

# Corporate development strategy

## Thriving in your business ecosystem



Deloitte's corporate development survey, fifth edition

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# The continuing evolution of corporate development

**T**HE recent surge in M&A activity means that corporate development teams are working harder than ever. The catch is that hard work may not be enough. To create successful transactions, today's deal environment demands new levels of creativity and forward thinking from corporate development professionals. Whether the question is where to find targets, how to structure terms, or when and what to communicate with shareholders about a transaction, one sure answer is that what worked yesterday may need to evolve and adapt to an increasingly fast-paced and ever-evolving environment to succeed tomorrow.

As we explore in this report, innovation has become a core need for just about any company in any industry. A large majority—nearly two-thirds—of the 357 corporate development professionals who responded to our survey are being tapped to help fill this need. The path to succeeding in this mission starts with challenging some sacrosanct concepts embedded in traditional corporate development processes. Instead of thinking about corporate development as filling gaps in a product portfolio or geography, for instance, it may be time to break free from conventional organizational charts and look at the enterprise as a dynamic platform of valuable assets, where the objective is to consider a variety of transaction alternatives and business partners, some outside traditional industry

norms, that can be grown and monetized in different ways, with different combinations of partners or transactions. Rather than pass on an early-stage asset because it doesn't fit standard transaction profiles, consider for example, creating a strategic option by incorporating it as a partnership or as a venture-capital type of investment. Conventional approaches to stimulate deal flow may not be adequate to create the types of opportunities that will leverage the value of the business platform and create competitive separation. And when it comes

to negotiating, the mind-set of winning and walking away is quickly becoming passé, as the benefits of long-term partnerships with founders and specialists become clearer.

In parallel with internal challenges to innovate, corporate development professionals should also rethink how to handle the rising tide of external pressure from increasingly activist shareholders: not just activist hedge funds but shareholders of all stripes who are increasingly inclined to express their views and preferences about the strategic direction of businesses they invest in and the businesses' performance. As headlines suggest, and our survey respondents confirm, activist agitation is driving higher deal volumes and deal values. Developing constructive dialogues with investors and helping them gain confidence and understand actions corporate executives are taking to help optimize value within the

**Innovation has become a core need for just about any company in any industry.**

corporate portfolio of assets and businesses are becoming nearly as important as creating a robust transaction in the first place.

Push and pull, corporate development is moving into a new era. Yes, the playbooks, technical competencies, repeatable deal disciplines, and governance structures companies have honed over the past few decades are still essential—but these fundamentals are no longer sufficient to seize market opportunities that may be amorphous where new business models or ways of doing things need to be defined. This reflects rapidly evolving ecosystems and the increasing impact of technology on all industries, which is redefining competitor and business partner behavior and the opportunity set. What should be considered now for success is fresh thinking, a high tolerance for disruption, and the ability to be nimble and quick to convert change into an opportunity for value creation.

## Innovation through M&A: Partnering with the business

Our latest corporate development survey reveals that the pursuit of innovation is transforming the M&A world. Roughly two-thirds of corporate development leaders who responded to the survey say their function has become a more important source of innovation over the past two years, and nearly 60 percent of executives believe the volume of innovation-centered deals will increase over the next two years. Industry ecosystems are expanding and nontraditional participants are entering the mix, creating both threats and opportunities. Examples abound, with, for example, technology companies making their mark across a broad range of industries.

Disruption arrives in different forms for each industry. The challenge for corporate development teams now is how to handle the new worlds they face. The skills and technical expertise that teams have honed in past years are still essential, but should now be complemented with a knack for creativity and flexibility. In some cases, it may mean knowing

how to take a hazy business model and shape it into a deal opportunity. This can be particularly daunting for corporate acquirers since new business models can be perceived as risky and can, therefore, discourage established acquirers from their pursuit. Becoming more accomplished risk managers is an increasingly valuable part of the corporate development tool box.

In striving to achieve excellence in a new age, leaders should take stock of the specific new capabilities their teams will need. Most likely, this list will include new methodologies and tools to assess cutting-edge companies that often lack traditional metrics or where business models are yet to be defined and therefore diligence focused on past performance may have limited value in evaluating future performance expectations. New deals will also likely require new subject matter specialization. Similarly, due diligence processes will also have to morph to adapt to the unique risks associated with an innovative transaction. One major risk of acquiring an early-stage business, for example, is that the founding team leaves, taking with it valuable intellectual property.

Corporate development professionals will also have to adapt to new deal structures that may not include the levels of ownership or control they're accustomed to. Innovative firms are often the product of passionate entrepreneurial teams that may stipulate staying involved operationally or financially with their organizations as a main condition of a deal.

Innovation is not easy, but with it may come an unprecedented opportunity for corporate development teams to add value to their enterprises in outstanding ways. Strong leaders who can adapt to the new environment may stand to see great results, and with them, great rewards.

## Deal origination: Making yourself irresistible

Keeping the deal pipeline filled is a perpetual task for acquisitive companies. The challenge, in a nutshell, is how to effectively create

a proprietary deal pipeline without exhausting all of corporate development's resources. A company's own employees are generally expected to be the source of the most successful deals, in executives' opinions, but few can afford to devote enough time to origination and the ongoing development of relationships with potential sellers. Even at the most experienced dealmakers, fewer than half of the deals (45 percent) come through employees.

To stay competitive, many companies are focusing on an alternative, less resource-intensive route to good acquisition candidates: drawing entrepreneurial targets to them. This tactic of building a magnetic corporate reputation attempts to prompt sellers to proactively approach a company rather than a buyer standing in line with the rest of its competitors to get a bite at the apple. Some 60 percent of corporate development leaders say they are investing in being perceived as preferred acquirers.

Developing that kind of positive reputation means companies can create a strong presence in the communities that matter to their industries. From attending conferences to setting up satellite offices, the goal is to build long-term relationships and to be seen as part of the fabric of the community. At the same time, corporate development professionals require new levels of flexibility within deal-making parameters to be nimble when opportunities arise. Teams that are bogged down by corporate bureaucracy may find they lose out on attractive targets that do not want (or need) to conform to standard ways of doing things. Behind the scenes, companies may also want to consider investing in specific technologies to manage their deal pipelines and relationships more efficiently.

Ultimately, corporate development leaders will need to balance deal origination resources between direct and indirect approaches. Those who can juggle well may stand to see an evergreen pipeline of viable deal opportunities; those who sit back and expect to find good deals the same way they did 10 years ago will likely miss out.

