMittal USA was sold to Cleveland-Cliffs in September 2020, the buyer agreed to pay $1.4 billion (one-third of that in cash and two-thirds in the form of equity) to share the upside and downside risks.

In the Covid-19 world and beyond, these creative deal structures will become increasingly necessary to align the incentives of buyers with sellers and to hedge the risk, making divestitures a win-win.

How M&A and Divestitures Helped Asia's Conglomerates

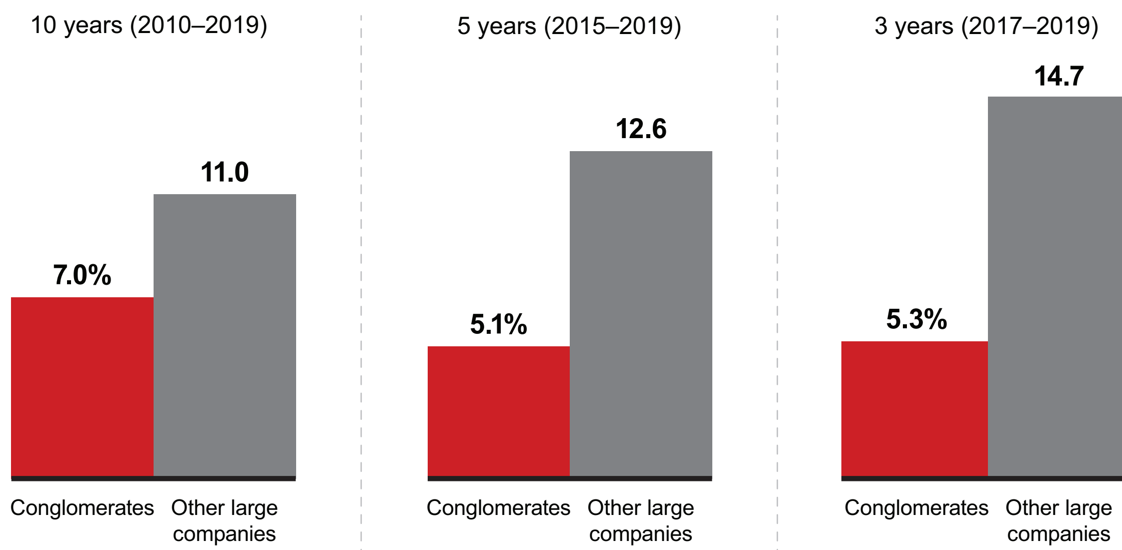
Conglomerates in China, Japan, and Korea faced a conundrum. The diversified business model that served them so well for decades turned into a disadvantage. Bain's analysis of nearly 150 conglomerates in the region found that, over the past 10 years, they achieved a lower total shareholder return (TSR) than pure play companies of similar size in the same market. And the performance gap is widening *(see Figure 2.5)*. The major culprit: Lower growth and differences in industry multiples reflect the fact that many of the conglomerates are struggling because a large portion of their business is in unattractive industries or weak competitive positions.

Yet conglomerates that have diligently pruned their portfolios using both M&A and divestitures delivered three times the TSR of conglomerates that failed to actively manage their portfolios to focus on core businesses or new areas of opportunity in which they could gain a leadership position *(see Figure 2.6)*.

After experiencing an $8 billion loss in 2009, Japan's Hitachi announced that it would shift away from its comprehensive electronics conglomerate portfolio. In 2015, Hitachi began restructuring its portfolio to focus on integrated Internet of Things solutions. By the end of 2019, it had completed close to 45 acquisitions and more than 30 divestitures. The company acquired to fortify its core, systematically divesting unrelated businesses to fund the acquisitions. One example is the merger between Hitachi's automotive supplier business and three Honda affiliate suppliers as well as CBI, a European peer. Through this deal, Hitachi Astemo (name of the merged entity) will significantly enhance its leadership position in a core vertical market.

Figure 2.5: Conglomerates in China, Japan, and Korea averaged lower total shareholder returns compared with pure plays in the same markets

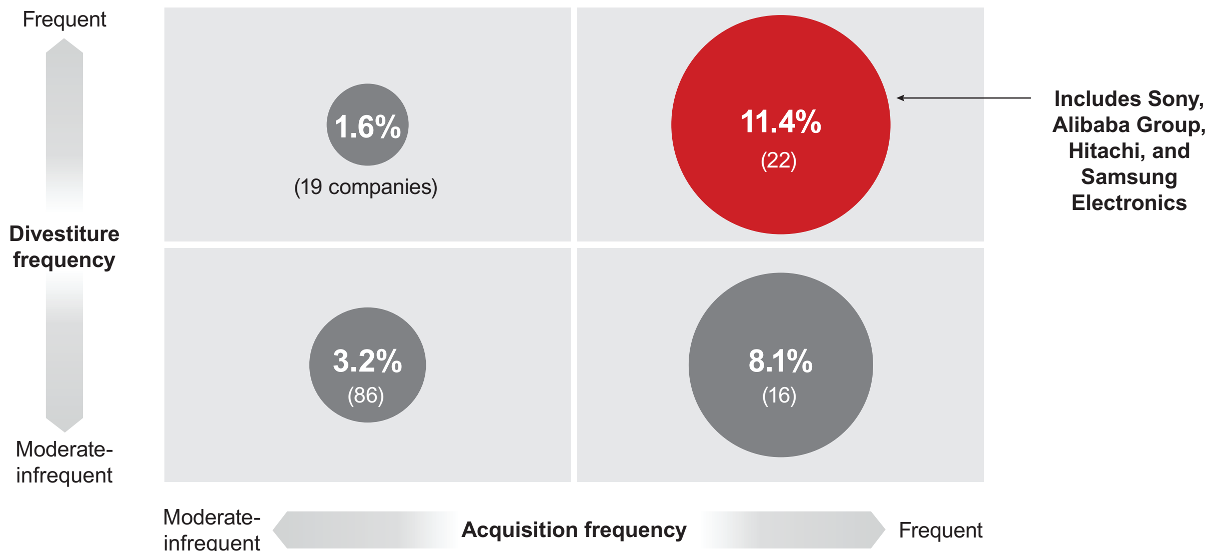
Annual total shareholder return performance of Asian conglomerates



Notes: Our sample sizes for conglomerates are 146 for 2017–2019, 145 for 2015–2019, and 139 for 2010–2019; our sample sizes for other large companies are 686 for 2017–2019, 646 for 2015–2019, and 547 for 2010–2019
Sources: Capital IQ; Bain analysis

Figure 2.6: Conglomerates in China, Japan, and Korea that were active in acquisitions and divestitures outperformed

Annual shareholder return, 2016–2019



Notes: We define frequent as the top 30 percentile; Samsung Electronics was a moderate-infrequent divestiture group in 2016–2019 after it conducted a series of divestiture deals in the early 2010s
Sources: Dealogic; Bain analysis

Korea's Samsung Electronics used M&A and divestitures to shift its revenue mix dramatically over the past 10 years, adding significant heft to its portfolio with deals that increased its IT and mobile businesses. Throughout this journey, the company conducted more than 20 acquisitions and more than a dozen divestitures. Samsung Electronics regularly assesses each business's attractiveness and competitiveness with a long-term perspective. This discipline enabled timely divestiture decisions—such as the exit from its hard drive and printing solutions divisions at a strong valuation, a move that helped fund the growth of priority businesses.

Finally, China-based Alibaba has completed more than 35 acquisitions since 2011, always with two clear strategic objectives: continuing the growth momentum of its core e-commerce business; and developing media and cloud services as its second growth engine. Alibaba acquired multiple e-commerce platforms outside of China, maintaining more than 40% annual growth in e-commerce over the past five years. During this period, the media and cloud service business, expanding with the acquisition of players such as Youku Tudou, has grown by 75% annually. As it acquires, Alibaba also continues to trim its portfolio, focusing on its priority areas and keeping its management focus clear.

Replicating such superior results from M&A and divestitures requires disciplined capabilities that can be repeated to capture the most value from transactions. The best companies have a focused portfolio strategy and tightly aligned M&A and divestiture roadmap. They establish clear roles and responsibilities between M&A functions at the center and business units in all steps, from deal sourcing and prioritization through integration management.

Section 3: Industry Views

A Wave of Scope Deals and Portfolio Changes in Consumer Products

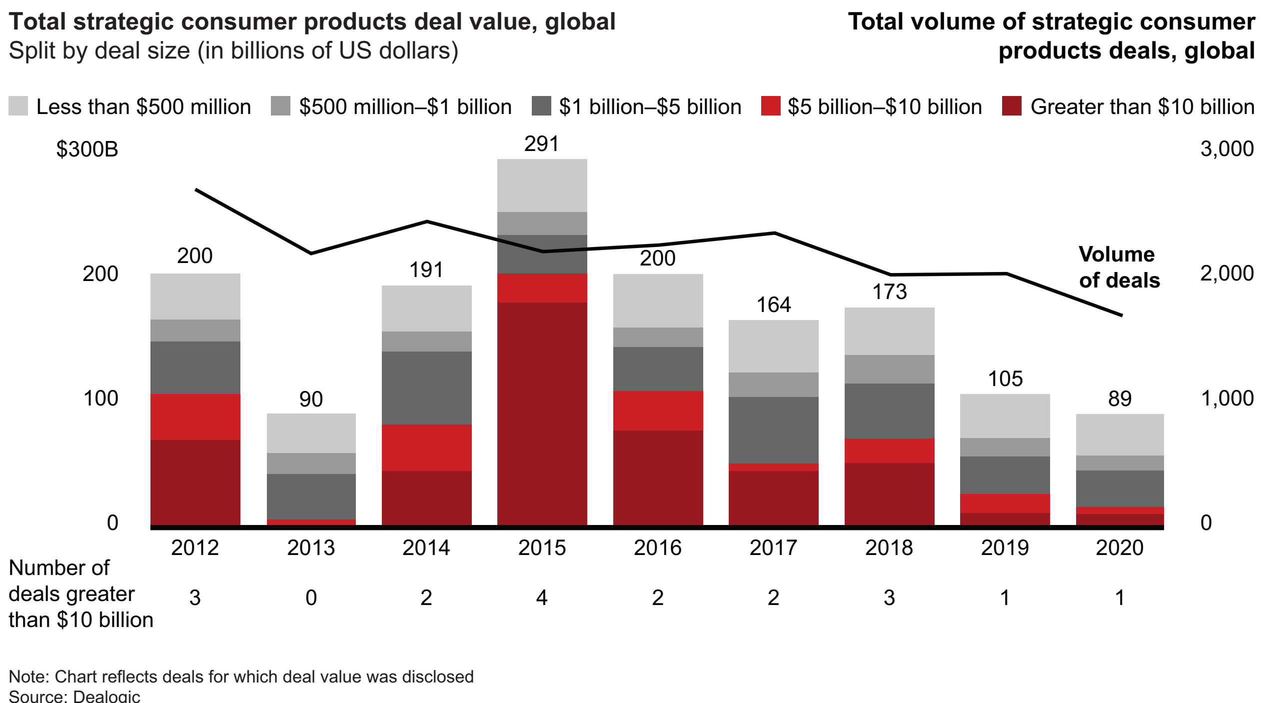
The state of consumer products M&A—the challenges and opportunities it brings

In consumer products, the year 2020 saw deal value drop by 15%, similar to the broader market decline.

It would be natural to blame the Covid-19 pandemic for these results, but digging deeper, we see that they represent a continuation of trends that have been playing out over the past three to five years. For example, global deal value for transactions greater than $500 million has dropped since 2015, the year in which megadeals peaked *(see Figure 3.1)*.

The most profound change in consumer products M&A is in deal mix. Scope and capability deals now make up 60% of deals greater than $1 billion despite multiples that are about 30% higher and cost synergies that are roughly 45% lower than they are in scale deals. Deal activity for insurgent brands—that is, those brands that significantly outpace category growth while simultaneously reaching minimum scale—has grown twofold to threefold since 2015.

Figure 3.1: Consumer products M&A deal value has been declining since a peak in 2015



Note: Chart reflects deals for which deal value was disclosed
Source: Dealogic

These trends point to a more fundamental change in M&A strategy as the consumer products industry reacts to low growth and historic disruption in consumer needs, channel shifts, and competition. Revisiting strategic priorities is reflected in the findings from our M&A practitioners' survey: 76% of respondents in consumer products say that their companies have updated their strategies in 2020.

Building the required portfolio of brands and capabilities organically can be time consuming and risky. The inorganic route, while still uncertain, offers the opportunity to act decisively. That view was reflected in the fact that 45% of surveyed consumer products M&A practitioners expect deals to increase over the next 12 months; only 10% expect them to decrease.

M&A creates challenges and opportunities.

First, the good news. Despite recent turbulence, the golden rules of M&A still hold. Frequent and material acquirers outperform those that acquire less frequently, with an average total shareholder return of 10.9% vs. 7.6%. This is because they build the end-to-end, repeatable capability for effective screening, diligence, and executing transactions and integrations.

Executing a smaller scope deal, however, is drastically different from a scale play. Executives in our survey rightly worry about the best way to achieve the required revenue synergies while retaining talent and scaling the acquired capabilities.

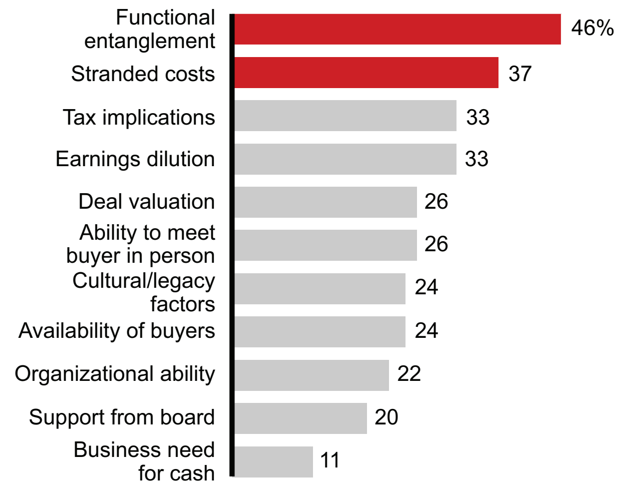
Furthermore, rebalancing the portfolio means selectively divesting to free up capital and focus. About 35% of consumer products executives responding to our survey expected divestiture activity to increase. Even if divestitures are attractive, they can be difficult to time and distracting for management. Survey respondents mentioned the challenges of dealing with functional entanglements, stranded costs, tax, and earnings implications as the biggest factors inhibiting divestitures *(see Figure 3.2)*.

In the next two sections, we share what companies are learning from smaller deals and divestitures.

Winning with smaller rollup plays

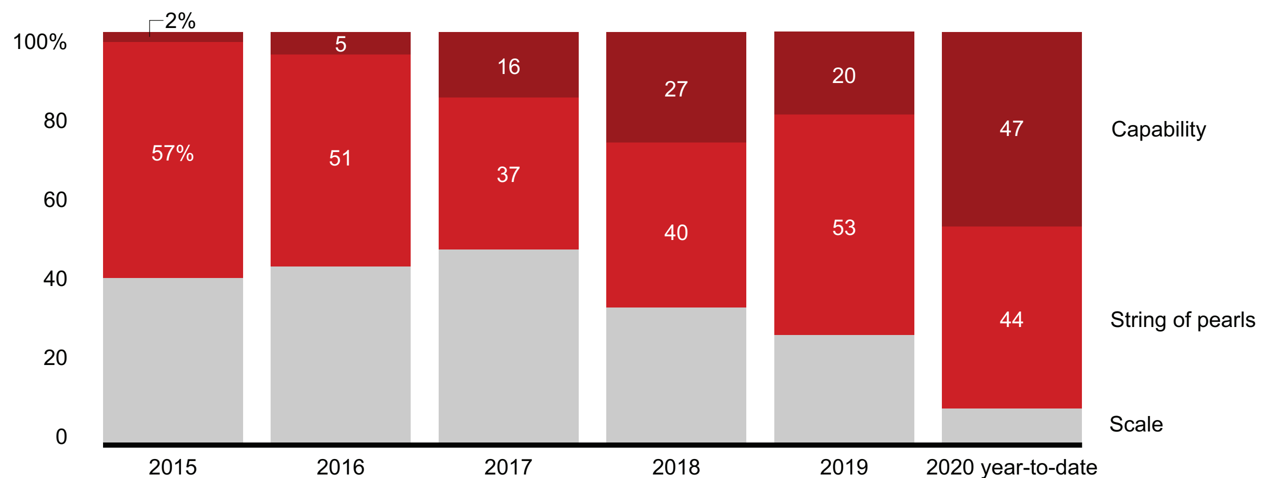
Smaller deals in consumer products are typically done for two reasons. First, to buy and build a new business (for instance, in a new category or geography). These often are called "string of pearls" deals. Among our survey respondents, 60% expect these types of deals to increase over the next 12 months. A second deal objective is buying or building new capabilities. Such deals done by the top 11 most acquisitive consumer products companies represented less than 5% of all M&A five years ago, and they have now grown to account for more than a third of all deals *(see Figure 3.3)*. For example, Unilever expanded into personal care with the acquisition of Dollar Shave Club (men's grooming) and Hourglass (cosmetics) as part of a broader strategy to shift from food into more premium segments. Nestlé built its presence in pet care by acquiring Zuke's, Merrick, Terra Canis, and Lily's Kitchen; it had earlier expanded into pet services with Petfinder. In beverages, AB InBev created a rollup of smaller craft and local breweries, such as Goose Island, Elysian, and Craft Brew Alliance, to compete in this high-growth, premium space.

