



cutting through complexity™

KPMG GLOBAL SURVEY

# A new dawn: good deals in challenging times

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“If we had a clear integration plan then we would have seen the benefits quicker.”

**(UK, Electronics, software & services, Vice President)**

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“We had problems due to the time of the acquisition. The economy was strong when we completed the deal but then took a dive shortly after which meant that the deal was not as successful as we had originally hoped”

**(US, Food, drink and consumer goods, Finance Controller)**

# Introduction

This is the sixth global survey that KPMG has commissioned to examine M&A deals, the way they are managed and the value they represent. Since our first, which looked at transactions completed in 1997 – 1998, we have tracked deal trends and success rates through several economic cycles.

This latest study focuses on acquisitions completed between January 2007 and July 2009. This was a period of transition, which included the final months of the M&A boom in early 2007, the credit crunch in 2008 and the subsequent global recession in 2009.

Many people expected this to be a challenging period for doing successful deals, but we found that the results were actually quite good. For some buyers the recession was an opportunity for them to be successful. In the findings of this survey we have seen:

- An increase in the proportion of deals that create value - 31 percent of deals created value compared with 27 percent in the previous survey.
- A shift towards domestic deals, which have proved to be the most successful. Relatively domestic deals were much more likely to create value - but we do not see that as a sustainable trend.
- Corporates taking advantage of available cash and ‘frothy’ pricing to fight back against the Private Equity (PE) houses who had been dominating competitive auctions in the mid-2000s. Whilst corporates managed to reduce the numbers of poor deals they did, an increasing number of PE houses admitted that they thought their deals destroyed value.
- Fewer PE houses active in the market, leading to softer prices and improved chances of completing deals at prices that allowed value to be created.
- Increased scrutiny of perceived value by stakeholders. Corporates have had to work harder to persuade stakeholders that there is real value to be had from what they are buying.
- Successful deals being done with a focus on delivering growth, rather than reducing costs.

These changes have brought the market back to a roughly equal three way split between deals that have created value, deals that have reduced value, and deals that are value-neutral. This ratio has persisted, with a few variations, since 2000. It has remained through the professionalization of the buy side and the sell side and through periods of economic boom and bust.

It’s reasonable to ask whether this ratio has some structural significance. Does it represent some kind of equilibrium point to which the world economy will return under virtually all circumstances?

There are some trends which might suggest this. For example, as suggested above, the recession which effectively removed PE houses from the market in this period and which put values under pressure, has also reduced the level of competition for acquisitions, which has allowed corporates to be more careful



in their selection of targets and to take the time to avoid overpaying.

Decreased access to credit for potential buyers has increased the difficulty of extracting investment returns by simply divesting at higher multiples than initially paid. This inability to sell at a higher multiple has encouraged existing corporates or PE owners to implement the type of meaningful operational changes which can help materially increase the probability of transaction success.

But based on our research, we are not convinced that all the changes we have seen in 2007-2009 can persist. The focus on domestic deals, for example, is unlikely to be a long term trend, while the high level of scrutiny from stakeholders is a reaction to high levels of uncertainty created by recession. Confidence should return as market conditions improve, and we may see some reduction in stakeholder concerns.

This shouldn't prevent corporates from learning the lessons of these past few years to improve the way they manage acquisitions. We see five key areas in which corporates can increase value from their transactions.

- The first relates to revenue **SYNERGIES** (strategic growth) which banks and external markets find it hard to value. Corporates need to track, analyse and, most importantly, report on their success in delivering revenue synergies, to improve market perception of the value arising from their deals.
- The second is to adopt a new approach to due diligence and planning, moving away from the emphasis on historical analysis and placing more on **FUTURE GROWTH PLANS**. Deals in more recent times have been based on a 'hockey stick' forecast; a performance improvement plan that is half completed, plus expected cost and revenue synergies. This means that the value is all in the future.
- The third is that corporates will need to plan for a shift from local to more **MULTINATIONAL** deals. Certainly, for the mature Western economies, emerging and high growth markets are already proving to be more attractive to acquirers wanting to deliver their growth agenda.
- The fourth is a long-term area for improvement. We found once again that there is work to be done in management of **'PEOPLE'** issues. These are still a low priority on the due diligence list

despite the critical impact they can have on the success of a deal. Managers are still not focusing on areas that have regularly been singled-out as key post-deal challenges, particularly cultural alignment.

- Finally, frequent acquirers can increase the repeatability of delivering better transaction performance by institutionalizing transaction processes and tools to learn from and build upon their experiences.

The benefits of a successful acquisition are evident. Our analysis showed that among those deals that created value, 10 percent were able to improve shareholder value by over 40 percent. At a time of recession and retrenchment, that is an impressive achievement; but does it mark a new dawn in delivering successful deals? We believe that with the right attention to planning, preparation, and the information needs of the market, this is a level of performance that could be achievable by many more.

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...acquirers were reacting against the inherent complexity, uncertainty and greater risk of cross-border deals. In an increasingly globalized market, this can only be a temporary phase...

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# Trends Over Time

In the 12 years that KPMG firms have been surveying the global M&A market, we have tracked the interaction of two important trends. One has been the underlying economic circumstances which have created the opportunities and impetus for businesses to acquire. The second has been the development of a more professional approach to M&A.