## Shareholder activism: Investors flex their muscles

Shareholder activists are making their mark on M&A. This year's corporate development survey found that nearly 60 percent of corporate development leaders see shareholder activism affecting transaction activity in their industry. Reinforcing this sentiment, nearly a quarter (24 percent) of respondents say their own companies are more likely to engage in M&A transactions as a result of activism. The recent wave of shareholder activism has emboldened many investors of all stripes to assert their views when it comes to how companies deploy capital and manage performance.

Historically, when activists have circled the gates, they've often advocated for companies to divest assets in some form: to sell nonoperating assets, split up their enterprises, or undo past acquisitions. Effective preparation for companies should include having a comprehensive and objective understanding of the intrinsic value of the enterprise and its individual businesses and assets. This forms a baseline against which the expected market value of logical strategic and transaction alternatives can be compared. Corporate development teams can play an important role in providing a view of intrinsic value, defining possible strategic and transaction alternatives, and providing an informed point of view on market conditions. This analysis should be routinely refreshed and, to the extent the portfolio includes any businesses that are underperforming or could conceivably create more value combined with another company, executives should have identified them and have an exit strategy in mind, in case they need to act.

The next phase of agitation, however, is likely to focus on accelerating growth. Rather than break up a company, many investors are increasingly seeking to use strong companies as platforms for bigger and better growth through acquisition. Before activists hand executives their lists of preferred acquisition targets, though, it's imperative for corporate



development executives to get a head start. To be effectively prepared, as part of the normal routine, companies should have a well-defined M&A strategy and prioritized list of preferred targets and associated pros and cons so that they can stay in control of the M&A conversation should a debate arise with shareholders.

Finally, to the extent that activist activity puts companies in play unexpectedly, corporate development teams should be prepared to respond quickly and capture opportunities when they arise.

## Investor relations: Corporate development's hidden asset

Today's investors have strong opinions and are not afraid to share them. As a result, getting buy-in from shareholders may end up being nearly as important as coming to terms with the target when it comes to executing a successful deal. But our corporate development survey suggests that dealmakers are underutilizing employees who are generally best positioned to create this dialogue: investor relations (IR) professionals.

According to the data, IR teams are usually pulled into the deal process fairly late in the game. Few corporate development executives (20 percent) say IR is critical to achieving deal targets. Overall, corporate development

executives mainly see IR as a function that disseminates information and answers questions, rather than as a key business partner that advises on shareholder perspectives during transaction processes.

Yet, to the extent these trends hold sway, companies are missing out on opportunities to create a robust feedback loop with investors. On one side, closer connections between IR and dealmakers allow IR professionals to fully understand transactions so that they can satisfy investors' information requests about a deal. At the same time, IR professionals can offer their companies valuable insights into investor sentiment and likely reactions to deals.

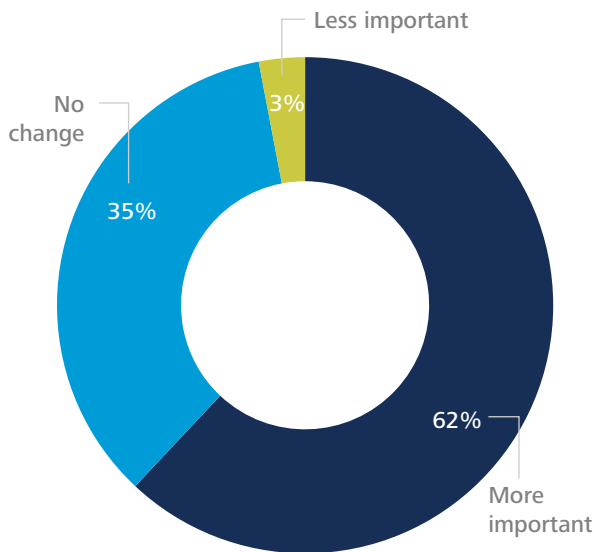
To be sure, the role of IR varies by company size and deal experience, as well as by industry. Ironically, the data suggest that large and frequent dealmakers may have the furthest to go in fully utilizing all that IR has to offer. We also believe that simply providing investors more information is not necessarily always the solution.

Getting the right message out at the right time is essential for a company to get credit for the value embedded in a deal. However, tuning your communication strategy to investor desires takes more than simply putting a mouthpiece in place; it takes thoughtful two-way partnership and a new level of respect for those who know shareholders best.

# Innovation through M&A

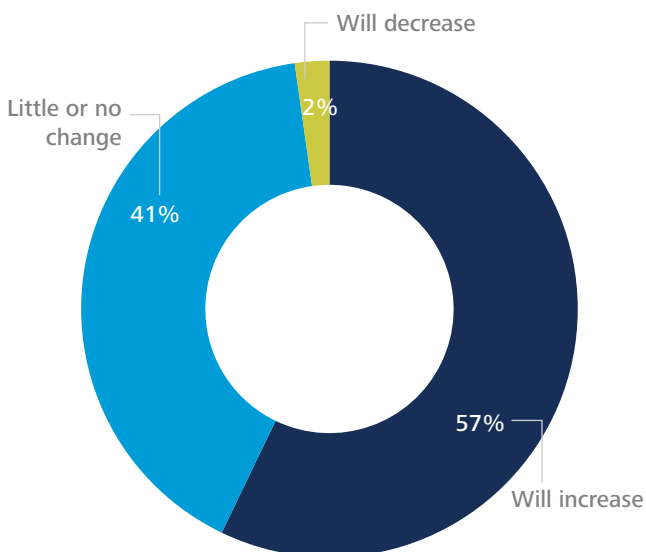
## Partnering with the business

**Figure 1. Change in importance of corporate development as a source of innovation over last two years**



Graphic: Deloitte University Press | DUPress.com

**Figure 2. Expected change in volume of innovative deals over next two years**



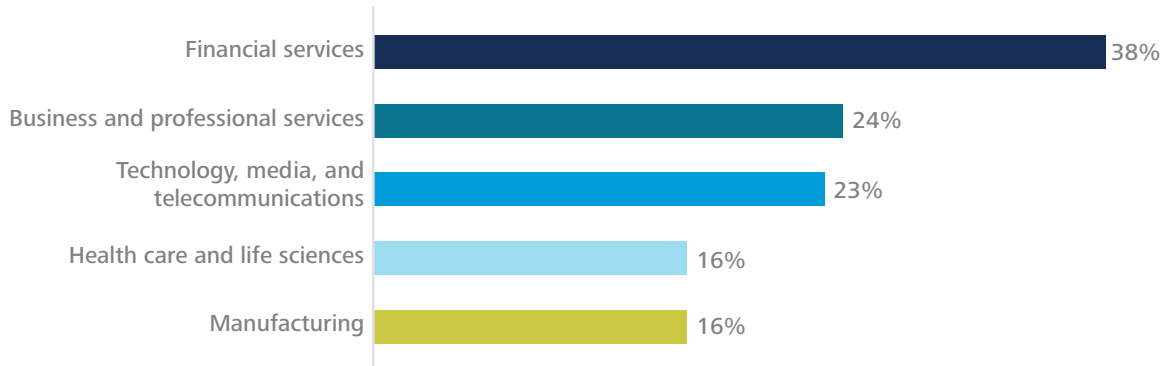
Graphic: Deloitte University Press | DUPress.com