Figure 3.2: Valuation and buyer availability are the top factors supporting a divestiture decision



Source: Bain M&A Practitioners' Survey, 2021 (consumer products n=46)

Figure 3.3: 'String of pearls' and capability acquisitions have increased over the past five years



Notes: Analysis includes nearly 250 deals of 11 leading consumer product companies; 2020 year-to-date is per November 1, 2020; scale deals gain market share in the core product category within the same geography or an acquisition of a third-party manufacturer that was already part of the supply chain; "string of pearls" deals expand into product adjacencies, including noncore products, expansion into related/adjacent product categories, and expanding into new geographies; capability deals acquire noncore and new capabilities such as delivery services, e-commerce, or e-marketing tools
Sources: Dealogic; Bain analysis

When we looked at this topic in our 2018 M&A annual report, the jury was largely still out on both the best way to integrate these smaller deals as well as how successful this strategy would prove over the long haul. Two years later, there is consensus that these deals can be successful. More than 65% of our respondents involved in “string of pearls” deals claimed success; less than 10% said the deals were failures. We also now have a clearer understanding of what makes these deals successful. The top factors cited by M&A practitioners included having a clear deal thesis and developing the appropriate operating model to integrate and scale the business *(see Figure 3.4)*.

On the flip side, however, our analysis found that insurgent brand growth rates drop by an average of 58% post-acquisition. While some decline can be expected as brands mature, we see four common reasons for failure:

- missing critical red flags in diligence (often cultural or operational elements);
- overintegrating and suffocating the target’s capabilities, undermining its culture, or driving critical talent departures;
- scaling distribution too fast and ahead of velocity, impacting long-term brand health; and
- underintegrating and missing the parenting advantages that underpinned the deal in the first place.

Figure 3.4: High success rates with ‘string of pearls’ acquisitions

Source: Bain M&A Practitioners’ Survey, 2021 (N=291, consumer products n=46)

In line with these lessons and based on more than 50 projects in this area over the past five years, we see a new "string of pearls" playbook emerging.

Widen the aperture on screening opportunities. Set a clear long-term strategy based on your unique parenting advantages. Proactively implement a two-for-one approach—that is, hunt for companies that bring both a new product or brand *and* critical capabilities. This will give you the conviction required to pay today's deal multiples.

Push the boundaries on world-class diligence. Even when transparency can be low, start with a clear, testable deal thesis, articulating why this deal will add value. Use the deal thesis to pressure test the base business, identify red flags, and clarify parenting advantages that only you will unlock. Lastly, think about integration early—assess organizational and cultural fit, and begin to identify Day 1 issues.

Have a tailored integration thesis that flows from the deal thesis. Be clear on what to integrate and what to leave alone. Integrate where there will be definite functional synergies, such as compliance or back office. Selectively integrate where required to deliver the value in the deal thesis, and separate areas that risk otherwise destroying the culture (for example, human resources, incentives, headquarters).

Protect the Founder's Mentality® magic. Most insurgents' success is rooted in the founder's conviction to meet a real need that the brand is uniquely placed to address. This Founder's Mentality permeates throughout the organization and creates a passionate and empowered front line with an aversion to bureaucracy. Sustaining that insurgent mindset is critical. Acquirers must actively secure key talent (most often, including the founder) early. Furthermore, allow the acquired business to opt in to services or capabilities in which they see value (supply chain and sales, for example) rather than imposing integration top down. "Chief interference officers" can help to reduce unwanted distractions and limit requests to the most critical.

The Founder's Mentality permeates throughout the organization and creates a passionate and empowered front line with an aversion to bureaucracy. Sustaining that insurgent mindset is critical.

Set appropriate margin expectations. Margins will not always be accretive, depending on the category and business model. Pushing for cost synergies can starve the business, lead to critical talent departures, and severely affect morale. Define long-term expectations and the path to get there, and be patient.

Balance your scaling ambition. For many of these deals, a larger consumer products company's ability to more rapidly scale the asset is a cornerstone of the value creation plan. For smaller insurgent

brands, however, being measured and thoughtful about where and when to expand distribution is critical to achieving sustained growth. Maintaining distribution for these smaller brands can be as difficult as attaining it. Therefore, ensure that post-acquisition efforts balance brand health and other velocity-driving actions alongside the pushes for increased distribution.

While the first 100 days are important, they are not the end state. The most successful teams think through and plan for evolution in two areas. First, defining areas in which to transfer capabilities back to the parent. Second, using the acquisition as a stepping-stone to build out a bigger, wider platform—for example, continuing to grow the string of pearls.

We have seen similar trends for capability deals, with deal volume increasing multiple times since 2015. Competition for these assets is only likely to increase, especially for capabilities spotlighted in response to the Covid-19 crisis, such as consumer and shopper insights and data, digital marketing, business-to-business sales, e-commerce, and supply chain agility. The playbook for these deals is similar, with additional nuance. For example, due diligence becomes even more critical—the acquirer will often have less visibility and knowledge of the target business model, market dynamics, and talent, requiring increased scrutiny and conviction in the parent company value add.

Remember, identifying and integrating these smaller deals without destroying the value is more challenging than many historic scale deals, even for serial acquirers. You will need to retool and retrain your teams and boost your M&A ecosystem to get this right.

Divestitures to benefit buyers and sellers

Over the past two years, carve-outs have represented around 43% of large deal value, fueled by significant appetite from strategic and financial buyers alike. Just in 2019, we saw AB InBev selling its Australian business to Asahi, Nestlé's announced deal to sell its US ice cream business to Froneri, and Campbell's selling Arnott's to KKR. In 2020, deals continued to be struck—for example, Kraft-Heinz selling its natural cheese business to Groupe Lactalis in September.

As we mentioned above, 2021 is unlikely to be different. Covid-19 has created an urgency for sellers to carve out noncore businesses for immediate liquidity, to refocus management bandwidth, or to redeploy capital to faster-growing areas. Meanwhile, with few structural capital constraints, buy-side demand is strong, both from corporates and from private equity firms sitting on record levels of dry powder. With today's environment and management teams already running at full tilt, it may sound appealing to wait, but that will often prove wrong.

From the seller perspective, we have always maintained that divestitures create highest value when they are done proactively and regularly. Most consumer products companies acknowledge this, but too many still hold on to noncore businesses for too long, attempting to optimize timing or valuation. Value only erodes further, however, as business performance suffers from lack of resources and focus. Meanwhile, buyers are looking to bring new parenting advantages to revitalize brands that have stalled or that are undermanaged under current ownership.

For both sellers and buyers, executing a carve-out is never straightforward and typically more complex than most other forms of M&A. From years of experience, we observe five best practices that can separate the successes from the failures.

Sellers should look to build conviction and take a buyer lens to act decisively.

Build conviction to act. Proactively address your portfolio by reevaluating each business for strategic and parenting value add in the post–Covid-19 world. Commit to a proactive phased plan—once a business has been identified for divestment, it is often best to move quickly. Then prepare to enable a successful transaction by engaging the best prospective parents and setting realistic expectations for the negotiation, valuation, and walkaway price.

Think like a buyer. With significant uncertainty, it is critical to identify what will be most attractive for the buyer. Develop a clear equity story and an investment thesis that addresses multiple scenarios. Execute reverse due diligence. Anticipate buyer transition service agreement (TSA) needs, and set up the separation program to orchestrate the process.

Buyers hunting for deals in the current disrupted environment are flexing standard processes to minimize risk.

Differentiate on screening and diligence. Competitors are widening the aperture on screening, using a broader range of data sources, ecosystem partners, and artificial intelligence to update their chessboards and priorities. Given remote ways of working, some are prioritizing assets that can be analyzed at a distance, have less entanglement, and lower uncertainty. They're also acknowledging the deal premium these assets demand. Diligence then pushes beyond standalone commercial and operational issues to get to a deep understanding of the risks created by talent, culture, operational linkages, and resulting TSAs.

Get creative on deal structures. Given future uncertainty and high asset prices, it can be difficult to get the right bid. To make the deal work, find ways to share the risk and upside with the seller. Consider earn-outs, waterfalls, use of equity, and other results-driven incentives to ensure seller commitment to the future business.

For ***both sellers and buyers***, striking the right deal is only the first step; execution must be robustly planned and managed.

Be smart about important process and technology decisions. These decisions typically carry the biggest dis-synergies, the highest one-time costs, and impact the bulk of the TSAs. In our experience, they are also the least understood. The right approach and resulting dis-synergies can vary widely, driven by the complexity of the situation.

Faced with this uncertainty, a robust fact base and option assessment are required. Cloning systems is one option. It can be lower risk, less costly, and faster, but it is never as simple as it might at first

appear and can reduce the long-term value for the new company. Alternatively, taking a greenfield approach can bring more long-term value, but it often requires one to two years of stabilization. In the end, the most common approach is a hybrid, with the majority of systems standardized and cloned but a few differentiated elements dealt with separately.

Technology separation should also serve as an unlocking moment. In our experience, companies that invest in their long-term growth agenda during technology separation (for instance, evolving their infrastructure to the cloud) typically generate more growth post–carve-out.

Divestitures are likely to remain a large part of the deal mix, and they offer a powerful tool to realign portfolios and revitalize brands. While some companies have already started to develop the muscles to pull this off—for example, Nestlé, Unilever, AB InBev, and Procter & Gamble have all executed more than 30 divestments over the past 10 years—for many, this will be a newer journey, requiring new capabilities, muscles, and playbooks.

In summary, Covid-19 significantly disrupted consumer products industry dealmaking in 2020, but the challenge to find growth and realign portfolios is as strong as ever. We expect a rebound throughout 2021 as consumer products companies continue to shift their deal mix to smaller brands, coveted capabilities, and divestitures. Experience suggests those that seize these opportunities will emerge from the subsequent shakeout as the next winners, and those that miss out may struggle.

For many companies, pulling off new types of deals is not easy, which is only exacerbated during a pandemic. Having said that, we can all learn from the winners of the past.

- Rebase your M&A strategy for the new reality. Understand the impact of the latest market, category, and channel disruptions and trends.

- Don’t get caught holding on to noncore assets too long. Systematically manage your portfolio through an effective, consistent rhythm of integration and divestiture.

- Invest in better, faster due diligence that not only identifies red flags but also rapidly creates a proprietary view on full potential and highlights integration challenges.

- Update your integration playbooks to deliver bespoke integration approaches. Even if you have them today, revisit chapters for the latest deal types, digital tools, and learnings. Double down on your process and systems capabilities.

- Build differentiated capabilities, ecosystems, and tools. To win, your teams need to move faster and with more conviction, enabled by better data and the right support.

The Unsurprising Boom in Technology M&A

Technology acquirers resume deal activity in the second half of 2020

After pressing the pause button in the first half of 2020, technology M&A came surging back in the second half as companies positioned themselves for a post–Covid-19 digital economy. In semiconductors, AMD acquired Xilinx in a $35 billion all-stock deal. In software, Salesforce bought workplace communication company Slack for $27.7 billion in stock and cash. All told, deal value for corporate acquisitions of tech companies crossed $200 billion in each of the last two quarters of 2020, a level last seen more than two decades ago.

In many ways, it is not surprising. Covid-19 gave businesses in all industries a preview of their virtual futures, and both tech and nontech companies alike rushed to buy and build their way into the opportunity. Across industries, companies are preparing for the post–Covid-19 world by (among other moves) augmenting collaboration tools in areas such as videoconferencing and chat while also reinforcing cybersecurity. Companies with the means are using the opportunity to add these and other new capabilities to reposition their organizations for the future. For example, Verizon announced a timely April acquisition of BlueJeans, a cloud-based videoconferencing and events platform, to extend its portfolio offerings for businesses. As Zoom's usage grew exponentially and security concerns emerged, Zoom acquired Keybase for its end-to-end encryption expertise to beef up its security credibility.

There are other forces propping up technology M&A. In general, large tech companies—namely, those valued at more than $10 billion—have the benefit of strong cash positions, they have proven themselves relatively resilient during the downturn, and they continued to acquire throughout 2020. Meanwhile, premiums have dropped for many of the small tech companies that hold valuable capabilities and that are potential targets for larger tech acquirers.

Regulatory roadblocks

One force, however, is working against deal volumes. While regulatory scrutiny has increased in most industries, it has had a particularly heavy impact on technology as regulators take a heightened interest in technology deals.

Regulators are reviewing deals aggressively for antitrust concerns. Antitrust was at the heart of the suits launched in December against Facebook by the US Federal Trade Commission and 46 states. The suits allege that the company is maintaining its personal social networking monopoly illegally through a yearslong course of anticompetitive conduct, and they ask the company to divest Instagram and WhatsApp. As antitrust concerns mount, regulators in the US and elsewhere are investigating new approaches to evaluate and manage antitrust issues in technology, where traditional measures to assess competitiveness (primarily revenue) are difficult and where start-ups often maintain high valuations before the company even has revenue, banking on future potential to monetize daily active users down the road.

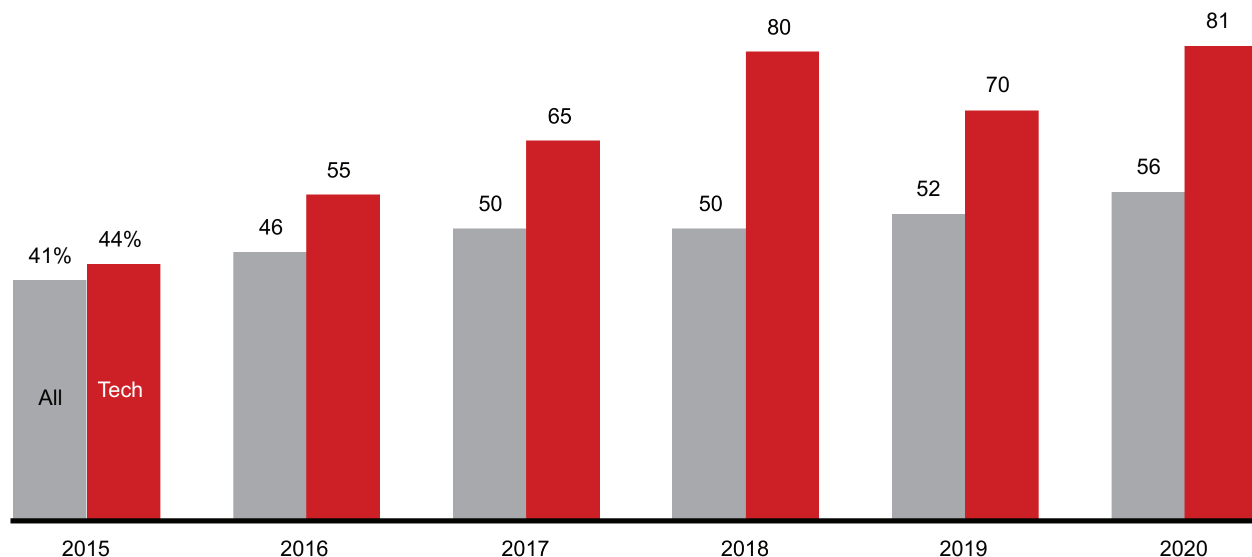
Also, as we've examined in previous M&A reports, regulators are intensifying their efforts to scrutinize cross-border tech deals as a matter of national security. This is most dramatically reflected in the rising actions by the Committee on Foreign Investment in the United States, an interagency panel that reviews foreign investments for potential national security risks, which has heightened its scrutiny of Chinese ownership. Another unprecedented move on national security in 2020 was the Trump administration mandate that TikTok's US operations be sold to a US buyer on grounds of national interest, with concerns that user data could be compromised.

Data privacy is another growing area of concern among regulators. Questions of who owns the data and what companies are going to do with the data surface in many proposed tech deals. It became an issue in Google's $2.1 billion bid for Fitbit, a wearable tech company, for example. All of this increases the need to prepare for consultations with regulators and broader stakeholder communications during the deal's diligence and negotiation phases.

Scope deals rise inside and outside tech

Deal activity in 2020 continues a trend that has been steadily building over the past five years. Scope deals, which are usually designed to help a buyer enter faster-growing business segments or to acquire new capabilities, intellectual property, or talent, have grown from representing 44% of large tech deals in 2015 to 81% in 2020 (year-to-date in September), far outnumbering traditional scale deals that generate cost synergies. Compare that with the average of 56% scope M&A among all industries *(see Figure 3.5)*.