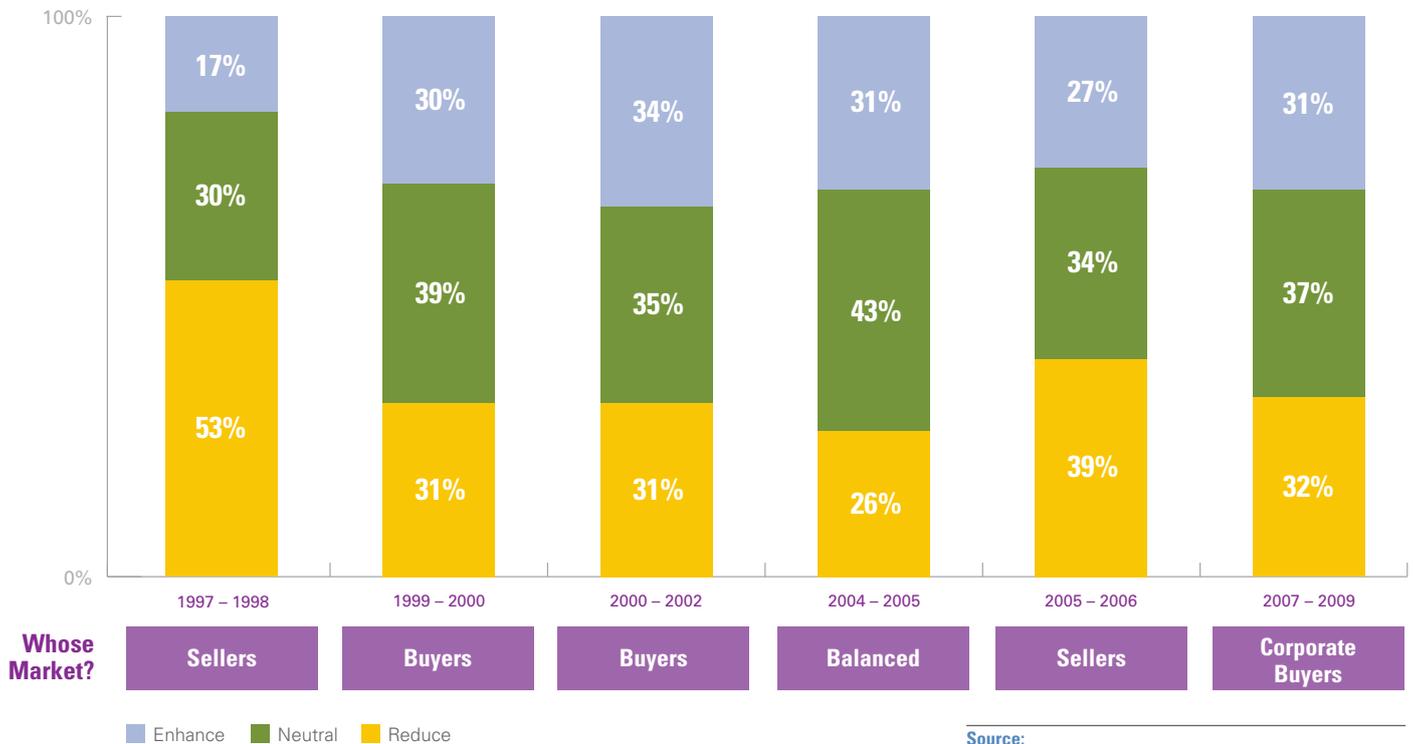
This approach appeared first on the buy side, which contributed to the rising trend of value enhancement from 1997 to 2002, and then on the sell side, accounting for the shift in the balance of the proportion of deals that enhanced value as sellers found ways to improve their returns on the sale. A key characteristic of 2007-2009 was the transition from 'boom to bust'. During 2005-2006 there was 'deal heat' in the market which drove up prices and lowered the proportion of deals which created value. Record M&A activity continued into 2007, but it gave way in the summer of that year to the first signs of a deep international recession. It would be reasonable to expect that the proportion of value-enhancing deals would fall, under pressure both from sellers well-experienced in getting the best prices

for their assets, and from the general economic slow-down. But in fact, it appears that the economic 'boom to bust' had relatively little effect on the long-term trend.

To explain this, we need to look closely at the dynamics of the M&A market. Much of the heat in the pre-2007 market was generated by the heavy involvement of PE houses in competitive auctions. But as economic circumstances changed, PE activity declined rapidly.

At the start of the period, during the boom, corporates were unwilling to take part in PE-driven auctions. As the downturn emerged and gathered pace, corporates were more and more cautious in the deals they were prepared to do. They pulled back from deals during 2007 that they

## Tracking trends in M&A value enhancement over the past 12 years



**Source:** KPMG International. The transition between who is dominating the market between sellers and buyers has evolved since 2000.

might have completed a year earlier, and abandoned competitive auctions early when pricing got too ‘frothy’.

The result was a corporate buyer’s market. Those deals that were done were more likely to create value because companies were more aware of the price of overpaying. Corporate managers were much more careful both in the deals they took on and the way they executed them.

Given the uncertain economic climate, corporates knew that in the cold light of day, once a deal was completed they would be under particularly close scrutiny from shareholders and the market. They had to be able to show that the deal was executed well, for the right reasons, and for the right price.

This period also marked a new resurgence in building greater professionalism into the deal process. Executive teams and boards built stronger and experienced internal deal teams, and were more willing to approve assistance from outside.

The result was an increase in the proportion of deals enhancing value, from 27 percent in 2005-2006 to 31 percent in 2007-2009.

One consequence of this new caution has been an increase in the number of deals done within one country suggesting that acquirers were reacting against the inherent complexity, uncertainty and greater risk of cross-border deals.

In an increasingly globalized market, this can only be a temporary phase, and we are confident that major corporates in low growth mature western markets will have to look again at cross-border deals involving emerging high growth markets in order to meet their growth agendas.

**Looking at the longer term trends, could this signal a return to a more balanced market?**

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...we are still seeing a great deal of attention paid to the cost element of transactions...