**T**HIS year's corporate development survey reveals that the pursuit of innovation is transforming the M&A world. A large majority—roughly two-thirds—of the corporate development leaders who responded to the survey say their function has become a more important source of innovation over the past two years; virtually no one says it has declined in importance (figure 1). The pressure to transform is only likely to increase, as nearly 60 percent of executives believe the volume of innovation-centered deals will increase over the next two years (figure 2).

Disruption—and the imperative to embrace and leverage it—arrives in different forms for each industry. And while research-intensive industries like life sciences and technology may seem to have an inherent advantage in the innovation game, the fact is that few companies understand what it means to be truly disruptive and do business in a totally different way. In financial services, for example, a whole new group of alternative lenders has arisen as Dodd-Frank rules challenge traditional lending, forcing many old-line banks to consider and monitor new solutions. Perhaps not surprisingly, financial services executives are the most likely to consider their corporate development teams very well prepared to handle innovative deals in Deloitte's survey (figure 3). In health care, reform legislation is pressuring many hospitals to reevaluate their technology investments as well as the ways they measure performance.

The challenge for corporate development teams now is how to prepare to handle this new world. For the past couple of decades, most have achieved high levels of success with

**Figure 3. Percentage of respondents whose corporate development groups are “very well prepared” to manage expected increase in innovative deals, by industry\***



\* Percentages calculated on a base of respondents expecting the volume of innovative deals to increase (N = 201).

Graphic: Deloitte University Press | DUPress.com

a focus on defining, streamlining, codifying and practicing a repeatable deal process to drive efficiency; honing technical skills and introducing tools such as playbooks, knowledge management tools, e-deal rooms, and dashboards; and improving governance. This expertise remains important—but by their very nature, innovative deals don't conform to a single description. Rather, the next wave

## A first step in pursuing an effective innovation agenda: getting closer to the business.

of deals will likely require corporate development professionals who are futurists at heart: creative, nimble, and able to see opportunities in unusual places and circumstances and who are comfortable with uncertainty.

A first step in pursuing an effective innovation agenda: getting closer to the business. According to our survey, a lack of connectivity between the corporate development team and the business units they support is among the biggest impediments to driving innovation through corporate development. Although the

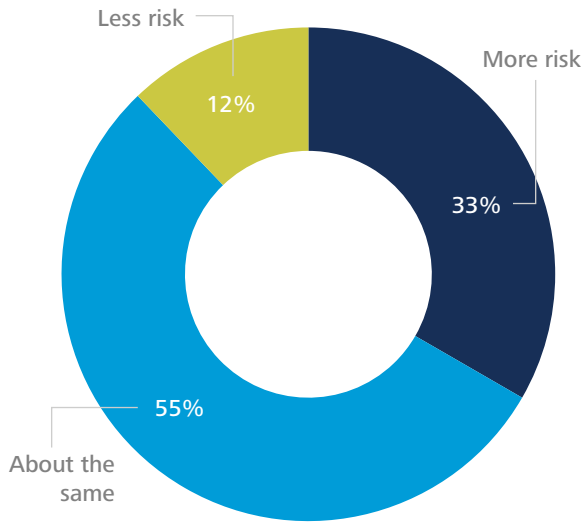
trend we have reported on in past corporate development surveys is corporate development teams moving further upstream and creating a closer connection to the strategists in the businesses, there are still many acquirers that limit the role of corporate development to its core objective of executing transactions. Although this can drive effectiveness by focusing corporate development on its core competency of

doing deals, it also creates the potential for strategic blind spots or situations where the dealmakers are more focused on getting the deal done rather than achieving corporate strategy. Fostering more connections between the two can allow the corporate development team to better

understand the business strategy and aspects of competitive differentiation, and how it could make quantum leaps by helping the businesses view potentially disruptive market participants as more of an opportunity than a threat.

From there, leaders should take stock of the specific new capabilities a future-forward deal might require. It's no longer enough to shoot for synergies by combining with competitors and suppliers in the same market. Instead, many companies are looking for cutting-edge firms with new business models

**Figure 4. Expected change in risk profile of deals over next two years**



Graphic: Deloitte University Press | DUPress.com

and technologies they can import to improve existing businesses, jump into new markets, or create competitive differentiation. Deal types are also morphing and new “currencies” like knowledge, data, and innovative culture are coming to the fore.

Supplementing the traditional transaction to acquire products and associated revenues, many companies are increasingly looking to acquire people and ideas that will help contribute to an entrepreneurial mind-set within the company to perpetuate more innovation. Finally, the standard post-deal ritual of severing ties with the seller is likely to give way to ongoing relationships as more companies participate in collaborative business partnerships and ecosystems.

What all of this means is that corporate development teams will likely need new methodologies and tools to assess deals. For one, teams that are accustomed to analyzing targets with established products in mature markets with orderly financial statements have to consider additional valuation methods for early-stage companies with shorter histories, limited revenues, and evolving business models. A traditional publisher, for example, would likely analyze a digital media property very differently than a monthly print magazine.

New types of deals will also require new subject matter expertise. Case in point: While bitcurrency may not find a place in mainstream commerce for years to come, banks can no longer ignore the blockchain technology that records transactions like no prior ledger system could, a technology which has the potential to change the very heart of their core banking processes. Corporate development leaders will need to assess their best sources of learning in promising areas, and decide if and when to bring in external specialists to help their teams come up to speed.

Similarly, diligence processes will also have to morph to adapt to the unique risks associated with an innovative transaction. One major risk of acquiring an early-stage technology firm, for example, is that the founding team leaves, taking with it valuable intellectual property. An equally unfavorable outcome could be that the founders stay, but lose their entrepreneurial spirit in the context of a larger company. Accounting for these possibilities is crucial, yet the Deloitte Corporate Development Survey suggests many dealmakers are now unaware of the technological, operational, and retention-related risks they may face. The majority of respondents (55 percent) expect no change in risk profiles despite the increase in innovative deals (figure 4). To succeed in this environment, corporate development professionals will need the business planning skills to imagine future opportunities, in addition to core due diligence skills that tend to focus on past performance and confirmation of existing business models.