Figure 3.5: Scope deals accounted for more than 80% of all technology M&A, far more than other industries



Note: Includes top 250 deals valued at greater than $1 billion for 2015–2019 and 131 deals for Jan–Sept 2020
Sources: Dealogic; Bain analysis

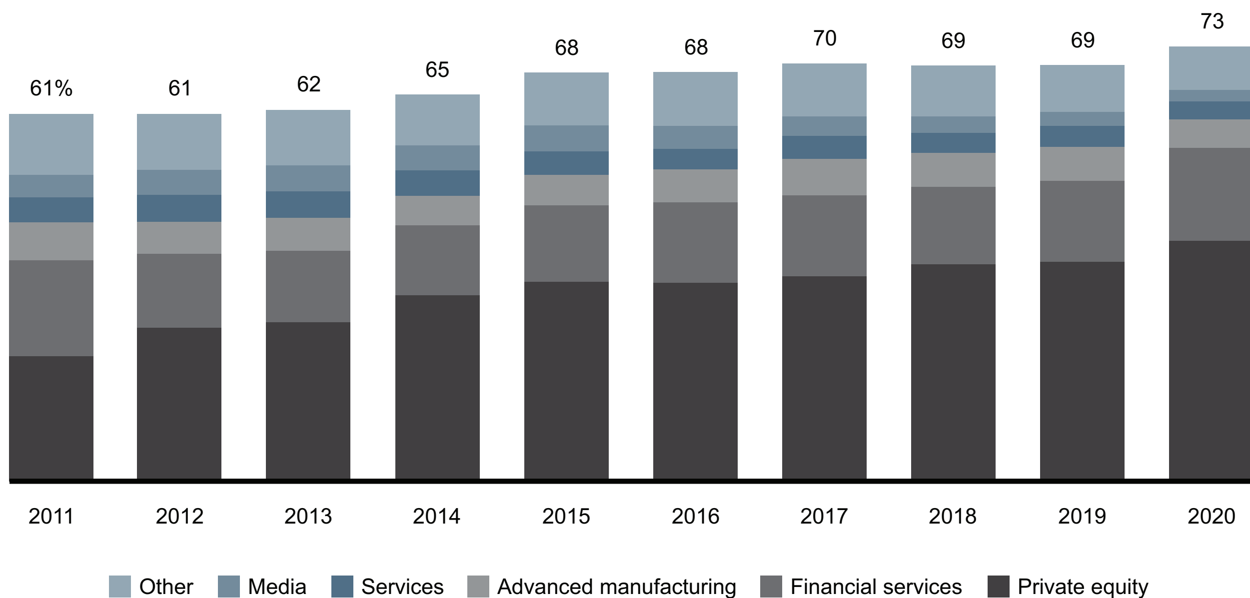
The scope activity takes two forms: technology companies buying within tech; and companies from other industries buying tech companies to get out ahead of digital disruption. Companies in automotive are acquiring capabilities for autonomous driving and electric vehicles, for example. Industrial companies are buying assets to deliver integrated Internet of Things solutions and products for Industry 4.0 and robotics—that was the impetus behind Aveva's purchase of OSIsoft. Financial services companies are buying their way into peer-to-peer payments, e-commerce payments, and blockchain. Most significant is the rising interest of private equity investors in the tech space. Together acquirers from other industries and private equity now account for nearly three-quarters of deals in the technology sector, up from about 60% a decade ago *(see Figure 3.6)*.

For technology industry acquirers, this interest from other industries and financial sponsors means more competition and higher deal premiums. The mounting competition requires tech companies to be more rigorous in what they bid on, with clear plans for realizing synergies.

Technology acquisitions require a different approach

Nontech companies buying tech assets have a new set of rules to follow. In many ways, technology companies are different from those in any other industry, and there are meaningful risks that need to be anticipated and mitigated.

Figure 3.6: Nontech acquirers are increasingly active in the technology sector



Source: Dealogic

Acquirers need to take a different approach to sourcing the right assets. Those more accustomed to purchasing large public companies need to plug into venture capital networks to track opportunities and court founder-led businesses. Some companies are doing this by investing in corporate venture capital, placing smaller investments to foster relationships that can lead to a future acquisition and integration of the assets.

In diligence, it may be necessary to anticipate a more forward-looking financial assessment. In traditional due diligence, much of the effort involves evaluating a target's past business performance and current competitive position. In digital M&A, acquirers need to become more forward looking, possibly through approaches that evaluate the potential success of the business model under different scenarios as well as through a rigorous understanding of the customers and their evolving needs.

Then, there is the matter of financing. Tech assets typically are expensive compared with those in other industries, often selling at discouragingly high multiples. To mitigate the risk linked with the target's high multiples, acquirers need to evaluate all potential financing solutions and consider adapted payment terms such as earn-outs or other deferred payment mechanisms. For many, the right answer will be alternative participation models such as partnerships (with or without equity) and not outright ownership.

Given the high premiums and risk of acquiring tech assets, it is more important than ever to have a clear integration thesis and a clear understanding of the critical few decisions that will make or break the success of the deal. The integration thesis needs to translate the deal thesis into a roadmap of what needs to be integrated (or not integrated), when to integrate, and how to go about the integration.

In technology deals, talent and culture retention are particularly important for deal success. That is why Amazon offered $100 million in stock awards to retain the more than 900 employees of Zoox, the self-driving car start-up it bought last year. The deal was conditional on acceptance of this retention incentive by a majority of employees. Acquirers must avoid the common mistake of forcing the legacy culture, policies, and approaches onto the new acquisition—it is a recipe for talent defection.

Finally, acquirers need to ensure that the operating model for both companies is designed to integrate enough to enable the new asset to add value to the acquirer's existing business without stifling the acquired company and killing the operating mechanisms that allowed it to be so innovative in the first place.

As technology deal activity maintains its healthy pace, learning to play by new rules will make the difference between those companies that guide the digital future and those that are written out of it.

Getting Ready for the Recovery in Healthcare M&A

Healthcare deal value dropped more than any other sector in 2020

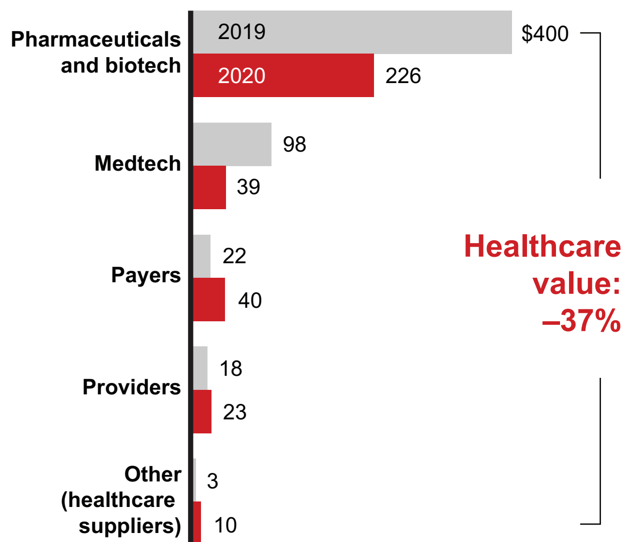
After reaching an all-time high of roughly $540 billion in strategic deal value in 2019, the ban on elective surgeries and general worries about economic uncertainty led the healthcare industry to experience a 37% drop in deal value in 2020. Healthcare suffered one of the biggest M&A value declines of any industry during the Covid-19 pandemic *(see Figure 3.7)*. Deal value fell significantly in pharmaceuticals/biotech and medtech, but it rose in payers and providers.

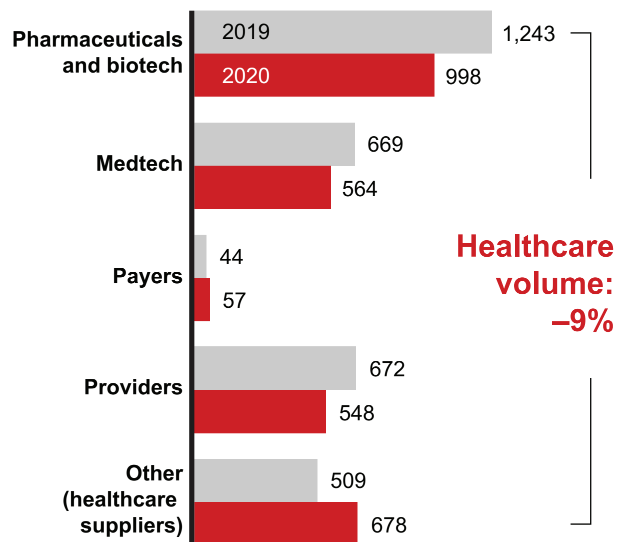
In terms of deal volume, healthcare saw a 9% decline, roughly in line with the overall market.

The decline in megadeals contributed to the overall lower deal value in 2020, with only five megadeals valued at more than $10 billion in healthcare. This compares with eight in 2019.

Scope deals, which generally are aimed at helping a company to enter fast-growing markets or to add needed capabilities, made up the bulk of healthcare M&A activity in 2020, with each of the year's top 10 transactions primarily scope in nature. In fact, scope activity accounted for a whopping 95% of all deals valued at $1 billion or more in 2020. This continues a trend the industry has been seeing since 2015. Scope deals are a higher portion of total transactions in healthcare than in any other industry, with the next-highest sector, technology, at 66%.

Figure 3.7: Healthcare deal volumes held strong in 2020, with the deal value decline mainly attributable to fewer megadeals





Sources: Dealogic; Bain analysis

There are several areas within healthcare that should benefit from significant deal activity in 2021 and beyond.

Pharma/biotech: The market rewards top-line growth over profitability

Even though pharma/biotech transaction value was down 43% in 2020, the subsector still made up two-thirds of overall healthcare transaction value. If you exclude 2019's BMS and Celgene as well as AbbVie and Allergan megadeals, pharma/biotech would be 4% higher in 2020, suggesting that sector fundamentals and underlying catalysts for deal activity remain strong.

From 2015 to 2020, about 56% of total shareholder returns (TSRs) in pharma/biotech were generated by revenue growth, which contributed about three times more than earnings before interest, taxes, depreciation, and amortization growth. Further, there is no discernable difference in the contribution to TSR from organic vs. acquisitive growth. Simply put, the market rewards high-gross-margin pharma/biotech companies for top-line growth more than anything else. As long as this relationship holds, we expect that transaction volume in the subsector will remain strong.

We continue to see pharma/biotech companies turn to M&A to supplement their R&D pipelines in existing areas of expertise. That was the impetus behind the Sanofi and Principia deal in autoimmune as well as the AbbVie and Genmab deal in oncology. The same is true for companies seeking to add new technology capabilities to their portfolios. Consider the Sanofi acquisition of Kymera in protein degradation as well as the Biogen and Sangamo deal in gene regulation therapy. We anticipate that the pursuit of R&D and new technology will continue to spur activity in 2021 and beyond.

Medtech: Despite elective surgery restrictions, some areas are poised for a rise in acquisitions

Medtech deal value was down by 60% in 2020 as companies absorbed the impact of elective surgery restrictions—elective surgeries dropped by nearly 90% in the US in the second quarter because of Covid-19 restrictions, but they rebounded in the third quarter before falling slightly in the fourth quarter *(see Figure 3.8)*. While the halting of elective surgeries did not affect all medtech companies equally, the overall influence was significant enough to drag down deal volume across the entire sector.

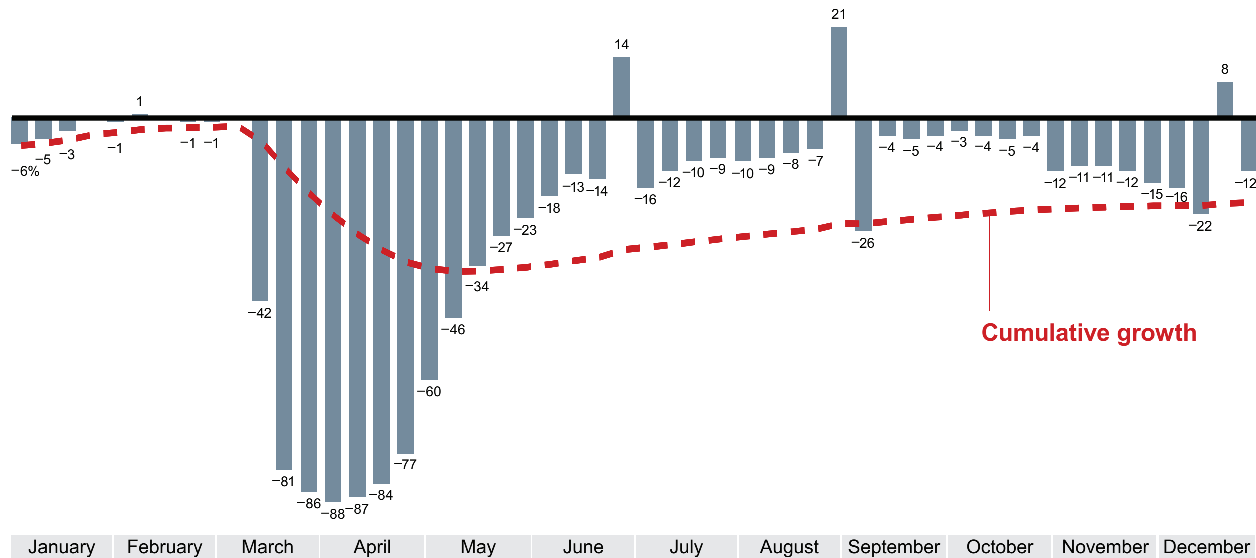
Of the medtech transactions that did occur in 2020, the largest was Siemens' acquisition of Varian for roughly $16.5 billion—it was the third-largest healthcare transaction for the year. This acquisition is a scope deal that will supplement Siemens' CT scanner business with Varian's linear accelerator business to create the largest provider of cancer treatment medical devices.

While the uncertain future for elective surgeries and hospital access should continue to depress medtech transaction volumes near term, there are two areas within which we anticipate a potential major revival in activity:

- Diagnostic and testing companies receive a major influx of cash and may use it either to reinvest in their core or to diversify into other businesses.

Figure 3.8: Covid-19's dramatic impact on elective procedures

Year-over-year changes in 2020 elective procedures, by week



Notes: Week 1, 2019, is the week ending January 11, 2019; week 1, 2020, is the week ending January 10, 2020; week 52, 2019, is the week ending January 3, 2020; week 52, 2020, is the week ending January 1, 2021; elective procedures based on IQVIA custom analysis; data includes claims from inpatient and outpatient sites of care; latest two weeks are estimates using a regency data factor that is adjusted out as all claims are received
Sources: IQVIA Medical Claims Data Analysis, 2021; Bain analysis

- Companies with portfolios less exposed to elective surgeries or larger players with strong balance sheets may opportunistically scoop up distressed assets.

Over the longer term, when elective surgery volumes return to pre-pandemic levels, we expect the pursuit of category leadership to return as a major force behind transaction volumes as companies purchase assets within areas in which they currently compete. In 2020, the largest example of this type of deal was Stryker's $5 billion acquisition of Wright Medical to enhance its extremities business.

Payers: Investment will continue in telehealth and payments technologies

Payer transaction value increased by 79% in 2020, largely the result of the $14.7 billion merger between Teladoc and Livongo in a deal that blurred the lines between a traditional healthcare provider and a pure-play technology company. Excluding that deal, transaction value fell by 4% in 2020, continuing the downward trend from 2017 as payers take a wait-and-see approach to the pandemic and integrate past years' megadeals. While the halt of elective procedures had a positive near-term effect on payers, the longer-term impact is less clear. Among the factors at play: a potential resurgence of elective surgeries, the shift to telehealth, and the unfolding health implications of recovered Covid-19 patients.

The Teladoc and Livongo deal could signal a pickup in activity in areas such as enabling software for telehealth/remote visitation and healthcare payments—technologies that are becoming increasingly relevant in a Covid-19 world and beyond.

It also is likely that financial sponsor activity will rise in this area because of the potential for building businesses that ultimately could be compelling targets for strategic acquirers.

Providers: Pursuing new opportunities so that the strong can get stronger

Covid-19's impact in healthcare has been most acutely felt among providers as hospitals not only lost a major source of revenue in elective surgeries but also faced the negative margin impact of Covid-19 patients. As providers focused on staying solvent amid the pandemic, provider M&A slowed down in the second quarter. The second half saw a pickup in activity, however, leading to an overall increase of 28% in transaction value in 2020.

Transactions focused on the consolidation of physician practice management and alternative care sites to drive down costs and increase clinical outcomes via standardized processes. Two such examples include GenesisCare's acquisition of 21st Century Oncology and North American Partners in Anesthesia's acquisition of American Anesthesiology.