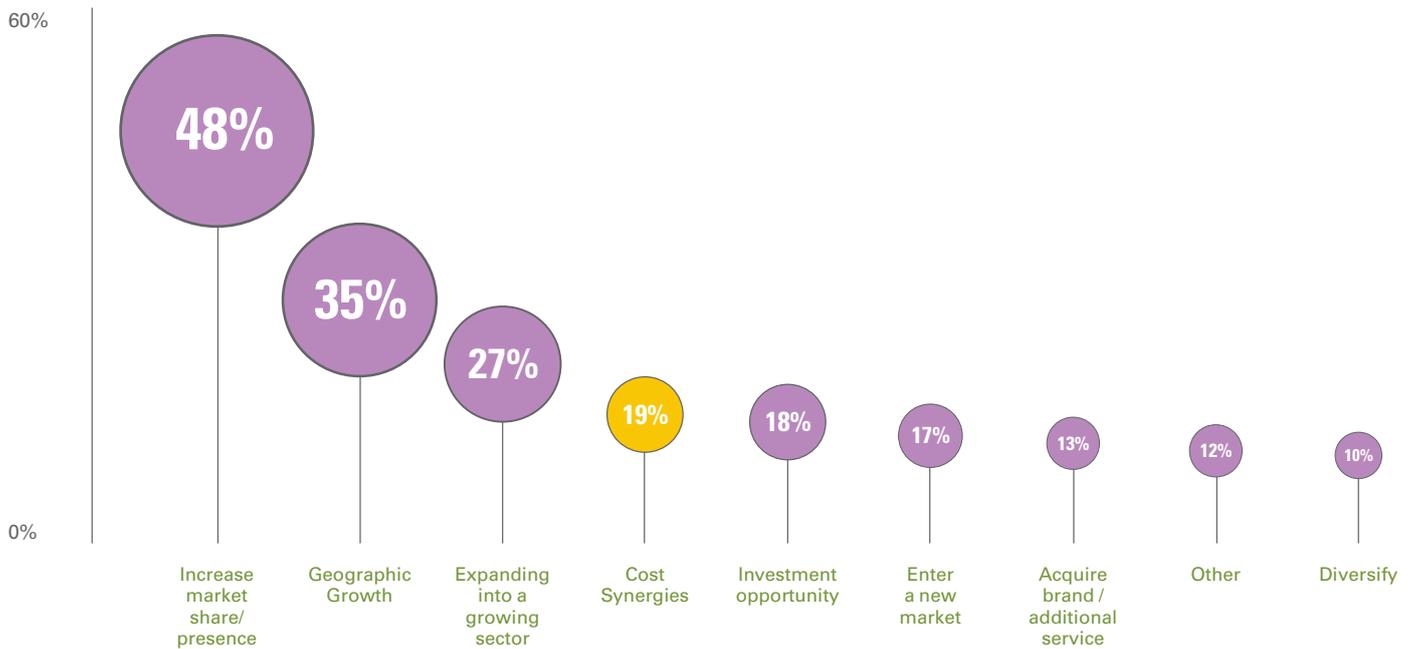
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# Deals done for growth

For many of the companies in this survey, the main driver for doing deals was **growth**. Their responses showed very clearly that they had come through the cost-reduction phase and were looking for opportunities to develop new markets, increase market share, and **boost revenues**.

Despite this when we come to look at what due diligence is performed, then **strategic** diligence in support of a growth agenda, is too low on the list with less than half the respondents undertaking **strategic diligence**.

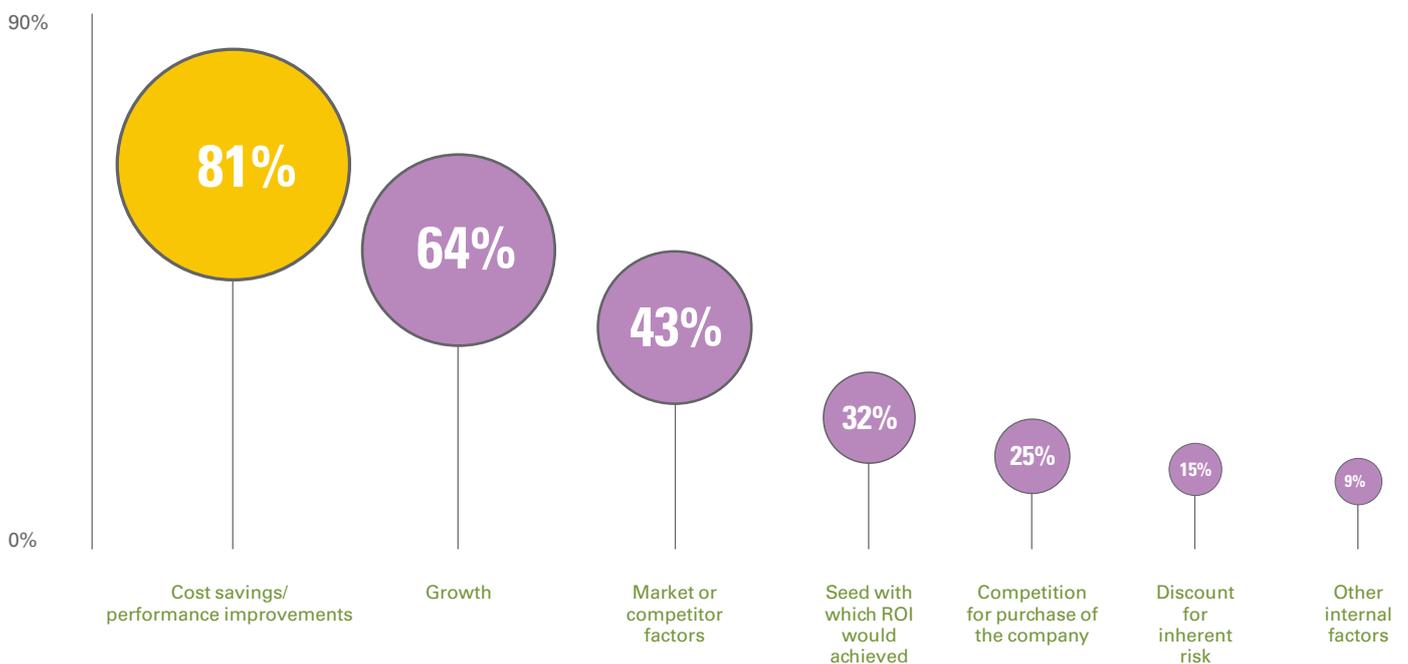
## What was the rationale behind the acquisition?