Corporate development professionals will also have to adapt to new deal structures that may not include the levels of ownership or control traditionally associated with M&A. Innovative firms are often the product of passionate entrepreneurial teams that may make staying involved operationally or financially with their organizations a main condition of a deal. And as business ecosystems evolve, transactions are increasingly multistep, multiparty affairs. Consider how Uber has gone about establishing operations in India: The process

involved an investment from Tata and a commercial relationship with Airtel to provide 4G services in vehicles, equip drivers with devices and plans, and provide second-party payment verification services, as well as a handful of other downstream transactions across a newly formed ecosystem.

While one-to-one deals will always have a place, the new “sharing economy” will make it increasingly incumbent on dealmakers to manage multiple parallel and serial business relationships to create their desired marketplaces. Corporate acquirers may consider taking a page out of the private equity and activist playbooks that have assembled a cadre of loosely organized specialists and advisors that they can tap into on an as-needed basis.

Other companies have created forums to attract business partners and foster innovation. Companies as diverse as DuPont, Johnson & Johnson, Nestle, and Samsung, among others, have introduced innovation centers in entrepreneurial hotspots around the globe that work with innovators and provide resources and collaboration to help accelerate success.

Innovation is not easy; that's clear. But the need for constant change can bring with it unprecedented opportunity for corporate development teams to add value to their enterprises in outstanding ways. Strong leaders who can adapt to the new environment may stand to see great results, and with them, great rewards.

## Next steps

Actions for leaders to consider include:

1. Consider ways to strengthen the tie between corporate development and business strategists. Would a different resource model—for example, corporate development embedded in the business unit—work better for your organization? Or are there mechanisms—rotations, standing meetings, reporting frameworks—that can help provide corporate development what it needs from business units to help it innovate?
2. Take stock of the new skills and attributes needed to drive innovation through M&A. In a deal reality that now includes the traditional one-to-one transactions as well as “multiple parallel and serial partnerships,” how should the team be bolstered? And in efforts to keep pace with disruptive, often mind-bending technologies, what are the best ways to move the deal team up the learning curve? How should external subject-matter specialists be identified and used?
3. To what extent do you need new policies or governance procedures around what a deal can look like? Will corporate development be allowed to cut new-style deals on the fly? Will everything need pre-approvals? Are there unbreakable rules that need to be broken?

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## ARLEN SHENKMAN

CFO of SAP North America, previously global head of SAP Corporate Development



**Deloitte:** What do you think about sourcing deals at SAP? To what extent are your own employees identifying deals, and how much do you rely on third parties?

**AS:** Almost all of our deals come through internal sources. We see about 500 unsolicited opportunities that come from external sources—but we rarely buy those companies. We don't participate in auctions. Frankly, we don't buy companies that we don't already have a pre-existing relationship with. If a banker brings us a company we've never heard of, we may then go form a relationship, but it's almost unheard of for us to buy a company that a bank pitches to us when we have no relationship.

Transactions here tend to either be top-down or bottom-up. Deals above \$1 billion tend to be driven top-down and deals that come bottom-up from a business unit tend to be smaller.

**Deloitte:** When does the corporate development team get involved with these opportunities?

**AS:** We tend to be involved from the time we realize there's a white space in our portfolio. We tend to be a very matrix organization, so we need to ensure the lines of communication across our organization are effective. For instance, a region may know, from a go-to-market standpoint, what our customers want, but it may not necessarily know, from a portfolio standpoint, what we're building on our roadmap. Generally, we have a portfolio planning process that looks at where we're going to build organically, where we intend to partner, and, then, where we intend to buy. Corporate development has a team of people who go to those business reviews where we're analyzing the portfolio. Once the business comes to the conclusion that we either don't have a top-tier partner or we're not going to build something, that's when we really get involved.

**Deloitte:** In many companies, corporate development struggles to interact in a seamless way with the business units. How do you promote that partnership at SAP?

**AS:** What I tell our people is, "It's not our job to say no to deals, it's our job to help people understand what the risks and rewards are around a deal." We've historically gone out of our way to try to help business leaders work through ideas. Even if a given idea may not be actionable, we'll still spend time to make sure that we're educating them about why the idea may or may not make sense, whether that's because of timing, price, or the fit in the portfolio. We want to get more people in the company thinking along those lines.

**Deloitte:** What's the relationship between strategy and corporate development?

**AS:** Our corporate strategy function is very high-level. It tends to focus on defining where we want to expand addressable markets, and where we want to enter new markets in terms of new countries or new industries. Once we determine where we intend to take our business, it's usually a relatively seamless handoff to corporate development.

**Deloitte:** How much do you interact with the venture capital community or with private equity to source deals?

**AS:** We see a fair amount of deal flow from venture-backed companies, and we have acquired many venture-backed companies. We also talk to many venture capitalists during the year. SAP has a close relationship with Sapphire Ventures, which has made more than 130 investments. This relationship also fosters our relationships with the venture capitalist community.

On the private equity side, we bought Fieldglass about 18 months ago from Madison Dearborn Partners LLC and Hybris, prior to that, from HGGC. Those are the only companies I can recall buying from private equity. I do think private equity is becoming more relevant as it acquires (more) software companies, and then uses some of those acquisitions as platform companies or continues to invest in other ways.

**Deloitte:** Based on what you've seen and done, is there one thing you think companies could do to try to generate more innovation out of corporate development?

**AS:** My two cents on that is: M&A is a tactic; it's not a strategy. If your idea is to go buy a company to innovate, it's one tool you have around innovation. But in and of itself, it's not a strategy. For example, when we decided we needed to transform into a cloud business, we wanted to ensure that we acquired assets in adjacencies where we hadn't had great success in building cloud assets. We bought a series of those companies and put them together. We had an integration paradigm around it and we accelerated organic development around our strategic acquisitions. I think if M&A is your innovation strategy, you have a problem.