In the months ahead, we expect M&A activity to continue to accelerate. There will be major opportunities for well-funded and well-run assets to acquire and turn around distressed assets as well as continued activity in capabilities and services such as telehealth and patient engagement. As our colleagues reported in *US Healthcare Trends 2020: Insights from the Front Line*, 50% of hospital administrators say their organizations are highly likely to make one or more acquisitions over the next two years, and nearly 70% of independent physician practices are amenable to a merger or acquisition.

Private equity (PE) will play a key role in provider M&A. Financial sponsors' share of deal value rose from 27% to 61% over the past five years. Given the amount of dry powder and availability of assets, this is a space to watch as sponsors look to build on existing platforms and develop new ones.

Regulatory uncertainty will continue to create complexity across all sectors

The year 2020 included endless speculation on new regulations that could result from governments evaluating their healthcare industries in light of Covid-19.

In the US alone, several major potential regulations took center stage—among the biggest: drug pricing regulations, adjustments to the 510(k) approval process for medical devices, and significant changes to Medicare reimbursement rates to include bundled pricing. Some states in the US have increased their scrutiny of PE-backed transactions. Our 2020 survey of healthcare M&A practitioners found that roughly 50% of respondents are highly concerned about the rising scrutiny of pharmaceutical pricing. In Europe, there continues to be uncertainty around the impact and timing of both EU medical device regulations and Brexit.

Meanwhile, growing US-China friction has led to an increased scrutiny of deals and post-close operations, causing corporate decision makers to reevaluate how they operate within China and to pursue alternatives such as joint ventures and minority structures instead of direct entry deals. Also, almost 60% of respondents agree that the desire to localize supply chains because of their current regulatory concerns will be a key factor guiding their M&A decisions over the next 12 months.

Finally, rising nationalism resulted in increased deal scrutiny in many parts of the world, and Covid-19 slowed the response time in market interviews. The combined result was longer approval timelines for deals and more mandated divestitures as a precondition for approval. Companies need to carefully devise integration plans so that they can move quickly while also avoiding possible rework if delays in approval occur.

A continuing lag in divestitures as companies focus on top-line growth

Healthcare companies did not view 2020 as an optimal time to divest. The uncertainty created by Covid-19 meant that there were no megadeal divestitures on the level of those we saw in 2019, such as Pfizer's divestiture of Upjohn to Mylan and GE's BioPharma unit divestiture to Danaher.

After a slow 2020 for divestitures, the year 2021 may see distressed companies divesting assets to free up cash or return to divesting as a way of cleaning out portfolios. We expect the aggregate value of divestitures to continue to lag full asset purchases. Healthcare executives will maintain their focus on dealing with Covid-19 and driving top-line growth before they turn their attention to divesting noncore assets.

Investing in a downturn for superior returns

Past recessions have shown that companies that are willing to invest during a downturn can emerge stronger and quickly gain share during a recovery. In 2018, nearly a decade after Roche's full acquisition of Genentech, about one-third of its total sales were generated by Genentech's flagship cancer drugs (Herceptin, Avastin, Rituxan). Another successful example is Medtronic's acquisitions of CoreValve and Ventor Technologies in 2009 to become a leader in the US transcatheter aortic valve replacement market. Over the following decade, Medtronic has averaged a 12% annual TSR.

To replicate such success, the best acquirers in the current downturn will have a clear investment thesis that articulates a short list of actions to achieve the most value from a transaction. They will be aggressive but realistic on synergies and one-time costs, running multiple post–Covid-19 scenarios. They will recognize the challenges of executing an integration in a virtual world, but they will know that they can succeed with planning and focus—and by injecting the strongest talent in the places that will deliver the deal and integration thesis.

While Covid-19 has introduced arguably the most complex deal market in decades, we believe that transaction value and volumes will rebound (in some areas significantly and quickly), with opportunities for companies willing to take on an increased risk of uncertainty.

For Retailers, Building Scale Will Be Critical—but Not Enough

Covid-19 raises the stakes for retail deals

The Covid-19 pandemic hastened the shift to e-commerce, increasing the importance of M&A in the retail industry. The retail M&A practitioners we surveyed expect M&A to contribute almost 60% to top-line growth over the next three years vs. around 35% over the past three years, representing one of the highest jumps among all industries surveyed. Activity will intensify for both scale and scope deals. Markets are looking for scale, growth, and digital performance—no player can do all of that without M&A.

Nowhere is this seen more clearly than in the grocery sector. Some of the activity takes the form of traditional consolidation in which retail chains buy other chains and sites. But increasingly, grocers are taking other approaches. For example, some are buying or partnering to integrate supply chains. Others are partnering to access new capabilities and technology and to accelerate growth of new channels. That was the aim of Kroger's partnership with Ocado, for example. And Ahold Delhaize's deal for online grocer FreshDirect was intended to shore up newly critical digital and e-commerce capabilities.

The need to build scale

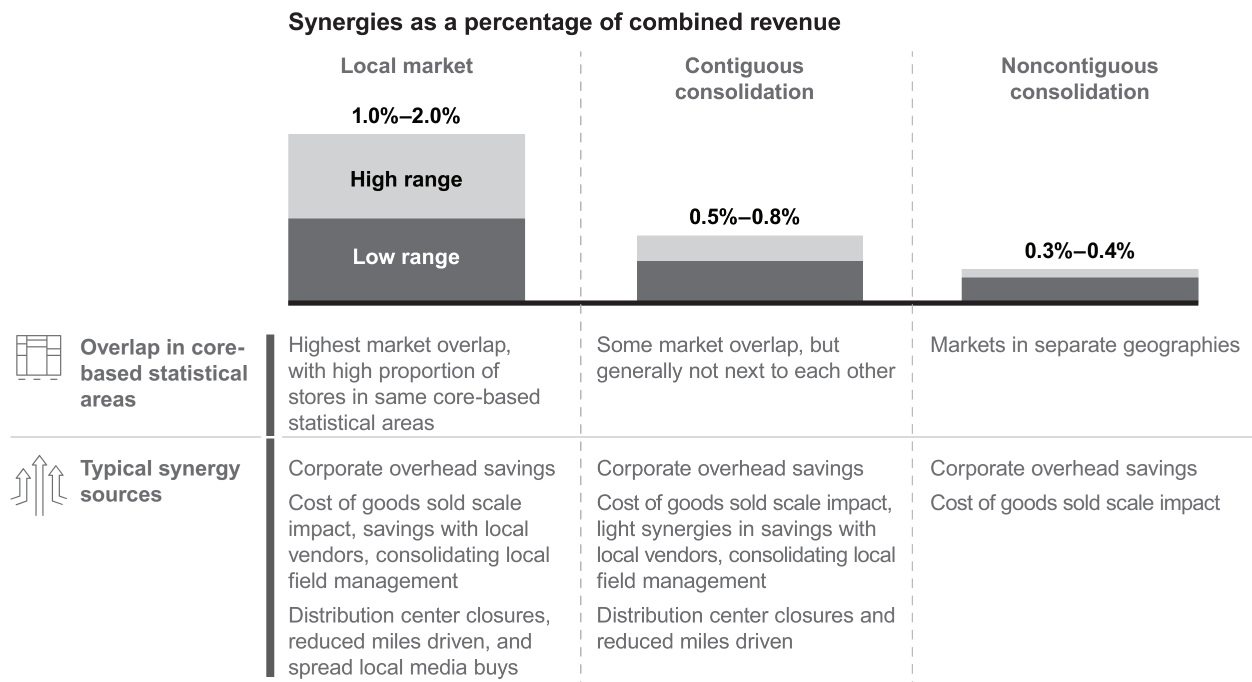
Scale M&A, both regional and absolute, is becoming one of the key enablers for securing a future in a retail world that is increasingly digital. Local scale drives profitability and enables investments in must-have home delivery capabilities now. Absolute scale enables companies to make the required massive investments in emerging e-commerce growth platforms and to unlock new transferable insights from data across markets. Covid-19 accelerated e-commerce, and e-commerce is a scale game. It also focused attention on the importance of labor stability, highlighting the need for faster automation, which also is the domain of scale players.

Grocery margins are often under intense pressure, and scale M&A is one of the few levers available for saving 1% to 2% of sales to provide cash to fuel growth *(see Figure 3.9)*. Companies that are able to implement and repeat successful scale deals create significant competitive advantages and are rewarded accordingly. From 2007 to 2017, such companies have grown profits by 6.6% per year vs. 2.2% for other retailers.

Gaining scale continued to be a strong deal rationale in 2020. For example, 7-Eleven acquired 3,900 Speedway convenience chain stores in the US, further strengthening its existing 9,800 store network in North America. The combined company's footprint includes 47 of the 50 most populated metro areas in the US, making it significantly larger than Alimentation Couche-Tard, the No. 2 convenience store operator in North America.

As retailers reevaluate their portfolios, they will also choose to exit some markets and turn their attention to building scale presence in other markets. That is what UK-based Tesco did by selling its Thailand and Malaysian operations to the Charoen Pokphand foods group. The deal was one of many divestitures that mark a refocusing on Tesco's core UK business.

Figure 3.9: Typical synergies differ by type of acquisition



Source: Bain analysis

The new battlefield is acquiring digital and data capabilities

As retailers scale up to generate synergies to boost margins and invest in growth, companies will differentiate themselves strategically from competitors by successfully integrating scope acquisitions. Scope will increase in importance for innovation, digital capability acceleration, and ecosystem building as companies pursue new sources of growth and ways to deliver a stronger value proposition to customers.

Online retail was already gaining momentum before the Covid-19 crisis, making omnichannel retail the decisive business model of the future. Traditional retailers have responded by turning to scope M&A to make advances in fast-growing e-commerce segments. Back in 2018, Walmart acquired Flipkart, India's leading e-commerce company, to get access to that vast market. Richemont acquired YOOX Net-a-Porter Group to gain a foothold in online luxury. In 2020, Caesars Entertainment entered online gaming through the acquisition of William Hill, a US-based online sports betting company.

Retailers also are using scope M&A to access capabilities that will improve their customer value proposition in different ways. For example, scope deals can help retailers speed the pace of innovation. Scope M&A enables them to leverage data and advanced analytics to resegment and more deeply understand the needs of their core consumers. Many companies are finding that it is faster and more effective to acquire or partner than to build these capabilities internally.

Meanwhile, retailers are entering deals that allow them to participate in open ecosystems that are becoming instrumental for making the most of their own assets, adding new capabilities and opening up new profit pools. Amazon, Tencent, and Alibaba set the pace by establishing ecosystems through internal capabilities as well as multiple scope deals and partnerships to deliver an engaging customer experience. Building such an ecosystem was one of the benefits of Target's acquisition of same-day delivery platform Shipt, for example. Finally, retailers use scope deals for the data, advertising, technology, and distribution that can help them boost margins and growth through business-to-business adjacencies.

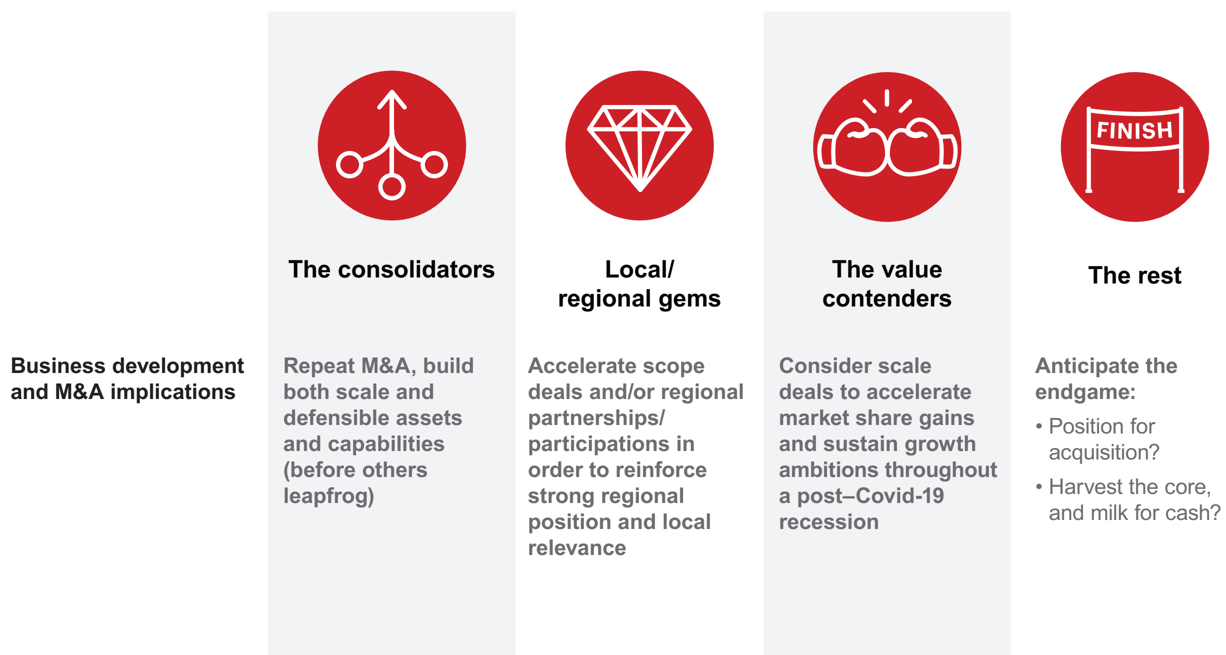
Four types of grocery retailers, four approaches to M&A

In grocery, one of the biggest retailing sectors, companies will use M&A to achieve different strategic aims. We see companies falling into four distinct categories: the consolidators; local/regional gems; the value contenders; and the rest (*see Figure 3.10* and the Bain Brief "The Future of Retail: Winning Models for a New Era").

The consolidators will use M&A to both build scale and invest in capabilities for everything from e-commerce to delivery to private labels. The year 2020 saw several deals in delivery alone, such as Ahold Delhaize's acquisition of FreshDirect and Costco's deal for Innovel Solutions.

Local/regional gems will continue to improve their local relevance by building loyal customer bases and differentiated value propositions. Gems such as H-E-B in the US or Migros and Sonae MC in

Figure 3.10: Different grocery strategies require different M&A approaches



Source: Bain analysis

Europe could accelerate their scope deals or regional partnerships and participations to reinforce their strong regional position and local relevance.

The value contenders will continue to simplify operations to help sustain strong growth plans. In many geographies, traditional scale deals, such as Aldi's purchase of Leader Price stores in France, will present important opportunities to accelerate market share gains and pursue growth ambitions through a possible post–Covid-19 recession.

The rest will evolve incrementally—and, by avoiding M&A, risk being left behind.

The new M&A imperative for retail

Retailers have a full list of deal options from which to choose. They can participate in the types of scale or scope deals we've described, or they can set up corporate venture capital units to invest in promising businesses. They can partner via accelerators, joint ventures, or other collaborative arrangements. They can build tech labs, incubators, or other entities for grassroots innovation. There is no single approach that works best. For example, some retailers prefer to go the purchasing alliance route while others find that scale deals can generate much bigger benefits. For all retailers, portfolio management and ecosystem building are essential to boosting the odds of long-term success.

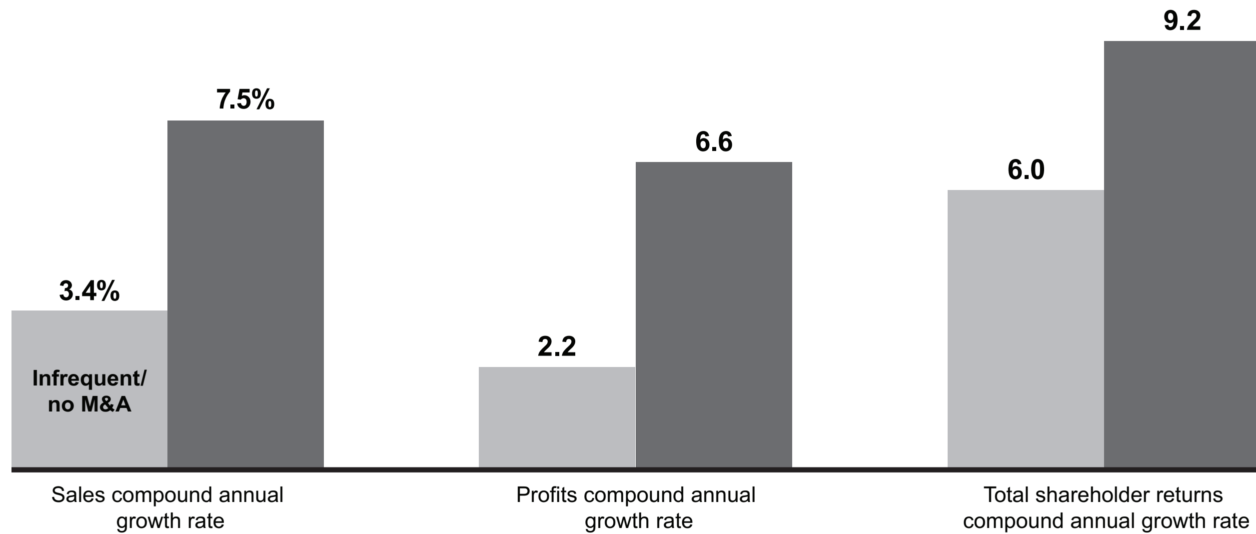
Across all winning strategies in retail, the best players repeat M&A, build an M&A engine, and tailor their M&A capabilities to their M&A agendas.