**Source:**  
KPMG International. Growth leads, but cost factors remain important in price calculations.

However this focus on growth is not so clear cut when it comes to pricing deals. Results from the survey confirm that growth is the major driver, but we are still seeing a great deal of attention paid to the cost element of transactions. This is, no doubt, because of the perceived bankability of cost savings rather than predictions of future growth.

## Aspects factored into determining the price to be paid



**Source:**  
KPMG International. Corporate priorities focus on growth.

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Corporates are sceptical of putting revenue in their pricing models... but ten years ago the same view was taken of cost synergies.

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# Price calculations still not taking revenue synergies into account

Markets tend to react with scepticism to suggestions that revenue synergies should be included as important value drivers in acquisitions. These synergies are often therefore given a low priority in the calculations of value created by a deal. Because of this corporates also become sceptical of putting revenue in their pricing models.

But ten years ago the same view was taken of cost synergies. This was a glaring omission then, and it contributed to a distorted view of the true value of many deals. Now we see markets undervaluing revenue synergies, in the belief that cost synergies are easier to identify and report on, and are therefore more important in pricing transactions in spite of overall rationale for the deal.

Being under increased scrutiny themselves, banks are often reluctant to factor in the idea of lending against projections of revenue synergies, despite the fact that they often rely on future revenue improvements to justify their own acquisitions. This presents a clear problem for businesses looking to borrow to fund growth.

This reluctance to recognise revenue synergies needs to be addressed, by encouraging a shift in the mindset of the markets. We believe that corporates can help this process by improving the tracking and reporting of revenue synergies.

To provide greater confidence in synergies of both types, buyers are increasingly recognizing the importance of building detailed operational execution plans around them. A benchmark driven synergy estimate may be the best a buyer can do in early deal phases when access to operational data is limited, but a synergy only becomes "real" when validated from the bottom up.





“It’s important to do a lot of planning to recognize the synergies and to know how to implement them. We didn’t carry out enough planning and at the end of the day we had to resell it because things didn’t work out.”

(Germany, Building, construction and real estate, Manager)

# Not enough work on synergies pre-completion, not enough reporting post-deal

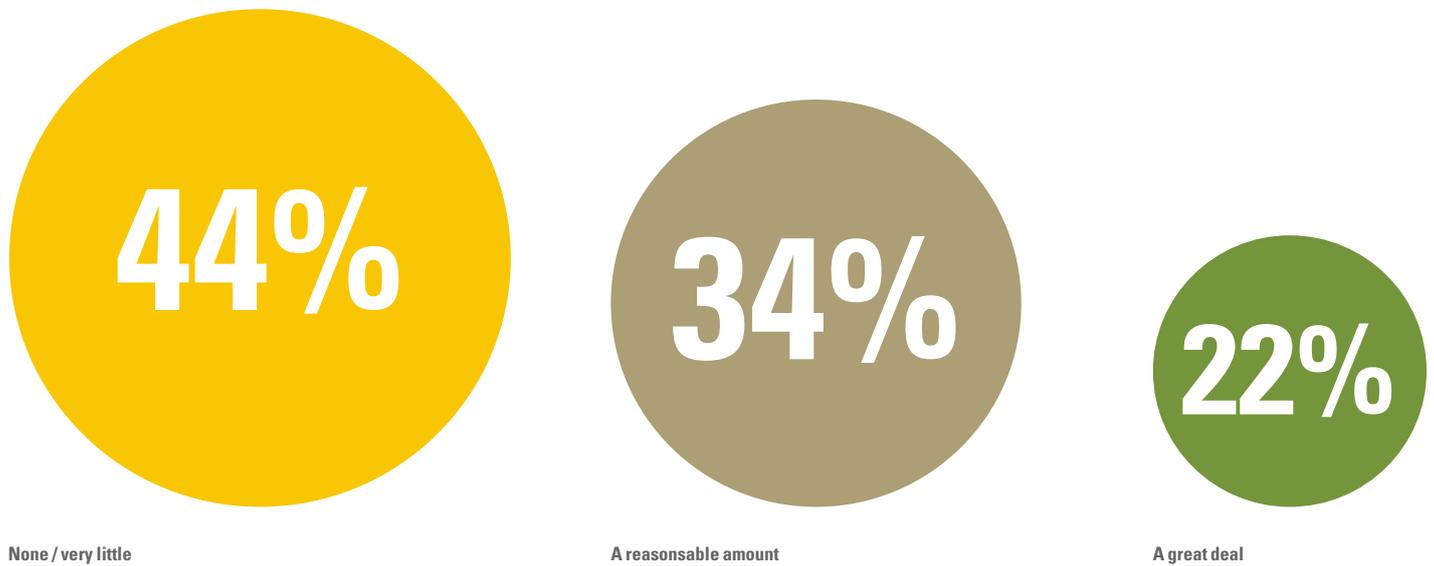
Despite the importance placed on achieving synergies and factoring genuine cost savings into the purchase price, we were surprised to find that the percentage of corporates spending time investigating the potential synergies remains relatively low. Nearly half of respondents to our survey said they did little or none at all.

We also found that reporting on revenue synergies in the post-deal period is relatively rare, which suggests that markets are not being given all the information they need to form an accurate view on whether or not a deal has created value for the acquirer.