# Deal origination

## Making yourself irresistible

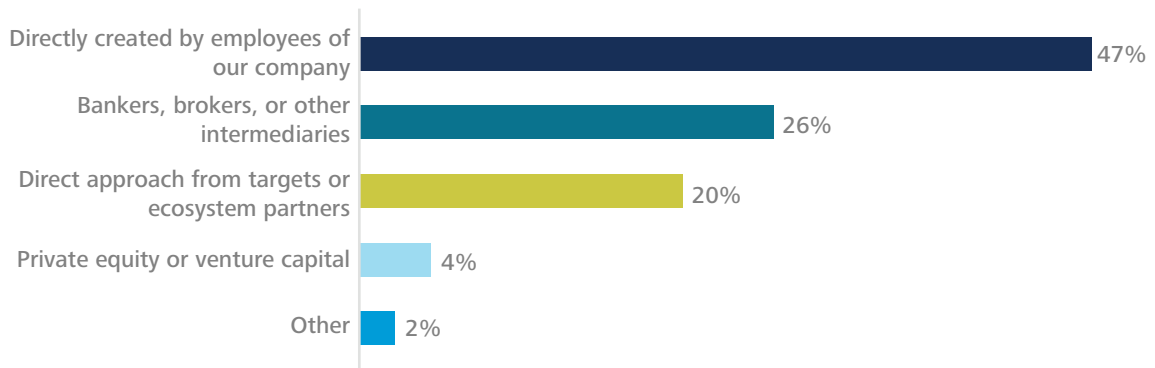
**E**VEN in the age of powerful Internet search engines and robust databases, finding and managing quality transaction targets is no easy task. Yet, stimulating deal flow is critical to future growth, particularly when change is occurring at a rapid pace and competition for attractive assets is high. The challenge, in a nutshell, is how to effectively create a proprietary deal pipeline without exhausting all of corporate development’s resources.

An obvious solution to finding more deal targets is to devote more people to the task. In fact, nearly half of the corporate development professionals who responded to Deloitte’s

Corporate Development Survey expect their own employees to be the source of the most successful deals in the next two years, far ahead of other sources such as bankers or intermediaries (figure 5).

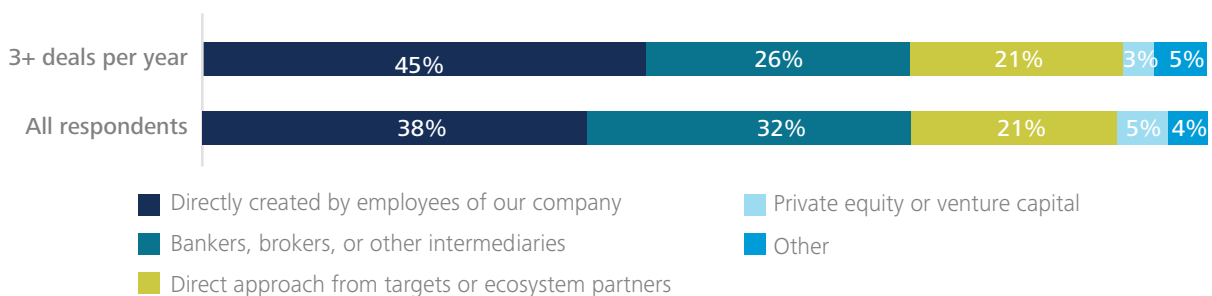
Today, only 38 percent of deals come directly through employees, barely ahead of the proportion (32 percent) that come through intermediaries such as bankers or brokers (figure 6). At experienced dealmakers that complete more than three transactions per year, the ratio of employee-created deals increases to 45 percent, suggesting that regular

**Figure 5. Expected source of the most successful deals over next two years**



Graphic: Deloitte University Press | DUPress.com

**Figure 6. Current primary source of deals**



Graphic: Deloitte University Press | DUPress.com



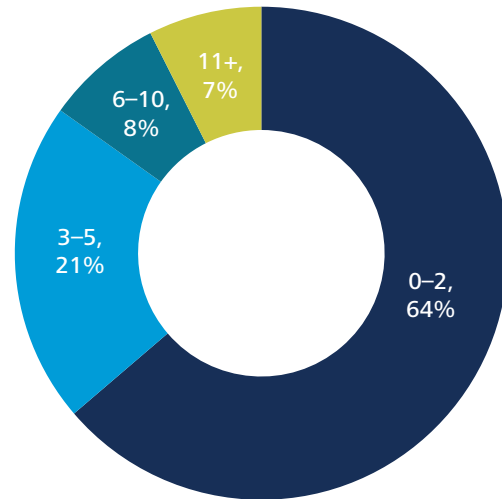
acquirers expect more value from deals that they originate.

Yet human capital is expensive. Most companies have between 0 and 2 employees devoted to sourcing, and only about 20 percent are very likely to add more resources over the next two years (figures 7 and 8).

So how can companies source comprehensively, yet efficiently? One effective tactic is to build a magnetic corporate reputation, prompting sellers to proactively approach a buyer instead of waiting for the buyer to pursue them. This focus is evident in the survey results this year. When it comes to considering returns on investment, 36 percent of executives say relationship building within their ecosystems is most promising, a full 20 percent above the next most favored options, such as choosing to add headcount to scout deals and using technology. And some 60 percent of corporate development leaders say they are investing in being perceived as preferred acquirers, with the aim of developing more relationships with potential targets.

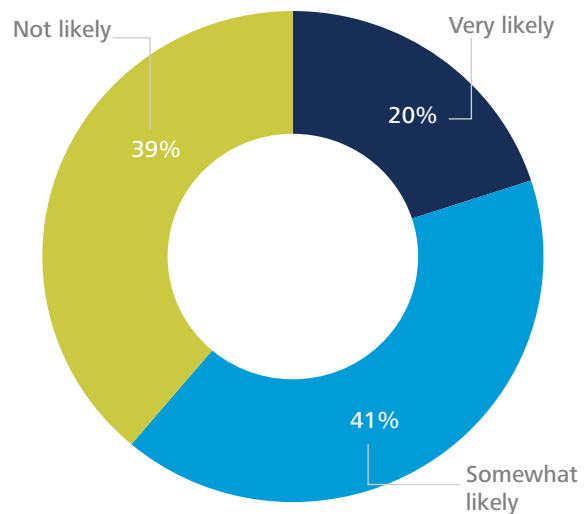
Becoming a preferred acquirer suggests taking a multidimensional approach to the marketplace. For one, companies that want to be known as friendly buyers strive to establish a strong presence within the industries, ecosystems, and microclimates that pique their interest. For some, that simply means attending conferences and setting up meetings on a consistent basis. For highly acquisitive companies, particularly those targeting entrepreneurial targets, it could also involve establishing an office in known hot beds of activity. New York-based CA Technologies, for example, recently opened an R&D center in Santa Clara, CA, to increase its presence while consolidating acquisitions in the region.<sup>1</sup> Corporate venture funds can also be powerful ways to create presence. Whatever the specifics, the main goal is to have an ear to the ground to get an early indication of mature companies that may be coming on the market or early-stage companies eager to accelerate growth in partnership with a larger enterprise. The objective is to ensure that the first time a potential seller

**Figure 7. Number of full-time employees responsible for identifying and creating deals**



Graphic: Deloitte University Press | DUPress.com

**Figure 8. Likelihood of dedicating additional resources to deal origination over next two years**



Graphic: Deloitte University Press | DUPress.com

learns about a company isn't when they initiate an auction process.