Serial buyers are more successful. Not only do they deliver stronger shareholder returns, top-line growth, and profit growth but also with each successive deal, they increase the odds for the next M&A success.

Repeat M&A. Serial buyers are more successful. Not only do they deliver stronger shareholder returns, top-line growth, and profit growth but also with each successive deal, they increase the odds for the next M&A success *(see Figure 3.11)*. Again, consider the experience of serial acquirers such as Walmart, Ahold Delhaize, and Costco—all of which were able to respond swiftly to Covid-19 by purchasing delivery companies.

Build an M&A engine. The best acquirers sustain the M&A capability over time. They build a strong M&A culture and a community to support and continuously strengthen it, even in times of lower M&A activity.

Figure 3.11: Frequent scale M&A delivers higher sales, profits, and total shareholder returns



Notes: Cumulative relative deal value is the sum of relative deal size (deal value divided by market capitalization three months prior to announcement) across all deals over 2007–2017; deal size for deals with undisclosed value is estimated using median deal value benchmark, calculated for each sector from disclosed deal values as a percentage of acquirer market capitalization; deals involving partial stake acquisitions, an increase in controlling interest, and remaining interest acquisitions are excluded; multistep deals have been consolidated into a single deal; consortium, intracompany, and property portfolio deals are excluded
Sources: Dealogic; Bain M&A database, 2018 (N=211 companies)

Tailor M&A capabilities to M&A agenda. Winning dealmakers find the right approach for each type of deal, choosing the right mix of scope vs. scale, national vs. more challenging cross-border deals, and buying vs. partnering. The most successful acquirers never assume that their old playbooks will always work. As a start, any retailer needs to ask a series of questions:

- What do we need to own at any cost?
- What capabilities should we be cultivating?
- Which traditional capabilities (supply chain) and new capabilities (digital) will move the needle for us?

Making the Most of Banking's M&A Season

Conditions are prime for banking deals

The banking industry is primed for an upswing in M&A activity. Valuations are dropping, with average price-to-book value decreasing by 35% globally in 2020. Even after gradual consolidation, banking remains a fragmented industry across all key markets, with the top five banks accounting for only 30% of total deposits in the US, 40% in the UK, and 38% in China.

Unlike many other industries, regulators are creating conditions and frameworks that favor consolidation. For example, the European Central Bank recently published guidelines for consolidation in the banking sector.

Finally, there is the impact of Covid-19. Despite government interventions, the economic fallout has caused banks that entered the pandemic in a weaker position than their competitors to weaken even further, widening the rift between the less healthy banks and those that have remained relatively robust despite substantial losses and lower capital ratios. The rift will create opportunities for stronger players to acquire and for weaker players with capital ratio gaps to look into their portfolios for potential businesses to divest. For example, in the US, almost 100 banks with more than $5 billion in assets started the crisis with already low profitability and balance sheet issues, and they will emerge even weaker out of the crisis.

Four trends will define banking M&A in 2021

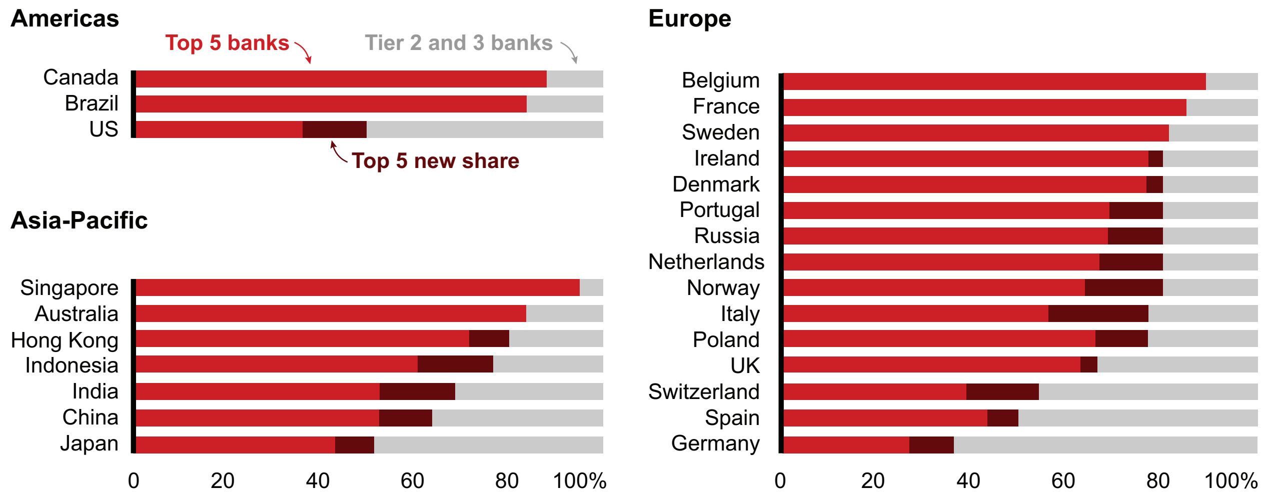
As conditions ripen for M&A, we see four important deal-making trends.

A rise in domestic consolidation: A wave of domestic consolidation is already underway in Europe, with deals such as the more than €4 billion merger between Caixa and Bankia in Spain and the Intesa acquisition of UBI in Italy for around €5 billion. With the nearly $12 billion acquisition of BBVA USA, PNC will further consolidate its position as the fifth-largest bank in the US. Rising costs and regulatory support will spur domestic consolidation that will give rise to local champions. Through acquisitions, we expect the share of the top five banks in total deposits to increase by an average 10 percentage points, from around 48% to approximately 59% *(see Figure 3.12)*.

More divestiture of noncore businesses: As costs mount and scale becomes increasingly important to stay competitive, banks will continue to divest businesses and operations that are noncore. Such divestitures might include businesses such as payments, asset management, and fund administration. Private equity (PE) funds and other financial sponsors will play an active role in restructuring and aggregating these businesses. That's what they did in the payments sector in Europe with the €8 billion acquisition of Nets in the Nordics by PE-invested Italian payment giant Nexi, which itself was created from a bank divestiture.

Figure 3.12: M&A and consolidation are expected to help top 5 banks gain up to 10% share of their respective domestic markets

Deposit shares of countries' top 5 banks



Notes: Average consolidation (nearly 50% current) is calculated using weighted average of top 5 players by deposits; top 3 players assumed to maintain share, and top 4 and 5 expected to achieve proportionate market share, with 80% being maximum consolidation expected among top 5; tier 2 and 3 banks will have to achieve deposit stock at least equivalent to current average in order to survive
Sources: SNL; Capital IQ; CEIC; Bain analysis

Scope deals will deliver needed capabilities or technologies: With some fintechs facing the risk of funding shortages and sellers willing to take advantage of rising high-tech multiples, banks will seize the opportunity to acquire new capabilities or technologies that help them adapt their businesses for a digital future that has been hastened by Covid-19. With its $13 billion acquisition of E*Trade, Morgan Stanley will gain further access to next-generation clients while also capturing digital capabilities.

Cross-border deals might become a reality: Cross-border deals have been in discussion for years but have not yet fully materialized in a banking industry that remains mostly local. The current economic environment and regulators' favorable attitude, specifically Europe's guidelines for capital and accounting frameworks, however, could remove traditional barriers, encouraging cross-border deal activity that builds regional champions.

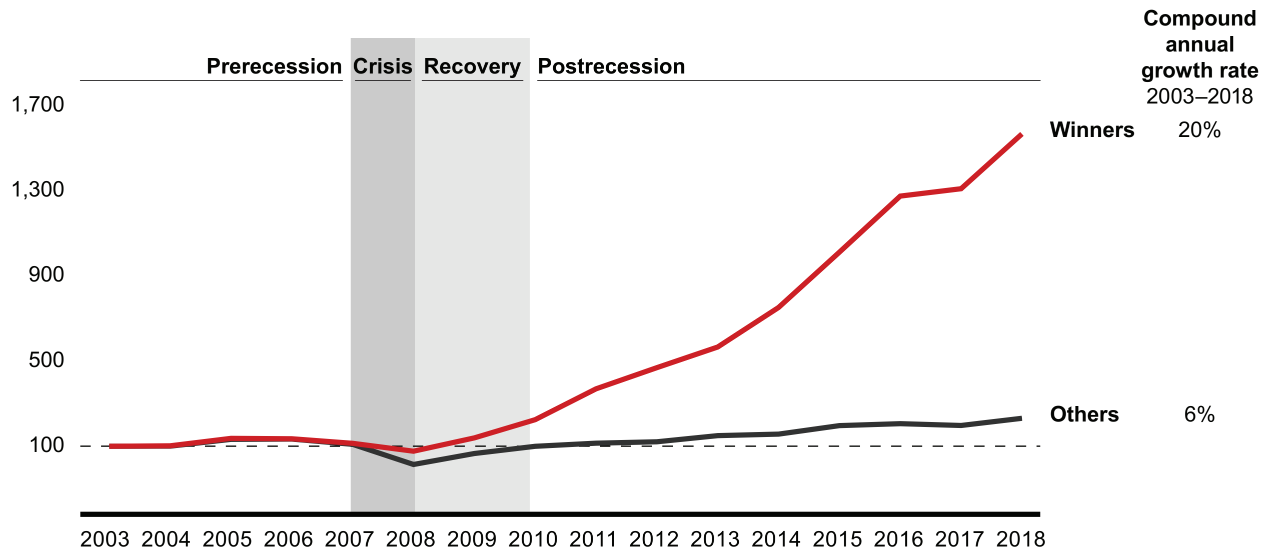
How the best banks will prepare for deals that spur growth and value creation

Over the years, many banks developed strong M&A capabilities for sourcing and screening potential targets, performing due diligence, and integrating acquisitions.

The one area that will differentiate winning banks will be due diligence capabilities in which the best banks will act more and more like professional investors. As for PE funds, winners will be those that

Figure 3.13: Crises offer unique growth opportunities—the 15% of banks that invested in growth during the great financial crisis outperformed their competitors

Nominal earnings before taxes, excluding unusual items (indexed 2003=100)



Notes: Winners defined as top 15% of banks in terms of earnings before taxes, excluding unusual items, growth over 2007–2017; analysis conducted on a sample of 352 banks with winners numbering 52 (15%) and others numbering 300 (85%)
Sources: Capital IQ; Bain analysis

excel at quantifying standalone value and synergies while rigorously assessing all potential impacts of Covid-19, from shifting consumer behavior to the risk of an increase in nonperforming loans.

Recent banking deals such as the Caixa and Bankia merger showed that acquirers will perform a deep assessment of the potential for synergies in revenue, costs, and capital while also thoroughly assessing risk in the current environment.

The current downturn offers a unique growth opportunity. Looking back at the past 12 years, the 15% of banks that invested in growth during the great financial crisis managed to emerge stronger and outpace their competitors *(see Figure 3.13)*. For banks looking ahead and considering the role of M&A in their strategy, the future really starts now.

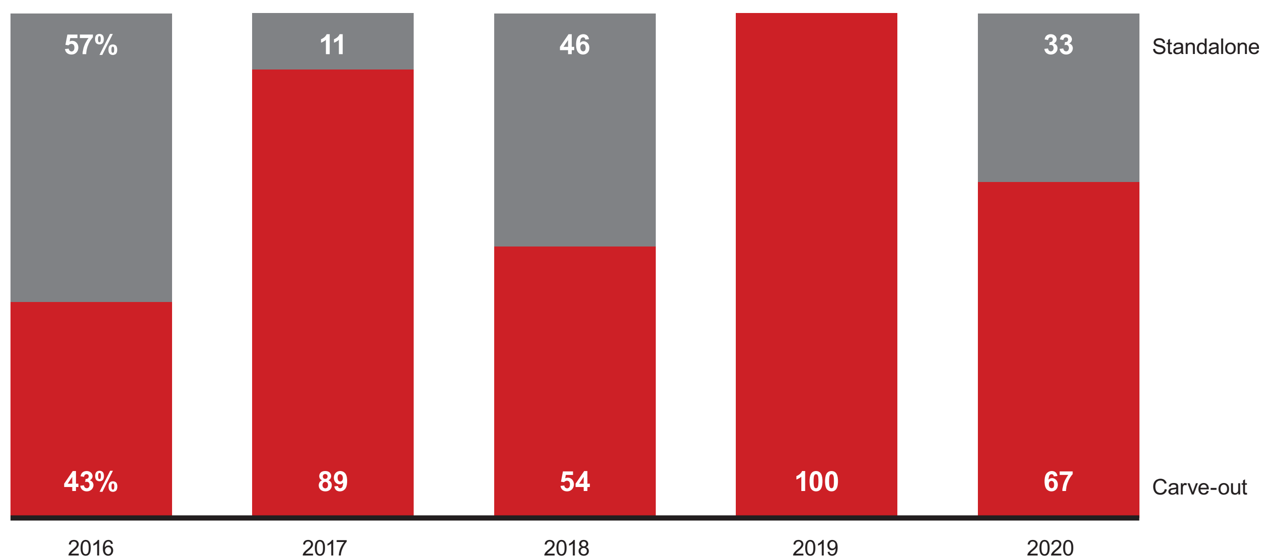
Using M&A to Help Insurers Focus on Their Core

Insurers are streamlining to focus on their cores

The year 2020 continued a multiyear trend in which global insurers are streamlining their businesses by simplifying operations and redefining themselves with a narrower scope and stronger core. Pressure on profit pools from low rates as well as increasingly complex capital requirements have forced them to take a more critical look at the ability of their business units to create sustainable value. Because of the higher demands on management attention and the need for digital investments in the company's core, peripheral businesses seem less and less attractive. US insurers questioned multiline models that do not provide clear distribution advantages. European insurers, with Solvency II capital/risk diversification benefits protecting multilines, questioned the logic of geographic reach. Increasingly, the answer was to divest. In fact, divestitures have represented the majority of insurance M&A valued at more than $1 billion over the past five years *(see Figure 3.14)*.

Examples of this drive for focus are everywhere. For example, Aviva sold its Singapore business and Italy's Aviva Vita. AXA also simplified its footprint and continued its shift to focusing on property and casualty, following the 2018 purchase of XL. Building on the 2019 separation of its US business, AXA completed the sale of its Poland, Czech Republic, and Slovakia businesses to Uniqa in October

Figure 3.14: 70% of insurance deals greater than $1 billion over the past five years were divestitures



Source: Bain M&A deal database, 2020

2020. That same month, AIG announced the separation of its life and retirement business to create a simpler corporate structure and establish two independent market-leading companies.

Streamlining also can deliver a more straightforward entity that is better positioned for sale. For example, UK mutual insurer LV= divested its auto and home businesses to Allianz in 2019, and a year later, announced their sale to Bain Capital (see "Private Equity Investors' Appetite for Insurance").

Buyers are doubling down to strengthen their positions

For buyers, "more of the same" helped strengthen the core and provided opportunities for meaningful cost synergies.

The largest insurance deal in 2020, Aon's $30 billion bid for Willis Towers Watson, is perhaps the best illustration of doubling down on what you know—it will create the world's largest broker and generate $800 million in cost savings. If the deal clears regulatory scrutiny, mandated divestitures will likely create attractive opportunities for others to acquire assets.