At the very least, there may be a gap between the terms on which a business is measuring the value that an acquisition has generated, and those on which the markets are measuring value.

It does raise the interesting possibility that if acquirers are able and willing to refocus their efforts on informing the banks and external markets of the true value of revenue synergies, the proportion of deals that are seen to be value enhancing could rise significantly.

How much synergy analysis was performed prior to completion?



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Source:  
KPMG International. Synergy analysis a low priority.

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Reporting on revenue synergies in the post-deal period is relatively rare.

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It is possible that for the Asia-Pacific markets, it is working differently from the rest of the world, resulting in deals that either succeed or fail, with little in between.

# Regional variations

## Europe and America

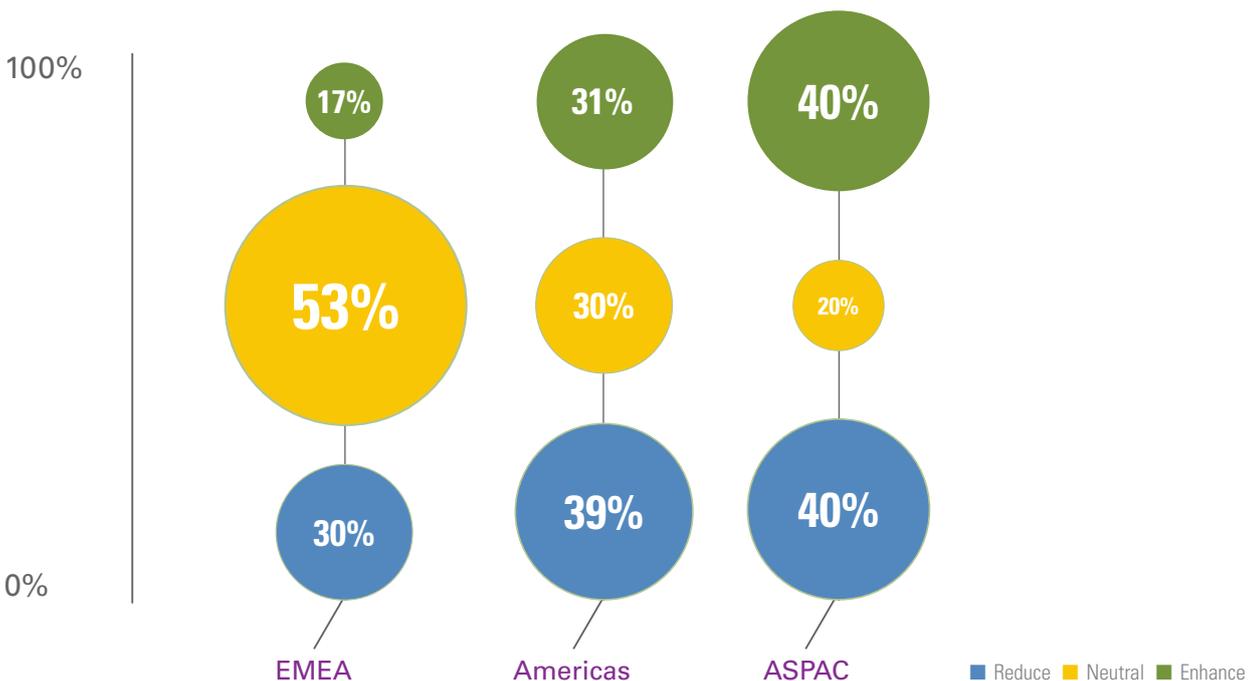
At a regional level, this new mood of caution produced a clear variation in results. European markets have become balanced between buyer and seller. The Americas continue to show clear delineation between 'winners' and 'losers', while ASPAC findings imply a binary chance of deals being successful or destroying value – again its win or lose.

Looking ahead, there are already signs that this mood of caution may not last very much longer. In the European zone, retrenchment is giving way to a new confidence, and there are signs of renewed cross border deal activity, much of that into emerging markets.

A recently released study of M&A plans among companies in the US reflected a similar mood (*KPMG in the US*)

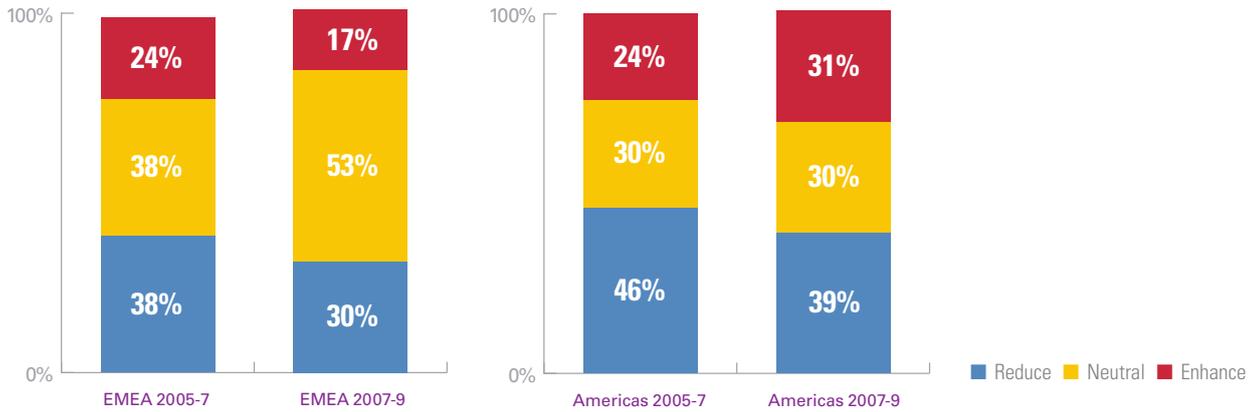
*Knowledge@Wharton survey, Confidence grows for M&A in 2011, February 2011.* Wharton professor Saikat Chaudhuri commented that during an economic crisis, M&A is used more for survival than growth. "Now, as we are coming out of the crisis," he said, "companies don't want to miss new opportunities. Leaders want to extend their lead."