Just showing up isn't enough, though. It's also increasingly important that companies demonstrate an interest in partnering with potential targets, rather than simply consuming them. This is true with both large and small and mature and early-stage targets, and it requires that corporate development professionals have some flexibility within corporate

deal-making parameters and the ability to be nimble and responsive in coming to agreements. Teams that are bogged down by corporate bureaucracy may find they lose out on attractive targets that do not want to conform to standard ways of doing things. Ideally, serial acquirers can also back up these efforts with a long list of references from past acquisitions, who can vouch for their collaborative abilities.

intelligence with minimal effort may be a powerful way to increase productivity without additional hires. For example, a biopharmaceutical company that was struggling to effectively screen hundreds of potential targets created a dynamic database populated not only with relevant target data, but also its own strategic priorities. They added a visualization layer with filtering capabilities which allowed the corporate development team

to identify and prioritize a string of targets that were well-suited to help accomplish the company's strategic priorities.

Ultimately, corporate development leaders will need to balance deal origination resources between direct and

## Corporate development leaders will need to balance deal origination resources between direct and indirect approaches.

Behind the scenes, companies may want to consider investing in specific technologies to manage their deal pipelines more efficiently. Many companies juggle tens or hundreds of potential transaction opportunities. These universes are dynamic and hard to capture in a spreadsheet, as the attractiveness of any given target may fluctuate in light of other corporate decisions and transactions. New systems that can track changes as they occur and give corporate development teams real-time

indirect approaches. They'll need their team to strengthen relationship-building skills and to convey the right message about the company's approach to deals, and then invest in programs and resources to back up that message. Those who can juggle these priorities may stand to see an evergreen pipeline of viable deal opportunities; those who sit back and expect to find good deals the same way they did 10 years ago will likely miss out.

## Next steps

Actions for leaders to consider include:

1. Consider the internal resources available for deal origination within your company, from executives to frontline employees. Are they optimally deployed now? How could you better leverage what you have in order to gain more intelligence around new targets and partners?
2. Examine the rules and governance processes for deal making that your organization has established. From there, aim to identify where the corporate development team might have latitude to negotiate in different ways, or outside the norms, without compromising the integrity of the process.
3. To the extent possible, gather some information about how your company is perceived by past and potential sellers. For example, if you asked a past seller to endorse your company, would you be happy with their response? If the answer is no, consider what corporate development can change about the ways the company does deals to be seen more favorably.
4. Take a hard look at the technology corporate development is using to manage the universe of opportunities. Is it effectively capturing the dynamics of that universe? What additional capabilities would help the deal team be more productive and agile?

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## MARK E. MLOTEK

Executive vice president and chief strategic officer, Henry Schein, Inc.



**Deloitte:** What is Henry Schein’s overall approach to deal sourcing, and has that changed during your tenure there?

**MM:** Traditionally, we’ve sourced most of our transactions internally, and I think that’s still true for the most part. A lot of people send us information about the market, and we digest, and we pursue. We get information from sales, from marketing, from our own observations, we get it from literature. And the senior leadership team is fairly well-versed about who the players are in the industry. So, we don’t have hundreds of people scouting; we don’t need to. At some point it may change, because as you get bigger you have to do bigger deals to move the needle. We may have to participate in more processes than we have historically, but for now, this still works for us.

**Deloitte:** What does your deal flow look like in a typical year? How many deals do you do and what size do you consider your sweet spot?

**MM:** We do somewhere between 10 and 15 transactions a year, and we focus on sub-\$100 million revenue companies, though every now and then, one or two exceed that amount. All told, we added on average over the past few years, approximately \$0.5 billion dollars of revenue a year through a series of transactions. We find less

competition that way, we find lower prices, and we find we keep our teams active and engaged. We believe that this is more productive than participating in a deal process for four months, spending \$0.5 million or \$1 million in fees, and possibly coming away with nothing in the end.

**Deloitte:** How do you find innovative deals—the ones that involve disruptive technologies or business models?

**MM:** We figure out how to do one or two transactions that involve innovative products, services, or technology a year, and budget for that investment. For example, the last investment that we just announced was a data company. But these types of transactions are complicated and difficult. At the end of the day, we’re a company that investors have traditionally looked to for consistent earnings growth. They’re not necessarily looking to us for the next best product that will bring a large spike in revenue. And generally, depending on the life cycle of the innovation, if you get it early, there’s very little in terms of ROI metrics that one could use that would make sense for a traditional company like ours.

**Deloitte:** Is there one thing you would suggest that companies can do to drive more innovation through the corporate development function?

**MM:** I really think it has to start at the top. The CEO has to make it a priority; I don't think it can come out of business development. In our company, our CEO and senior management team help drive innovation, and with their partnership, we help execute. Culturally, Henry Schein CEO, Stanley Bergman, meets all target companies at some point in every transaction process. If the transaction is something fairly big or involves a new strategy, Stanley will attend and present our vision at the first meeting.

**Deloitte:** As a large public company, how do you preserve the entrepreneurial spirit of some of these acquired businesses, especially those that are more technology- or innovation-focused?

**MM:** A third of our revenue is in what we call "joint venture partnerships," where we have former owners continue to hold a stake in the acquired business for a number of years. So when they grow the company, they grow their value as well as ours. We have figured out how to engage the private equity model of equity incentives within a big company that, I'll tell you, is quite complicated and difficult. It takes a lot of time and effort. Management is very different in a partnership than it is in a traditional org chart. But I would say it's one of our core competencies.

**Deloitte:** Along that same lines, is there anything your team does to explicitly promote Henry Schein as a "preferred acquirer"?

**MM:** I do believe we are an acquirer of choice, and I do believe it has to do with our track record. We must have done nearly 250 acquisitions since we have gone public. Of those transactions, at least half have to be in these equity partnership models. As far as I can recall, we've never had a fight about how to own the company or how to manage the company—in the buy, in the ownership, and, ultimately, in the sell. So we have a whole bunch of people who will stand up as supporters when the next person is interested. We just give acquisition candidates a list of people they can call, that we've worked with, and that's very helpful. Having a track record and this core competency is something that will continue to be a competitive advantage going forward.