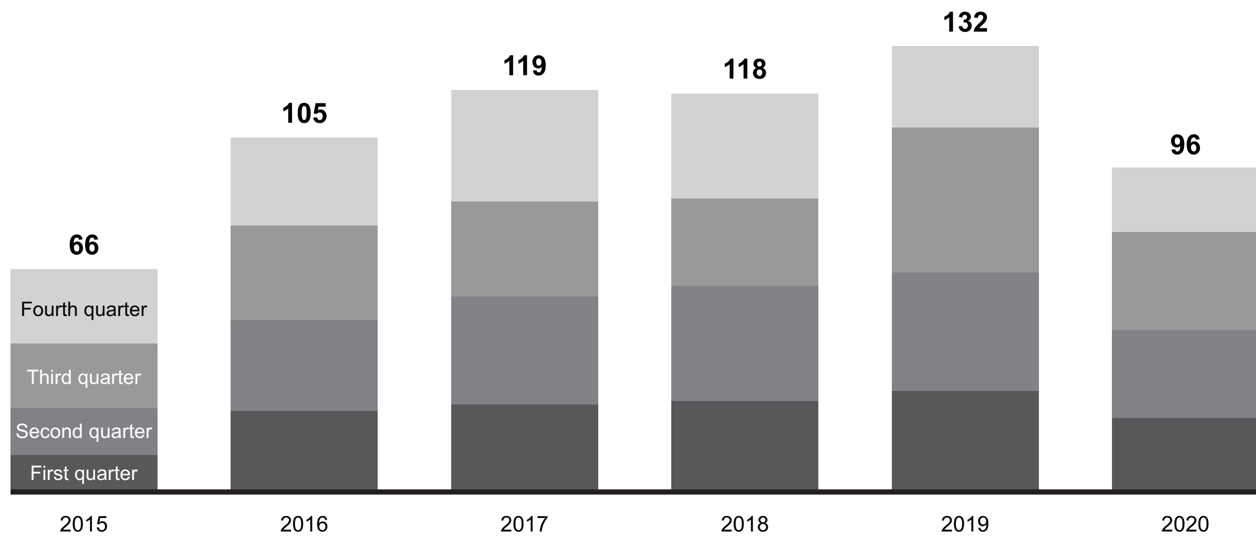
Allstate used its purchase of National General to jump to 10% market share, grow in nonstandard auto insurance, and reinforce its independent agent network. Rival State Farm took a very similar move in nonstandard auto insurance with its first ever acquisition, buying Gainsco. And Farmer's took advantage of MetLife's property and casualty divestiture to become the No. 6 US auto carrier and No. 3 US home carrier.

Investments and partnerships are helping insurers test the waters for new capabilities

While most insurers are staying close to home with their inorganic moves, they must build new capabilities to keep pace in a rapidly evolving industry. As there is still considerable uncertainty about how emerging capabilities will mature, many established insurers have chosen to access new capabilities with investments and partnerships. While private technology investments by incumbent insurers slowed in 2020 from their recent pace *(see Figure 3.15)*, we expect a rebound in 2021 as insurers build for the future. The continued market enthusiasm for insurtechs (see "Record Pace for Insurtechs") suggests that there is no shortage of innovative ideas and capabilities that could benefit insurers.

At the same time, partnerships for new capabilities flourished. For example, AIA's partnership with ZhongAn subsidiary ZA Tech enables the insurer to build new digital solutions faster and attract new customers. Meanwhile, AIA also has engaged in a broad range of investments and partnerships with players in the health and wellness space in 2019 and 2020, including medical case management provider Medix, global data science and healthcare technology company Holmusk, and India's digital healthcare platform Practo. For its part, Prudential Corporation Asia enhanced its Pulse digital health app through a partnership with PAI Health, augmenting capabilities gained from earlier partnerships with remote healthcare provider Babylon Health and personal wellness start-up Tictrac.

Figure 3.15: Insurers continued to invest in insurtechs in 2020, just not as heavily as they did in 2019



Source: CB Insights

Staying on course for 2021 and beyond

We anticipate that legacy insurers will continue their focus on cleaning up and reinforcing their core portfolios over the near term. Peripheral businesses in portfolios will continue to become the topic of exploratory divestiture conversations. This will create attractive acquisition opportunities for companies looking to strengthen their market positions or pursue adjacencies.

Partnerships and investments will continue to be the primary approach for companies pursuing new capabilities. While there is no shortage of good ideas out there, the exuberant levels of investment have made it difficult to sort the wheat from the chaff—and there are still more questions than answers about many emerging approaches.

That said, over time, as insurers become more confident about which capabilities will be most important and in their ability to apply these capabilities at scale, we expect to see increased interest from traditional insurers in owning and advancing proprietary capabilities.

Insurers need to pursue both of these paths—namely, actively strengthening their core businesses while building their conviction about the capabilities that effectively will allow them to compete and win as the industry continues to move faster toward a digital future.

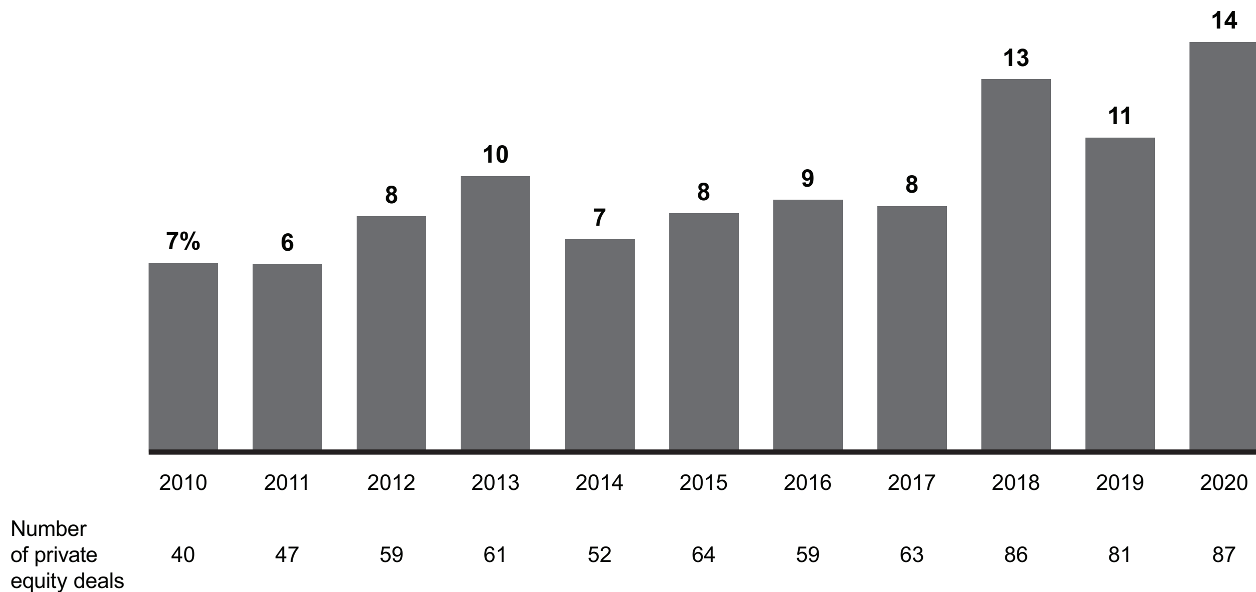
Private Equity Investors' Appetite for Insurance

There seems to be no end to private equity's appetite for insurance companies. Private equity investment accounted for 14% of deal volume in 2020, having more than doubled over the past decade *(see Figure 3.16)*.

In July, KKR announced its deal to acquire Global Atlantic, which, in turn, rounded out 2020 with a series of multibillion-dollar reinsurance transactions with Great American ($5.7 billion) and Unum ($8.5 billion). Carlyle and Hellman & Friedman invested $1 billion to launch reinsurer Vantage Risk, a subsidiary of Vantage Group Holdings. TPG partnered with Singapore Life to take the largest stake in Aviva Singapore as it spun out from its UK parent. In the closing weeks of 2020, LV= announced the sale of its savings and retirement and protection businesses to Bain Capital for more than $700 million. The deal followed Bain Capital's purchase of UK insurer esure for $1.5 billion in 2018.

We expect private equity investors will continue to pursue capital-light businesses such as brokerages and tech providers as well as increase their appetite for runoff and core insurance businesses in which they can apply their investment expertise and their risk appetite, which generally is higher than more traditional players.

Figure 3.16: Private equity continued playing an active role in insurance deals in 2020



Source: Dealogic

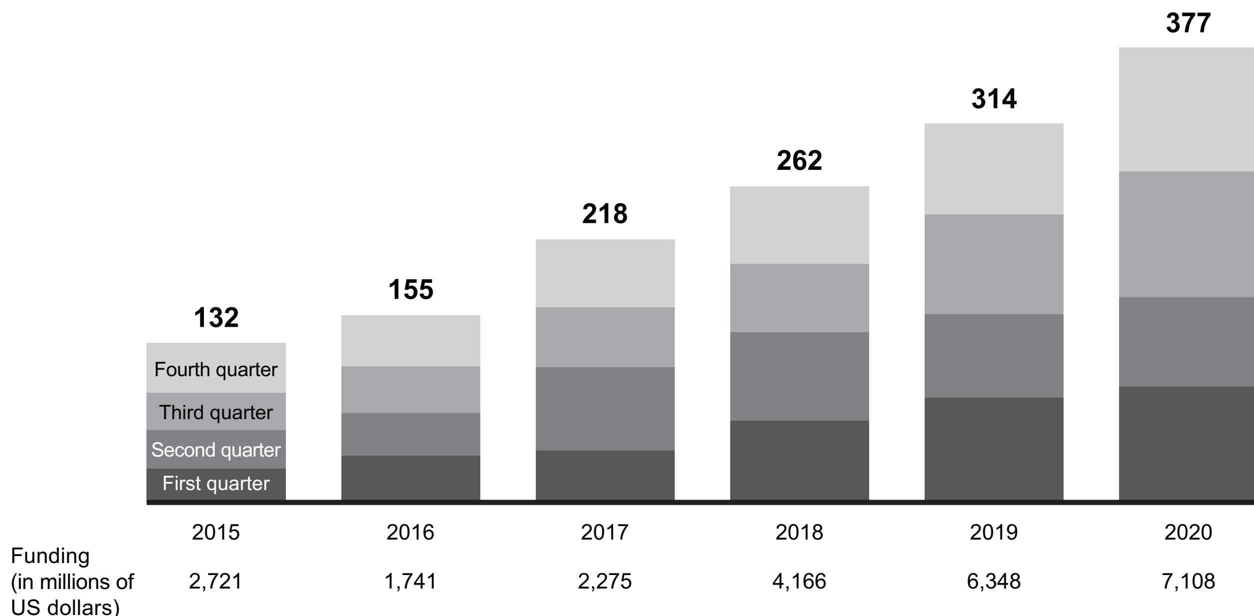
Record Pace for Insurtechs

Insurtechs are continuing to get more attention and funding than ever before from traditional insurers and other investors. Investments totaled more than $7 billion compared with $6.3 billion in 2019 *(see Figure 3.17)*.

The year 2020 saw significant exits. There were the long-rumored IPOs for Lemonade and Root, with valuations to match the hype—Root's IPO valuation of about $7 billion was 14 times its 2019 revenue. Home insurer Hippo followed its June announcement to acquire long-running partner Spinnaker Insurance Company with a July funding round valued at about 15 times revenue, leading to expectations of a 2021 IPO. Meanwhile, Metromile, hot on the heels of a partnership to provide insurance to Ford Motor Company customers in September, announced it would go public via a special purpose acquisition company.

The continued energy and round of substantial exits could spur increased deal activity as insurtechs consolidate to build sufficient size to become self-sustaining—or as traditional players become more certain about the winning capabilities they seek. In the near-term, however, insurtechs pursuing valuations in line with recent standouts may be out of reach to all but the most resolved of incumbents.

Figure 3.17: Despite disruptions, total investments in insurtechs continued at a record pace



Source: CB Insights

How M&A Will Reshape the Asset Management Industry

The asset management industry is at an inflection point.

Traditional public active managers had enjoyed a high-growth, high-margin business until the global financial crisis of 2007–2010, which ushered in an era of lower fees and eroded margins as investors shifted to exchange-traded funds and passive strategies. At the same time, regulations and technology requirements caused asset manager cost bases to creep up while prolonged low interest rates put pressure on large blocks of insurance assets held as fixed-income vehicles.

As all this was happening, competition heated up with new disruptive entrants, especially private equity funds going after large pools of insurance assets, such as KKR's $4 billion deal for Global Atlantic. Meanwhile, the flow of assets under management to megamanagers (that is, those with more than $1 trillion in assets) intensified. Companies such as Vanguard and BlackRock netted more than 50% of all new money in 2020.

Covid-19 has accelerated some of these changes and the challenges facing incumbent asset managers. For example, the continuing low interest rate environment keeps prices and margins depressed while the required technology investments continue to mount. Central bank commitments are boosting equity markets, however, helping to keep asset management an attractive business.

We see five models for success in the years ahead, all of which rely on M&A.

Trillion-dollar managers: Scale matters. The aforementioned megamanagers are well positioned to weather industry challenges. While few can aspire to achieve this position, those in the club reap enormous scale benefits from distribution reach to operations efficiency to funding ever-increasing technology needs. We expect to see more bolt-on M&A as companies take this path to growth. Consider the journey by France's Amundi, which over the past five years has gained scale through bolt-on acquisitions. For example, its 2017 purchase of Pioneer Investments, the asset management subsidiary of Italian bank UniCredit, enabled Amundi to expand its distribution network in Italy, Germany, and Austria, where Pioneer Investments already had an established presence, while consolidating its overlapping investment products to generate significant efficiency and scale benefits. The challenge for asset managers turning to scale M&A will be to sustain their nimbleness and innovation as their organizations become more complex and potentially more bureaucratic.

Scale through consolidation: Midsize traditional active managers will join forces to create efficiencies that will enable them to fund capabilities such as portfolio design and construction; risk/volatility management; and environmental, social, and governance—this is in addition to boosting distribution. Several high-profile consolidation deals took place over the past 12 months—including the Franklin Templeton acquisition of Legg Mason and Morgan Stanley's acquisition of Eaton Vance, outbidding JPMorgan Chase, which publicly stated that it is aggressively looking for M&A opportunities in asset management. Despite the steady flow of M&A activity among midsize asset managers, the field remains fragmented and ripe for continued consolidation.

Cost at scale for midsize asset managers: Over the next three to five years, we expect to see the emergence of ecosystem players (such as State Street, LSE/Refinitiv, Simcorp, and BlackRock) that will provide end-to-end software as a service to asset managers for needs such as data and distribution. The ecosystem approach will enable midsize players to achieve scale cost levels, allowing them to focus on the clients and products with which they can achieve the most value.

Manage and enhance the performance of stable asset pools: Private equity investors and other large funds will continue acquiring insurance blocks, driving higher risk-adjusted returns by expanding the investment capabilities beyond traditional insurance capabilities.

Alpha niche strategy: Some asset managers are divesting businesses that hurt their performance and divert focus away from alpha investments. These companies are shedding commodity asset classes that add no value while streamlining and simplifying operations and critically reorienting to alpha-generating strategies such as private assets and hedges.

As the asset management sector continues to change, companies that choose the right model for success and that hone their M&A capabilities will be those that evolve ahead of the pack.

M&A Delivers Powerhouse Players in Payments

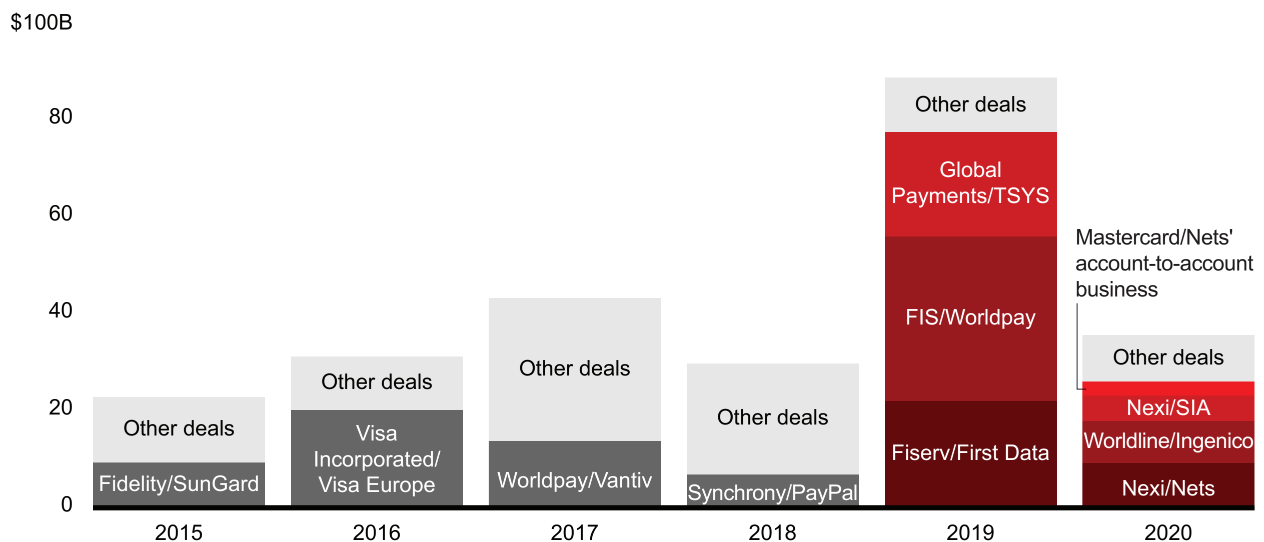
While the Covid-19 pandemic had a big influence on M&A activity in many industries, in payments, deal activity has remained brisk. The proportion of deal value represented by trade buyers has substantially increased, while the proportion of deal value by financial investors has decreased. The sector experienced a wave of scale-driven consolidation; scope M&A has been active as well, with larger firms looking to bolt on new capabilities and products to enhance their core businesses, especially those under price pressure.