## Regional variations in value enhancement of deals done in 2007-2009



Source:  
KPMG International. Have deals enhanced value? Clear regional variation in results from deals done in 2007-2009.

### Tracking trends in M&A value enhancement



**Source:**  
KPMG International. Caution in Europe has increased neutral deals. In the Americas, a savvy seller set has made the market more 'hit and miss'.

### Asia Pacific

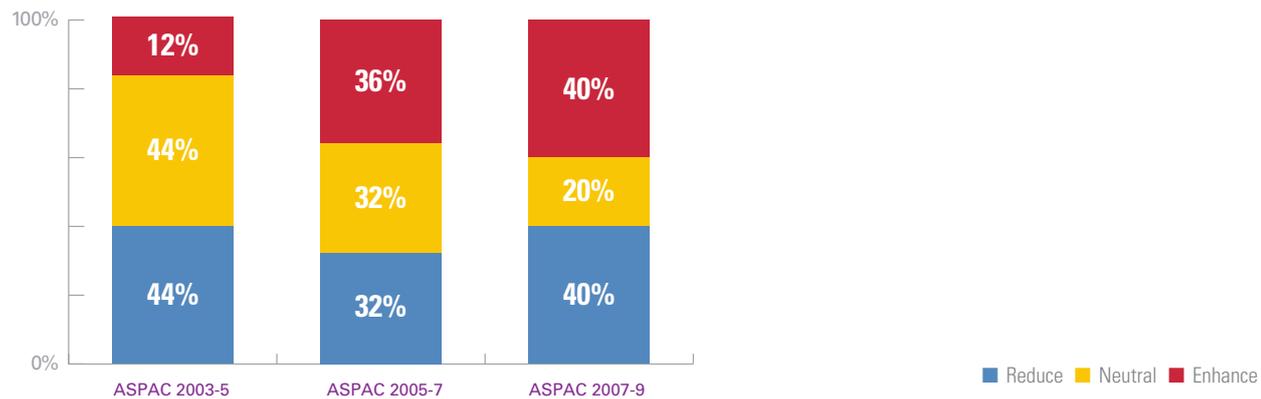
In earlier surveys, we have traced the rapid development of the Asia Pacific M&A market. The proportion of revenue-enhancing deals tripled from 2003-5 to 2005-7, and we said that Asia-Pacific markets seemed to be catching up

rapidly with those of Europe and the Americas in terms of professionalism and sophistication.

The days of acquirers utilizing what may be decades of greater deal experience to maintain a stronger negotiating position

over less seasoned counterparties is also coming to an end. Companies new to M&A are rapidly recognizing they can level the playing field by securing equivalent (if not greater) experience through hiring outside advisors.

### Tracking trends in M&A value enhancement



**Source:**  
KPMG International. Some progress in Asia-Pacific but failure rates rising.

The professionalization of M&A is not necessarily a smooth process, it is possible that for the Asia-Pacific markets, it is working differently from the rest of the world, resulting in deals that either succeed or fail, with little in between.

On the success side we see deals being done for growth across borders where the acquirer has no existing presence.

It's fair to assume that integration challenges will be a lot lower if there's nothing there to integrate. The focus then turns to the process of taking control and of course, to issues of people and culture.

Conversely, the high failure rates, which compare with those we saw in 2003 – 2005, can be explained through challenges of pricing in a high growth market.

Businesses are placing a lot of emphasis on future growth and future value, but, as we have seen in other markets, there is gap in market perception of what is driving value. Businesses are not factoring revenue growth into their transaction pricing, or proving to the external market the value of growth forecasts.

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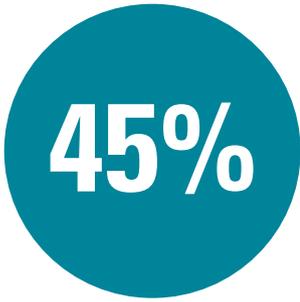
...respondents were clear about the value of revenue synergies in delivering post-deal value...

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# When it comes to delivering value: Revenue drives the West

Respondents to our survey were clear about the value of revenue synergies in delivering post-deal value. In the mature markets of Europe and the US there is a higher reliance on delivering value from revenue as more deals are being done for growth. In ASPAC there remains a higher proportion of value sought from cost synergies as businesses continue to consolidate.

To what extent was the overall value delivered by revenue/cost synergies?



Cost synergies



Revenue synergies



ASPAC (31)



Average value of the deal delivered by cost synergies

Average value of the deal delivered by revenue synergies



EMEA (74)



Americas (57)



...there remains a higher proportion of value sought from cost synergies as businesses continue to consolidate.



“A [merger] is like a relationship,  
you have to overcome your  
differences.”

**(Germany, Communications  
and Media, CFO)**

# HR and people

In the twelve years that KPMG firms have been conducting this survey HR and cultural issues have always been a major concern for acquirers.

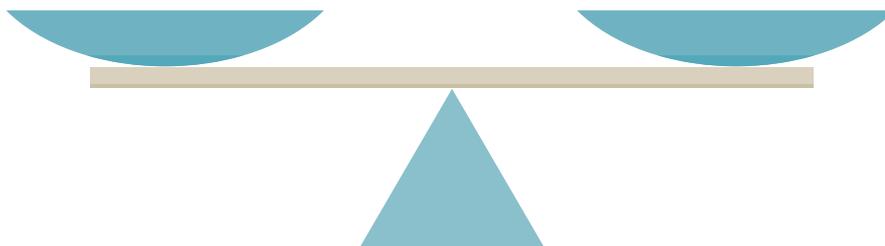
In KPMG’s 1999 Global M&A survey “Unlocking shareholder value: the keys to success” reported on six ‘keys’ which successful companies use to unlock value from their deals; three ‘hard’ factors which impact on value realization and three activities which address the ‘soft’ people and cultural issues.