# Shareholder activism

## Investors flex their muscles

**S**HAREHOLDER activism has reached a fever pitch. Investor groups targeted 200 companies in 2014, up from 120 in 2010,<sup>2</sup> and the market value of global investments in public companies by activist investors has topped \$250 billion.<sup>3</sup> These investors are assertive, they're vocal, and they're not going away any time soon. And since activists normally come with some type of transaction request for the company, corporate development executives are under pressure to consider how to respond—and stay ahead of their critics.

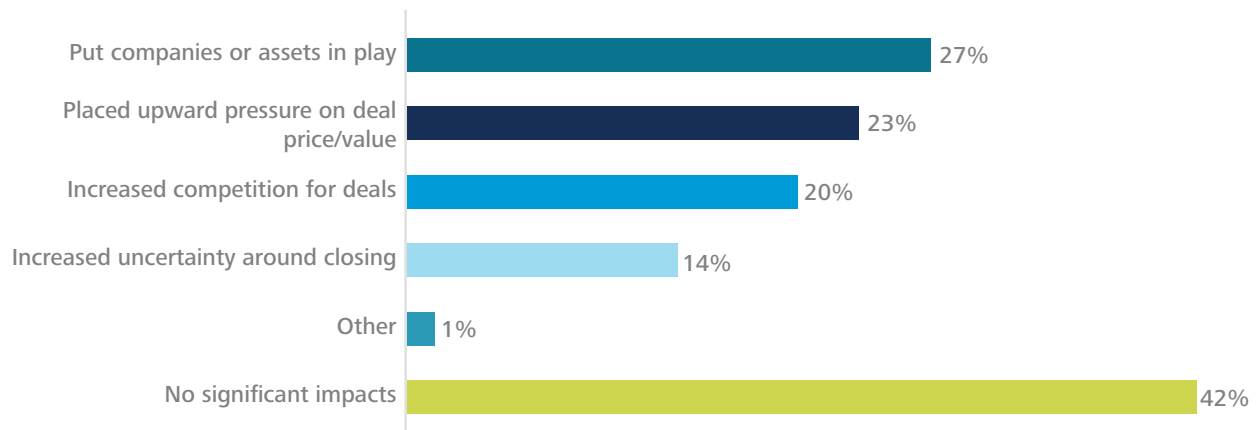
This year's corporate development survey found that nearly 60 percent of corporate development leaders see shareholder activism affecting M&A activity in their industry. The most common effect, cited by 27 percent of respondents, is to put companies or assets in

play (figure 9). This is in line with the standard activist strategy over the past several years to push companies to sell or spin off underperforming businesses in order to create more

Nearly 60 percent of corporate development leaders see shareholder activism affecting M&A activity in their industry.

value. In 2015, for example, this strategy led to eBay spinning off its PayPal division into a separate public entity and Manitowoc Company announcing a plan to split its crane manufacturing and food service equipment businesses into two separate companies. Deal totals

**Figure 9. Impacts of increased shareholder activism on M&A activity in company's industry**



Graphic: Deloitte University Press | DUPress.com

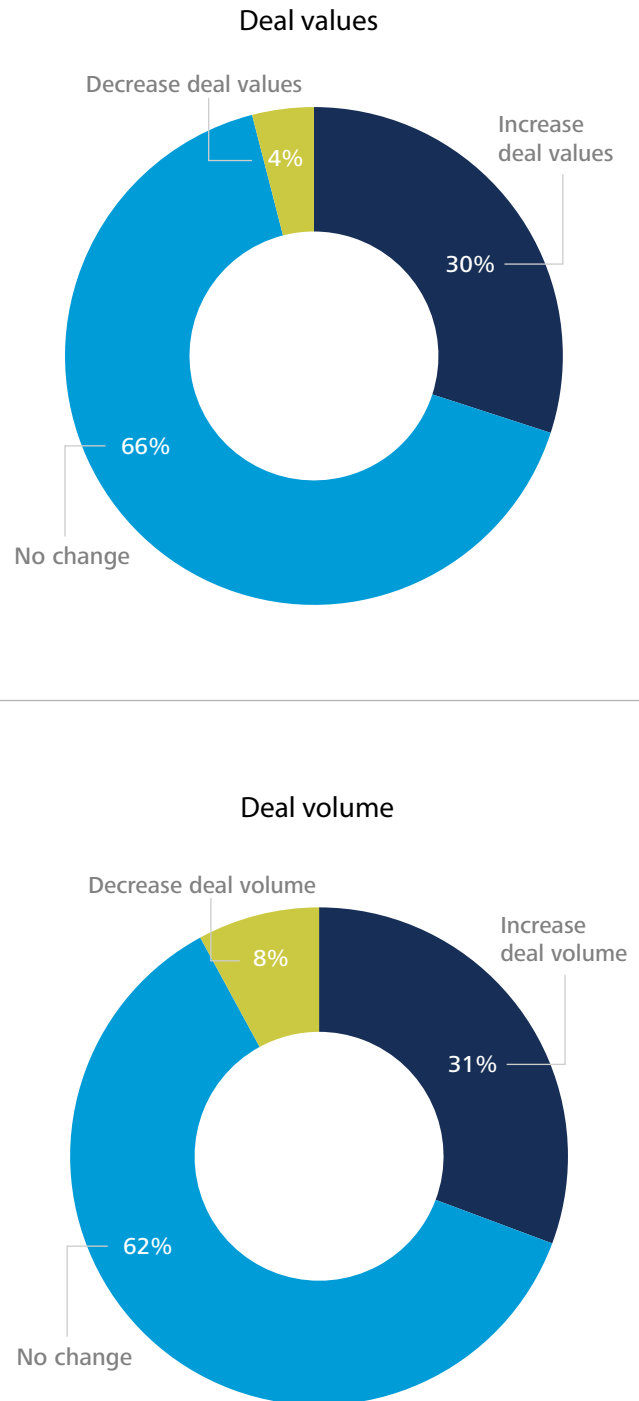
appear to reflect this activity; global divestiture values in 2014 were at their highest level since 2007 and are almost as high in 2015.<sup>4</sup>

Reinforcing these trends, nearly a quarter (24 percent) of respondents say their own companies are more likely to engage in M&A transactions as a result of shareholder activism. About a third of respondents expect activism to bring about an increase in both deal volume and deal value (figure 10). As of November, in fact, the aggregate value of year-to-date M&A in the United States for 2015 had already surpassed the record levels seen in 2007.<sup>5</sup>

When activists circle the gates, companies are likely to respond by being more careful in the deal process. Survey comments suggest they're more deliberate about the evaluation process, and there's more involvement from senior management. This kind of defensive behavior makes sense, as investors have often challenged the value the company has paid or received respectively from previous acquisitions or divestitures.