The year 2019 introduced the payments megamerger *(see Figure 3.18)*. While the number of deals stayed roughly the same, the average deal size rose fourfold, from $400 million in 2015 to around $1.6 billion in 2019, for the highest annual aggregate payments sector deal value in history. While there were some large deals in 2020, such as the Worldline and Ingenico merger as well as the announced Nexi deals for SIA and Nets, the total deal value was not enough to match the strength of 2019.

Bulking up regional scale, and generating synergies

The three biggest mergers of 2019 (Fiserv and First Data, FIS and Worldpay, Global Payments and TSYS) were all rooted in a combination of bulking up regional scale (and to some extent global scale) and joining forces to generate synergies—both scale-driven cost synergies and capability- or cross-sell–driven revenue opportunities.

Figure 3.18: 2019 was an outlier year; deal values have fallen back in 2020



Sources: Dealogic; CB Insights; Bain Private Equity Group database for North America and Europe, the Middle East, and Africa; Bain analysis

This trend continued in 2020, most notably with the Worldline and Ingenico merger, which not only created Europe's largest payments provider but also gave birth to a potential new global player in the e-commerce space, although it will take time to build a global presence from the constituent parts of the new group.

Regional consolidation is in full swing, especially in Europe. The announced deals to merge Italian payments leader Nexi with SIA in Italy and Nets in the Nordics pave the way for a handful of large players to lead on a regional basis. Nets itself had already been pursuing this approach via its 2018 deal with Concardis in Germany.

The consolidation activity in payments is more mergers than acquisitions. In many cases, the buyer and seller are of similar size, with both players grouping together to achieve unsurpassed scale and substantial cost advantages. The rise of a new class of mega-acquirer with sufficient buying power to exert influence over other parts of the cards ecosystem raises challenges for suppliers to the business.

The need to diversify pure play payments firms

Large players are diversifying through scope acquisitions, with Visa and Mastercard leading the charge by expanding into a wide range of adjacent services (security, cross-border business to business, open banking, and alternative rail payments). These transactions tend to be small in value, but they signal a need to expand services beyond traditional core businesses that are under significant price pressure. For example, expanding into security services was the impetus behind Visa's purchase of Verifi as well as Mastercard's acquisition of Ethoca.

Consolidation will continue as smaller players find it harder to compete

We expect to see the wave of consolidation continue over the next three to five years as the underlying catalysts are likely to remain unchanged and as subscale players find it increasingly difficult to compete on their own. This will be especially relevant in a post–Covid-19 world. For example, the pandemic has hastened the adoption of e-commerce. As a long-term result, smaller point-of-sale–focused acquirers with a shrinking share of overall consumer payments will feel pressure to consolidate.

Using M&A to Evolve Financial Market Infrastructure

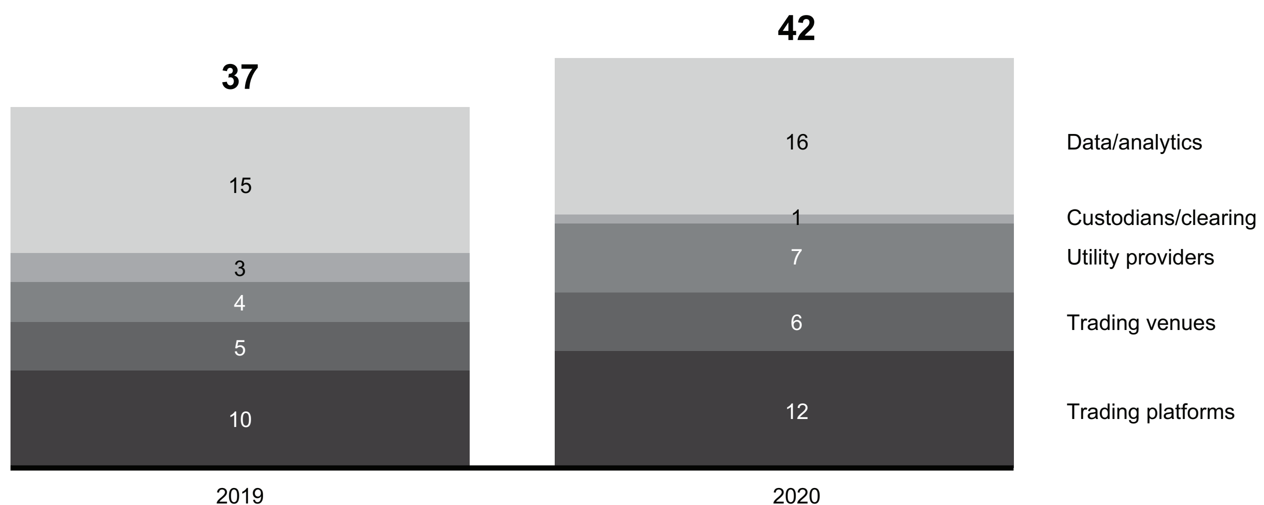
M&A helps financial market infrastructure operators improve markets

Despite the many economic uncertainties introduced by the Covid-19 pandemic, M&A has maintained its steady pace since March across the global financial markets infrastructure (FMI) industry, with much of the focus on data and analytics company acquisitions *(see Figure 3.19)*.

The FMI ecosystem generally includes trading venues, clearing entities, custodians, central securities depositories, registries, data providers, software providers, and utilities. As alternative assets become available, as technology creates a path for digital assets–focused venues and redefines trade and post-trade activities, and as utility providers increase the scope of their service and share of wallet to compete with traditional FMIs, this ecosystem has been taking new shape and opening up M&A opportunities.

Traditionally, success in exchanges required a focus on scalability and liquidity. These changes in market structure and dynamics made it equally important to evolve along with the FMI ecosystem and benefit from its flexibility. Infrastructure players acknowledge the need to address client pain points by delivering new services in a strategically integrated platform that creates efficiency for the market and participants as well as less risk and better controls. These companies buy and build out

Figure 3.19: Corporate M&A activity in the financial market infrastructure industry grew in 2020



Notes: Includes deals without reported deal value; transactions filtered to focus on financial market infrastructure players as acquirers; year based on filing/announcement date; does not include credit card payment processing or other payment type companies
Sources: Dealogic; Bain analysis

fast-growing segments of the business such as information services, technology services, and post-trade services. Consider how the London Stock Exchange's recent $27 billion deal for data and analytics company Refinitv will significantly broaden its capabilities in market data. Such deals help exchanges boost their share of nontrading revenue and decrease their earnings volatility.

Overall, the FMI operators generate about 30 to 40 deals each year. Private equity (PE) firms, venture capital, and other financial investors generate even more deals. Some of the strategic FMI operator deals in 2020 were aimed at building scale—sometimes global scale. That was the case with the Cboe purchase of EuroCCP, for example.

Expanding the range of scope deals and players in FMI

M&A has become a highly effective lever for exchanges to advance their long-term strategic agendas across the global FMI industry. The M&A activity illustrates distinct investment themes among different sets of players.

Data providers and analytics players: FMI companies must meet the demand for passive equities, risk management, and trade efficiency, and that's only possible through actionable data. Expanding capabilities in this area was the impetus for Deutsche Börse's acquisition of risk management software provider Axioma.

Trading venues and brokers: With new asset classes, tokenization, new business models, and an accelerating build-up of digital asset propositions globally, FMIs must build and support new trading venues and distribution channels. On the distribution side, that is why FNZ Group, for instance, acquired leading German investment platform company ebase; it's also why Deutsche Börse's Clearstream acquired Zürcher Kantonalbank's Swisscanto Funds Centre and a majority stake in UBS's fund distribution company Fondcenter.

M&A has become a highly effective lever for exchanges to advance their long-term strategic agendas across the global FMI industry. The M&A activity illustrates distinct investment themes among different sets of players.

Trading platform providers: Changes in market structure and the growth of alternative capital requires FMIs to build platforms that efficiently connect investors with their assets. State Street's acquisition of Charles River Development will join Charles River's software-as-a-service capabilities with State Street's extensive front-, middle-, and back-office capabilities. The combination will create an end-to-

end and interoperable buy-side platform, thereby also acknowledging the growing strategic importance of buy-side clients for FMIs regarding the optimization and expansion of their business models.

Given the growing number of attractive opportunities globally, PE investors have systematically started increasing their activity across the entire FMI value chain. For example, Deutsche Börse built a new company by acquiring Axioma, a global provider of cloud-based portfolio and risk management software solutions, and combining it with its existing index businesses (STOXX and DAX) in 2019, with General Atlantic entering into a strategic partnership as a minority investor in the new company. Through this innovative PE-backed transaction, Deutsche Börse and General Atlantic were able to create a fully integrated, leading buy-side intelligence player that will provide products and analytics to meet the growing demand for end-to-end platforms in the global FMI sector.

Changes in market structure and the growth of alternative capital requires FMIs to build platforms that efficiently connect investors with their assets.

The road ahead: Five ways to succeed in FMI deals

As global FMI companies proactively use M&A to leapfrog the competition and fundamentally realign their existing businesses, there are five fundamentals to keep in mind in this growing market.

Screening: With the ecosystem rapidly expanding, FMI acquirers need to improve their screening capabilities to identify the most suitable and attractive targets—for example, which data firms to buy or which software partners to choose for alliances. The key will be to broaden the network constantly to be able to identify and then move on the best targets before they are even on the radar. Many acquirers have set up corporate venture capital units to invest early in promising companies.

Diligence and execution: With expanding competition from all corners of the FMI industry as well as from financial investors, it has never been more important to perform diligence quickly. But given the restrictions necessitated by the Covid-19 pandemic, it also has never been more difficult to do so. In light of these challenging circumstances and because of the growing strategic importance of M&A in the global FMI sector, it even has become usual for companies to close deals valued at greater than $1 billion without physically meeting the target company's senior management throughout the due diligence process. Adding to the degree of difficulty are the traditional challenges of buying in an unfamiliar corner of the industry—for instance, an acquirer of a digital asset platform might need to deal with a lack of financials—and new considerations such as environmental, social, and governance criteria, which are becoming increasingly relevant in deals. As the competition heats up, so does the need to hasten execution.

Integration: Creating value with diversified businesses requires intense attention to integration—using the old scale playbooks will only hurt the chances for success. Exchanges are complex businesses. Acquirers need to ensure that as they add new businesses, they also add seamless interfaces. They need to ensure that top talent stays on board. Acquiring a similar business does not mean that full integration will be simple. For example, companies must adjust product strategy to have a standard way to sell products across geographies. They also need to define an integration approach that gives them uniqueness in the market and find ways to deliver that integration using existing or newly built technology while minimizing the inherent complexity.

Partnering: The best acquirers are the most adept at finding the right partners and crafting partnerships to make critical deals happen. As we mentioned, Deutsche Börse teamed with General Atlantic for its Axioma acquisition. General Atlantic invested around $715 million to finance the acquisition along with Deutsche Börse, which provided its industry expertise through an integration of the firm's index businesses. As many companies are learning, it is not necessary to be a 100% owner to expand into fast-growing new markets or adjacencies, or to add a capability that makes you stronger.

Communication: Communication is key to ensuring that investors understand how an acquisition fits into and advances an overall strategy; it also helps to keep employees motivated during transitions and to ensure that new talent stays on board. Communication is critical for helping ecosystem partners understand your differentiation, your creativity, your ability to create value, as well as to stress the role that a newly acquired asset plays in delivering that value. This was the same challenge faced by software companies as they shifted to a software-as-a-service business model.

Market infrastructure companies need to embed efficiency, stability, and risk controls into the market ecosystem. The next wave of improvements needs to increase cost and capital efficiency and address client pain points through better data and analytics, software, and post-trade processes as well as innovation in new products and services. The challenge and opportunity for market infrastructure players is to integrate these capabilities and businesses quickly. Companies can build things, but a lot of the near-term opportunity is about creating value by acquiring and integrating these capabilities into a more efficient market platform.

In Video, Scale M&A Matters More Than Ever

The coming flurry of media deals for streaming

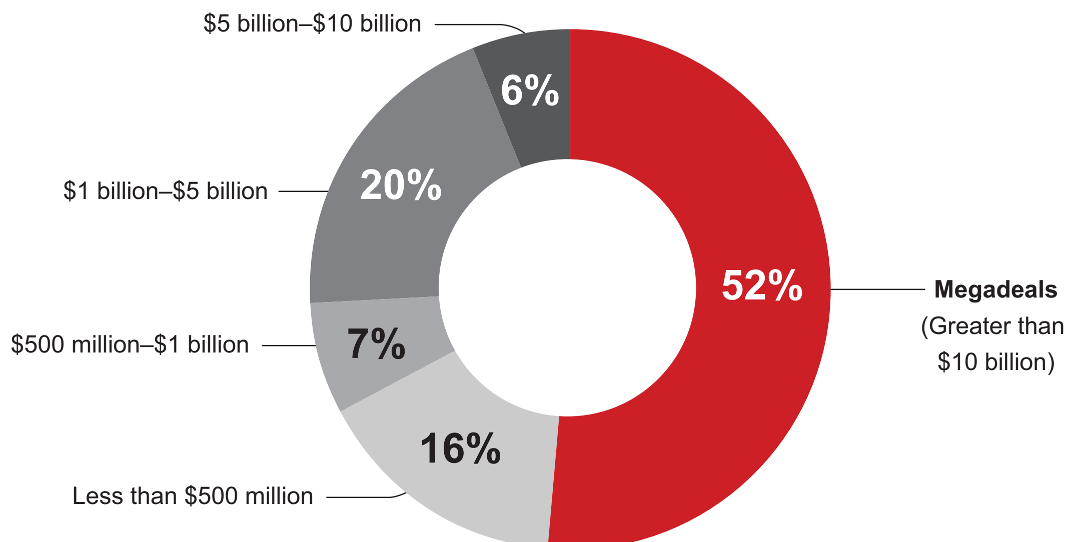
Over the past five years, media M&A activity has centered on a few megadeals, including three of the largest deals in video: AT&T and Time Warner, The Walt Disney Company and Fox, and Viacom and CBS. Megadeals valued at greater than $10 billion have accounted for more than 50% of media M&A during these years. There has been a lull in dealmaking recently as acquirers have paused to digest their recent acquisitions, but we expect a flurry of new deals over the next two to three years as global leaders march on and regional players across the world react *(see Figure 3.20)*.

Media is becoming increasingly global. The rise of streaming has untethered the media business from geographic footprints. In addition, Covid-19 has significantly shortened the runway for traditional forms of media, including TV, by accelerating expected declines. The majority of growth in the media sector will come from video streaming offerings.

Our research suggests that there will be only a few scale winners once the dust settles. Consumers expect to land on three or four paid video streaming subscriptions, and newer services will have higher churn rates. Companies will compete for the title of top streaming service so that they can be included in the core bundle of offerings and secure prime placement on user interfaces. Becoming a

Figure 3.20: Megadeals valued at greater than $10 billion have accounted for the majority of media deals over the past five years

Global strategic media deal value, 2015–2020



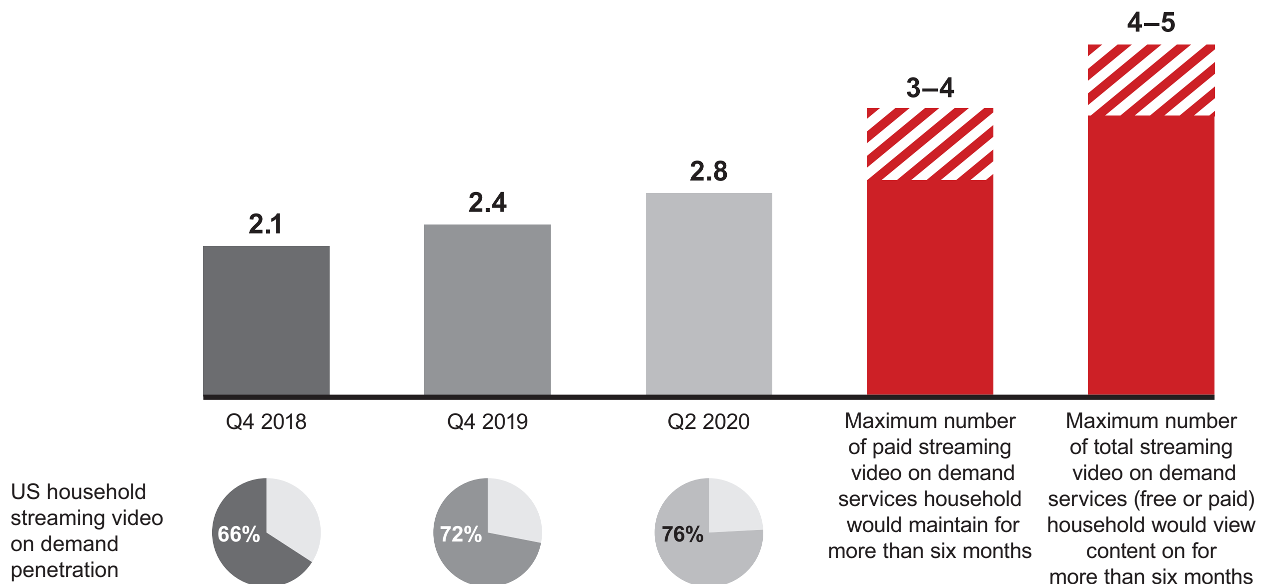
Notes: Strategic deal value reflects deals made by corporate acquirers, not by private equity firms; does not include media deals in which deal value was not disclosed; percentages do not add up to 100% due to rounding
Source: Dealogic

top streaming service means not only having a large existing library but also a sustainable content engine that continues to feed the service. In this land grab phase of streaming, M&A is a clear way to accelerate scale, which is why we believe this will spur a new wave of activity over the next two to three years *(see Figure 3.21)*.