## Hard Keys

- Synergy evaluation
- Integration project planning
- Due diligence

## Soft Keys

- Management team selection
- Cross border cultural issues addressed
- Communication internally and externally

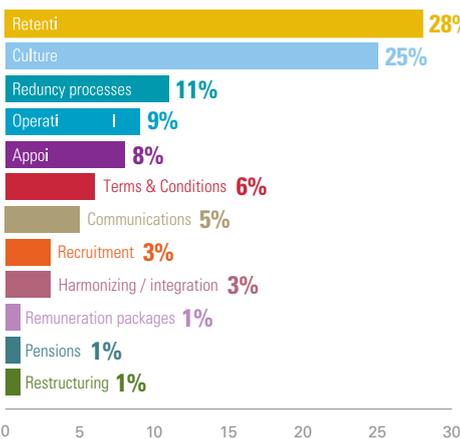




“We dealt with differences by using council and communication – the rationale was explained.”

**(India, Pharmaceuticals,  
Finance Director)**

### What were the top 3 people issues?



Source: KPMG International. Keeping the right people is a constant problem.

The results in the 1999 survey found that corporates who paid attention to the soft factors relating to a transaction were 26 percent more likely to have a successful deal, but that less than 10 percent of respondents focused on all of the soft keys.

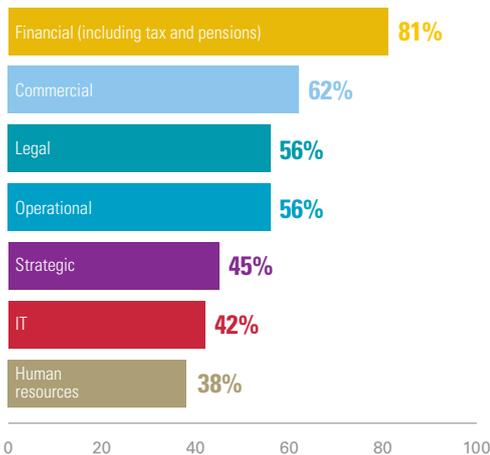
In our current survey the same ‘soft’ factors are still prevalent and yet the Corporates surveyed are still not giving them the focus they warrant.

Retention is still a key issue which has appeared regularly in past surveys. The approach to dealing with this problem has varied over time, with simple time-based bonuses taking precedence in one period, followed by more complex, targeted incentive and reward schemes in the next.

Remuneration seems to be less of an issue this time, possibly due to the effects of recession meaning people can’t just walk into another job.

In general, we have found that if people do remain in their roles post-deal driven by a lack of alternative, they will ultimately find ways of making the deal work. It is important for employers to develop retention strategies that get people to stay long enough to make a deal a success.

### What type of due diligence did you do?



Source: KPMG International. HR still a low priority.

But despite the well-documented impact of cultural issues on the success of cross-border deals, due diligence on HR-related matters was still a low priority among acquirers in the period under study. Many businesses continue to focus on the relatively less important aspects of HR due diligence, spending more time on terms and conditions than they do on managing culture and communications.

Management of cultural issues was an area which we had hoped would feature more strongly in corporate priorities, given

the general acceptance of the importance of these matters in making deals succeed. This is one of the most researched and commented upon areas of M&A yet it remains low on the list of issues to be managed. The corporates who can crack this issue will give themselves a much higher chance of doing successful deals.

Our report stated in 1999 “it’s the people who implement the mechanics of value extraction” and this still holds true today – the people and cultural issues should not be left to chance.



“We would spend more time in doing the diligence because we would then understand more about the target company.”

(India, Building, construction and real estate, M&A director)

# What would you do differently?

In each of our studies, when we ask acquiring managers what they would do differently next time, the three themes that recur are:

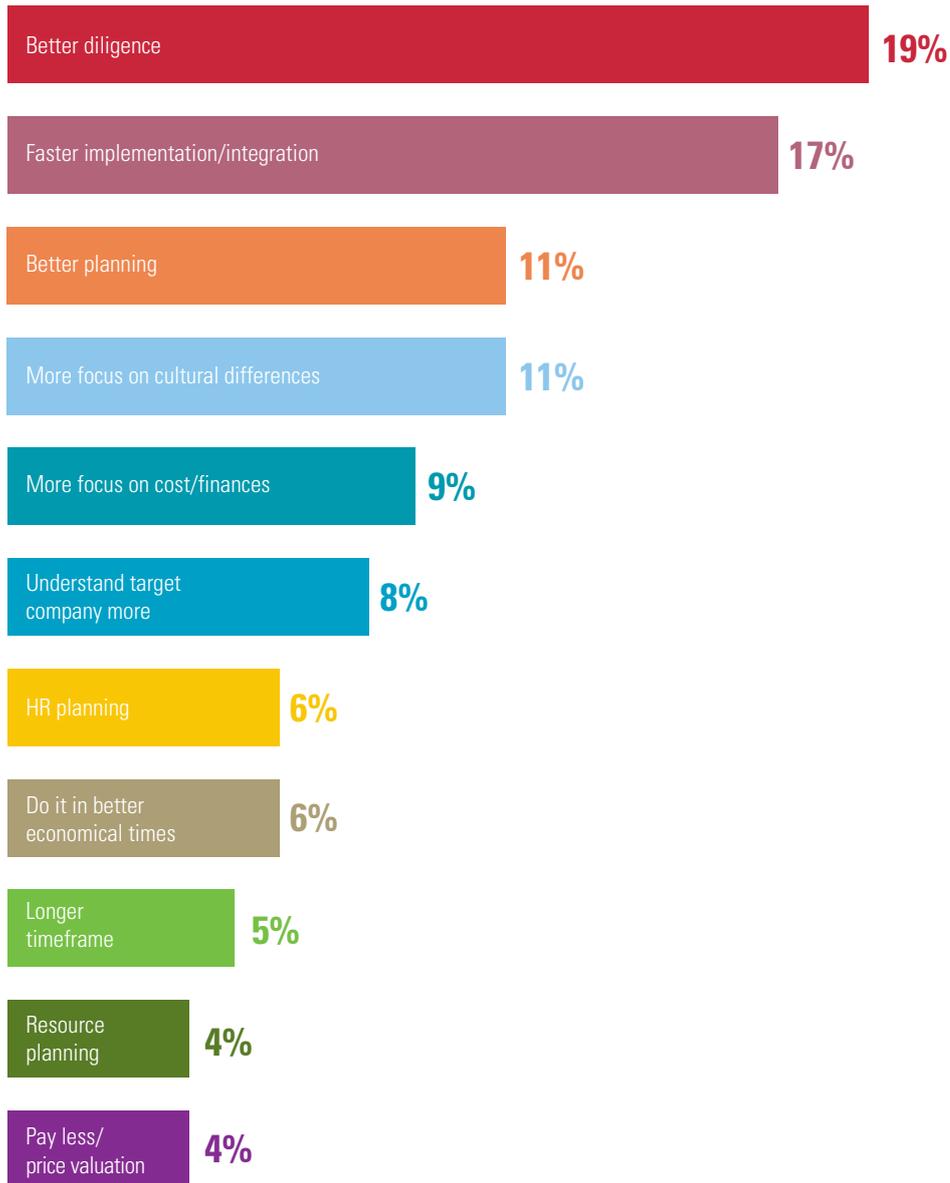
- Better due diligence and planning
- Faster implementation / integration
- More attention to HR and cultural matters



“We would integrate the businesses quicker and dispose of redundant assets faster.”

(US, Food, drink and consumer goods, Finance director)

## What might you do differently in your next deal?



**Source:**  
KPMG International. Better planning and attention to HR  
are themes that run through our surveys.

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We believe there is significant additional value to be gained from acquisitions if markets can be persuaded that expected revenue synergies are real and deliverable.

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# Conclusion

Strategic growth remains the dominant driver for doing a deal and market leaders wanting to retain and improve their positions will continue to want to do transactions. As boundaries within regions blur and opportunities for growth in local or near-shore markets diminish, businesses will need to look further afield to meet their growth targets.

To see a shift in the balance between value creation, reduction and neutrality we will need to see the market recognizing the value drivers in deals. In order for the market to accept the future value of businesses, acquirers will need to be prepared to provide evidence and report on where in the business they believe value will be created, to give confidence to the market. We trust we have entered a new dawn where corporates can be successful despite the challenging economy provided they focus on the right things and can prove to the market that they have delivered what they set out to.

That said we believe there is significant additional value to be gained from acquisitions if markets can be persuaded that expected revenue synergies are real and deliverable.

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To see a shift in the balance between value creation, reduction and neutrality we will need to see the market recognising the value drivers in deals.

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## Survey Methodology

KPMG's Transaction Services practice extends its thanks to all the companies and PE firms who have taken the time to participate in this survey.

This is our sixth survey on major global M&A deals. It builds on the 2008 report *All to Play for*. Our objectives were to ascertain the proportion of deals that enhanced shareholder value and understand experiences and processes undertaken by Corporates and PE firms related to post-deal management.

The fieldwork was conducted by Lighthouse Global between March 2010 and September 2010 via telephone interviews. The 162 Corporate participants were taken from a global sample of companies who had conducted deals worth over US\$75 million between 2007 and 2009.

Further research was conducted using share price information supplied by Evaluateserve on the top 500 deals of a sample of over 3500 using the same criteria as above. Each deal was categorized as having enhanced, reduced or left shareholder value unaffected. For each deal, a relative measure of change in acquiring company share price was taken at key intervals during a two-year period. This period ranged from one year pre-deal announcement to one year post-deal announcement. This share price information was then compared with the overall trend in the relevant industry segment. To preserve the confidentiality and anonymity of survey respondents (*and in accordance with standard market research guidelines*) analysis of the survey findings was carried out by Lighthouse Global and not by KPMG International or KPMG member firms

**Dan Tiemann**

**Global Head of Transaction Services**

KPMG in the US

**T:** +1 312 665 3599

**E:** dantiemann@kpmg.com

**John Kelly**

**Global Head of Integration & EMA**

**Head of Transaction Services**

KPMG in the UK

**T:** +44 (0) 207 694 3528

**E:** john.kelly@kpmg.co.uk

**Rob Vanderwerf**

**Transaction Services Principal**

KPMG in the US

**T:** +1 949 885 5580

**E:** rvanderwerf@kpmg.com

**Roberta Carter**

**Integration Partner**

KPMG in the UK

**T:** +44 20 7311 4190

**E:** roberta.carter@KPMG.co.uk

**Warren Phillips**

**ASPAC Head of Transaction Services**

KPMG in China

**T:** +852 2140 2809

**E:** warren.phillips@kpmg.com

**Dominic Orchard**

**Head of China Integration**

**& Separation Advisory**

KPMG in China

**T:** +852 2140 2262

**E:** dominic.orchard@kpmg.com

**Steve Miller**

**Head of US Integration**

KPMG in the US

**T:** +1 713 319 3461

**E:** stevenmiller@kpmg.com

**Hannah Twist**

**Integration Director**

KPMG in the UK

**T:** +44 20 7311 8287

**E:** hannah.twist@kpmg.co.uk

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