While using M&A to increase scale can help extend the runway of the traditional business for both aggregators and content creators, companies must use any deal as a catalyst to accelerate their shift from a networks-led company to one that is centered on streaming. In addition, the streaming ambition should be global, so assets or capabilities that a target can bring to hasten that global ambition are particularly valuable. In many cases, these would be more scope deals that broaden content, audiences, and capabilities. Examples of assets or capabilities that can accelerate global scale include the following:

- content engines, including both libraries and pure studios (for example, MGM, Lionsgate);
- existing streaming services and their customer bases (both subscription and ad supported);
- enabling technologies (for example, advanced advertising, predictive analytics); and
- video adjacencies (for example, video games, e-commerce).

Figure 3.21: Streaming video grew faster in the first half of 2020, but demand capped at three or four services per household



Sources: Bain OTT Consumer Survey, conducted Q4 2018 (N=10,007); Bain OTT Consumer Survey, conducted Q4 2019 (N=3,435); Bain/Google Streaming Video Consumer Survey, conducted Q2 2020 (N=3,772)

How to get the most out of the deal

Media deals are unique in that creative storytelling is still at the heart of any media business. There should be a focused effort to ensure that key creative talent feels supported throughout the integration and transformation by minimizing the impact of the day-to-day integration on that part of the business. This should also be an opportunity for creative executives to extend their ideas across the newly integrated company with operating models that enable content creation to flow across an enterprise, including making the best of an expanding international footprint. Media companies should also use the moment to look for ways to increase the diversity of their creative voices by elevating talent within the company and by forming new creative partnerships across markets.

Another way to get the most out of the deal is to use the integration to increase the metabolism of change for the entire organization. Media will be in a state of turbulence over the next three to five years, and the organizations that emerge as winners will be able to operate effectively within a constant state of change. Media CEOs should frame the integration as the beginning of a transformational journey, and they should set up the appropriate infrastructure to do that. Some of the most successful integrations started with a robust integration management office that then transitioned into an ongoing transformation office, using the infrastructure to continue pushing transformational initiatives.

Lastly, many of the largest media integrations over the past three years have surpassed the cost synergies originally reported. It is critical to use the integration process as a stimulus for reshaping a company's cost structure to maximize its ability to invest in streaming and other key capabilities such as data and analytics. Standard benchmarks are not aggressive enough for a true transformation of a given organization or function as they only focus on areas of overlap. Focusing solely on those overlap areas and Day 1 continuity would be a missed opportunity to prepare for the future, especially when companies can use the cover of an integration as a catalyst.

2020 Breathes New Life into Telecom M&A

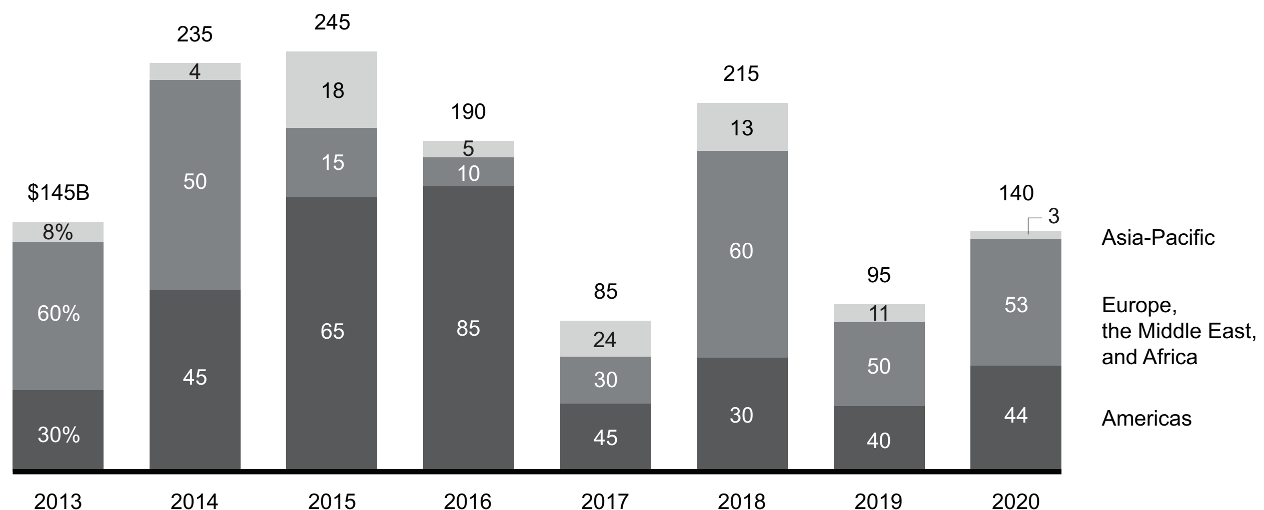
Just when you thought telecom M&A was pronounced dead, it is bouncing back to life, revived in part by Covid-19.

While other industries struggled, telecommunications fared well in 2020. Locked-down, working-from-home, schooling-from-home, and entertaining-at-home consumers relied more heavily than ever on digital connectivity, content, and services. It is true that carriers lost roaming revenue as travel declined and that they continue to anticipate the longer-term impact from broader economic strains such as unemployment and insolvencies, yet overall telecom industry performance was robust in 2020—robust enough to reignite M&A activity and to generate interest by private equity (PE) investors after about a decade of shunning the industry.

Following a steep drop in M&A activity in 2019, deal value grew by around 50% in 2020 *(see Figure 3.22)*. The industry also witnessed a changing deal mix. Despite fears that further industry consolidation (even with relatively few opportunities) would be quashed by regulators, scale M&A rebounded. In-country scope deals, which represented more than 20% of all telecom M&A deals from 2013 to 2019, took a back seat in 2020 as the capabilities typically acquired in such deals were considered less desirable in the pandemic economy. Meanwhile, infrastructure M&A, a third type of deal that's unique

Figure 3.22: After a sharp drop in 2019, telecom M&A activity grew by nearly 50% year over year in 2020

Total telecom deal value, globally
Split by region (in billions of US dollars)



Note: Deal value based on announcement year, excludes financial transactions
Sources: Dealogic; Bain analysis

to telecommunications, continued apace as companies sought to monetize infrastructure assets that command three to four times the valuation multiples of the integrated telecom operators themselves.

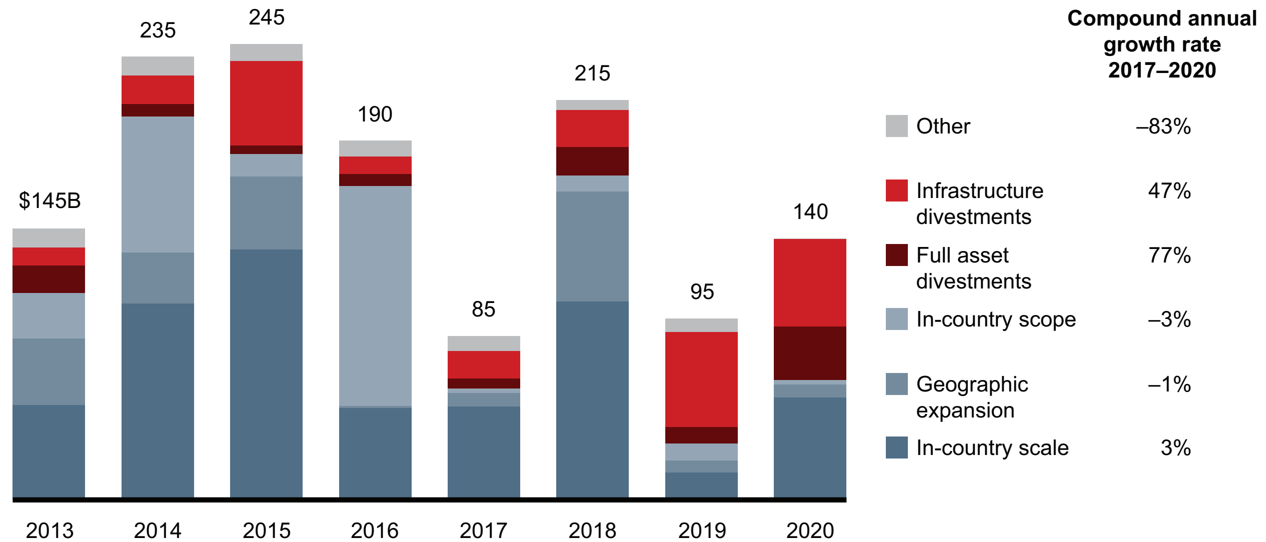
Beyond the pandemic, two main drivers fueled M&A engines for scale deals in 2020. First, in May, the European Court of Justice sent a big signal to the telecom industry when it annulled a decision by a European Commission competition authority to block mobile operators O2 and Three from merging in a $13.5 billion deal. The ruling found that the 2016 decision had failed to prove that such a merger would damage competition, opening the door for companies to revisit scale deals. Second, as governments throughout the world push to support 5G and fiber development, many markets still offer mobile-mobile and fixed-mobile consolidation options, with deals that provide opportunities for outsized cost synergies and improvements in industry structure and capital returns. The scale M&A comeback in 2020 included Virgin Media's joint venture with Telefonica's mobile company O2 UK in a deal valued by the companies at nearly $39 billion, Liberty Global's surprise more than $7 billion acquisition of Switzerland's Sunrise Communications to merge with UPC Switzerland, Verizon's announced acquisition of América Móvil's wireless service TracFone for $6.9 billion, and Orange Group's announced acquisition of a majority interest in Telekom Romania from Deutsche Telekom. It is important to note, particularly in Europe, that each completed scale deal reduces the number of companies available for others to make such deals in the future.

While scale M&A is gaining traction, the same cannot be said for scope deals. Before the pandemic hit, many telcos made (mostly small) acquisitions to gain new capabilities or to enter an adjacent market by adding new offerings, such as media services to consumers or security services to business customers. Covid-19 rendered many such deals superfluous. That said, telcos did announce some scope deals in 2020 to support the work-from-home environment. Also, in the months ahead, cash-rich telecom companies will seize the opportunity to selectively acquire assets that will support remote capabilities, such as collaboration services, cybersecurity, and remote health monitoring.

Meanwhile, infrastructure M&A, which has gained more importance in recent years, continues to ramp up across mobile, fixed, and data center infrastructures *(see Figure 3.23)*. Spinning off high-valuation infrastructure assets allows companies to bring in new investors who are interested in the more predictable cash flows of infrastructure units and who create synergies from better infrastructure utilization. As they face dwindling options for profitable growth in a mature industry, telcos can use infrastructure deals to finance much-needed network upgrades with fiber, 5G, and mobile edge cloud. We expect more active network sharing, separation, and the creation of new assets for this deal type. Our outlook is also backed by our M&A practitioners' survey, in which 31% of telecom executive respondents said that they expect deal multiples to grow over the next 12 months compared with only 18% who believe they will decline. This contrasts with 26% and 23%, respectively, across all executives surveyed.

A final big trend in 2020: Telcos' steady performance during the pandemic has been noticed by private equity, which had largely ignored the industry during its decade of consolidation. This includes an increase in public-to-private (P2P) deals, such as the acquisition of Spanish telco Masmovil by Providence, Cinven, and KKR; the deal for Altice Europe by its controlling shareholder Patrick Drahi; and the

Figure 3.23: Asset divestment and infrastructure deals have experienced strong growth over the past three years



Note: Deal value based on announcement year, excludes financial transactions
Sources: Dealogic; Bain analysis

acquisition of listed Polish operator Play by iliad. These deals reflect the different P2P flavors in which private investors or their investment vehicles go after listed telecom operators. In our view, P2P deals will continue for as long as private telecom valuations remain significantly higher than public company valuations. They will also remain popular where there are challengers with growth and opportunity for margin expansion (by moving a wholesale-based business onto its own infrastructure, for example). In our survey of M&A practitioners, 30% of telecom executives expected the P2P trend to accelerate, with only 10% expecting it to slow down.

Challenges for scale, scope, and infrastructure deals

But the revival of telecom M&A has also introduced challenges. With increasingly fewer scale deal opportunities, companies need to be proactive. First movers will have the advantage. Scale acquirers also will be required to preemptively (and creatively) prepare for potential divestments and other regulation-mandated remedies. Telecom companies that do not pursue scale M&A risk either missing the final round of industry consolidation or finding themselves to be another company's attractive acquisition target.

A different set of challenges exist for companies engaging in scope M&A. Scope deals are typically much smaller than scale deals, generate lower synergies, and cost more, particularly with deal multiples remaining stubbornly high. In addition to concerns about achieving the required revenue synergies,

executives need to worry about retaining talent, maintaining standalone momentum, and leveraging the acquired capabilities into their core businesses. Unlike their counterparts in other industries, telecom executives seem to grapple less frequently with the best way to integrate smaller assets into their existing portfolios. In our survey of M&A practitioners, more than 90% of telecom executives stated that they have done such "string of pearls" acquisitions, and almost 90% even believed that such deal activity is set to increase—despite scope deal volumes being muted in 2020 during the Covid-19 pandemic. This optimism was reflected in the fact that close to 70% of telecom executives reported that such deals were either successful or highly successful. They cited retention of critical talent and enablement of functional capability sharing as the two most important success factors.

And while infrastructure deals promise high valuations and cash proceeds, they also require carve-outs as well as changes to the expenditure (capital and operating) profile and the steering logic of operators. Perhaps more important, they require both a strategy and mindset shift in which a telco's infrastructure is no longer the source of competitive advantage and differentiation.

Finally, the rise of P2P bids and the return of PE owners such as EQT and Digital Colony to the telecom industry should signal a warning to telcos: They will need to manage much more ruthlessly for performance and learn how to act more like a private company that isn't required to report quarterly progress to public markets.

Bain's continuing research on M&A has consistently demonstrated that frequent acquirers outperform across industries and that the most successful acquirers build M&A capabilities for a repeatable model. To win with scale deals, telecom companies will need to update their strategies on the M&A chessboard, striving to be first movers. Scope deal success will require companies to refresh their M&A screening, among other capabilities. To make the most of infrastructure M&A, the best companies will assess their existing and planned infrastructure assets for deal opportunities. Meanwhile, to take advantage of the renewed interest by private equity, all telcos should track private investor interest in their businesses.

If anything, 2021 is the year for telcos to tune in to the new opportunities around them and tune up their M&A strategies.

Methodology

About deal classification—scale and scope deals

To understand the nature of M&A activity, we first identified the top 250 strategic deals for each year (top 131 strategic deals for 2020 year-to-date until September, since the analysis was concluded in October). From the initial list of deals with values greater than $1 billion, as reported by Dealogic, we excluded nonstrategic deals. These include asset or property acquisitions, financial investments, internal reorganizations, and minority stake acquisitions.

We then classified the strategic deals into scale or scope deals based on our proprietary framework applied consistently across the years. The proprietary framework uses the stated strategic rationale by the acquirer at the time of announcement to identify the key elements of the deal thesis. Based on these elements, the deals were categorized as scale or scope deals.

Scale deals are intended to strengthen market leadership and lower cost position through benefits of scale, such as cost synergies. Scope deals are intended to accelerate top-line growth by entering or expanding into faster-growing market segments, or by bringing in new capabilities. In reality, some deals are a blend of both scale and scope; however, the vast majority lean toward one or the other *(see Exhibit A)*.

Exhibit A: About the methodology

Source: Bain & Company

About the 2020 M&A practitioners' survey

In partnership with the Gerson Lehrman Group, we conducted a survey of 291 M&A practitioners. The survey ran in November 2020 in the US, UK, Germany, France, China, Australia, and Japan. Survey participants belonged to companies with greater than $100 million in annual revenue, and they held senior executive roles in the capacity of chief financial officer, senior vice president/vice president/director of M&A, or head of strategy/business development.

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