But while activists have historically entered as naysayers, pressuring companies to split up their enterprises and undo past acquisitions, the next phase of agitation is likely to have a more positive focus on accelerating growth. Rather than break up a company, investors are increasingly seeking to use strong companies as platforms for bigger and better growth through acquisition. Some signs that this type of activist approach is happening more broadly: Nearly a quarter of respondents report upward pressure on deal prices as an effect of activism, and 20 percent see increased competition for deals. This suggests that demand for assets is increasing along with supply as activists stoke activity from both sides. We are starting to see examples of activist hedge funds that accumulate a significant stake in a business and use that position to publicly advocate for accelerated growth through bolt-on acquisitions, or even for business combinations with larger competitors. This suggests a need for companies to have a prioritized point of view of accretive acquisition candidates that can be added to the acquirer's platform to drive

**Figure 10. Expected impact of shareholder activism over the next two years**



Graphic: Deloitte University Press | DUPress.com

value, as well as a view on potential value creation opportunities in combination with larger peer companies.

Before activists storm the board room with a list of acquisition targets for the company to consider, though, it's imperative for corporate development executives to have a head start. Anticipating the activist conversation begins with taking a critical view of the value of the enterprise, both in total and as the sum of the parts. To the extent the portfolio includes any businesses that are underperforming or could conceivably create more value spun off or combined with another firm, executives should have identified them and have an exit strategy in place.

Defending your company against activists—or even working constructively with them—also requires that you have a well-constructed

overall M&A strategy. Whether it's extending the platform or transforming the platform, it's important to define it and make sure it reflects a risk profile that is acceptable to the board and other shareholders. While activists may bring some good ideas, they are unlikely to have integrated them with internal considerations about risk management and/or cultural fit and may look to push the company to take on more risk for faster growth without fully appreciating the negative implications.

Finally, to the extent that activist activity puts companies into play unexpectedly, corporate development teams should be prepared to respond quickly and capture opportunities when they arise. This speaks to having the fundamentals of process and governance tightly nailed down, so that they help rather than hinder agility.

**Before activists storm the board room with a list of acquisition targets for the company to consider, though, it's imperative for corporate development executives to have a head start.**



## Next steps

Actions for leaders to consider include:

1. Take a hard look at the corporate portfolio—from an outsider's perspective—and identify any assets that could be viewed as underperforming or as a poor fit. What exit strategies are in place—or could be put in motion if necessary? If there is inherent value in keeping the pieces of the business together rather than splitting them up, management should have a viewpoint and detailed analysis to support its claims, which can quickly be pulled out and dusted off if and when the activists come calling.
2. Strengthen the M&A strategy, making sure there is an internal and external communications plan that ensures active transactions are being shown to your company. For proprietary deal flow, look at likely acquisition targets, know why your company is or is not planning to pursue them. Additionally, make sure your team knows what deals are happening and what your company has been invited to bid; a management team that is missing opportunities to look at transactions in the market may be viewed as being out of touch with the market.
3. Monitor market activity to make sure you know your shareholders and any changes in mix or behavior. Furthermore, know what is happening with your peers: Are any dealing with activists? If so, what shareholder activism strategies are being employed, and how would your company cope with a similar approach? If activism is a concern, be ready to define your value proposition so you can respond promptly with a fact-based viewpoint on short- and long-term value.

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## DAVID E. I. PYOTT

Former chairman and CEO, Allergan Plc



**David Pyott is the former chairman and CEO of Allergan, where he was at the helm for 17 years. He successfully defended his company against a hostile takeover attempt, and in the process, sold the company to a friendly bid by Actavis, which subsequently renamed itself Allergan. Sriram Prakash, Deloitte’s M&A Insights lead, caught up with Pyott during the summer of 2015. In this conversation, Pyott reflects on the high and low points of the takeover battle and offers words of wisdom on how companies can effectively defend themselves against hostile attempts.**

**Deloitte:** You led Allergan through an intense hostile takeover attempt in 2014 by an activist investor, Bill Ackman of Pershing Square, who teamed up with a competitor in your industry, Valeant. How did you plan your defense?

**DP:** The bid was an extremely unusual combination between Valeant and Bill Ackman, and that meant they could attack from two different points. In particular, Bill Ackman, as an investor, could say things that a public company’s CEO would probably not dare to say. He used the media extensively to his advantage. We realized pretty quickly we had to be prepared for the worst. It was a case of get your helmet on and assume that every tactic will be used.

By the third day, I took a decision that as corporate executives, we needed to divide and conquer. Over the subsequent eight months, I spent probably 96 percent of my time dealing with the raiders, and two of my top executives—the president of the company and the head of R&D—spent about 85 percent of their time running the business. It was a matter of focus and concentration.

The other angle was the internal stakeholders. In such a well-publicized, vicious fight that lasted months and months, the employees potentially could have been extremely distracted. So I reached out to them to say, “Please, if you spend all your days reading the press or watching TV, we will fail. So please do not do that; instead do your jobs to the very best of your abilities.”

We also made sure that both the management and the board understood that they had to be extremely careful with emails because of American-style litigation. We took extreme measures to protect our data and IT systems from external incursions.

Obviously, a large part of my time, probably 50 percent, was spent visiting the investment community. If you don’t take really good care of the funds that own most of your stock, I would say your strategy is misguided.

**Deloitte:** There was a lot of pressure, not only from the media but also from analysts, saying the company should take the offer from Valeant. Did you have moments of doubt during those times?

**DP:** Actually, no. I don’t say that just based on my own personal point of view, but it is based on analyses by the two banks we had hired. We were ramping up our performance—both in sales and as well as our earnings per share—due to our cost-cutting programs, and they kept re-running the valuation models. We had the fortitude to stick to our guns because we realized that the longer we held on, the more we could improve our results.

The day Pershing Square started buying stock in Allergan, the company was worth \$37 billion. The first bid from Valeant was for roughly \$48 billion. We ended up accepting a bid that was both cash and stock from Actavis for \$66 billion. And because the market liked the transaction, on the day of close, it was actually \$71 billion.

We proved we were actually able to accelerate sales and deliver cost savings, and showed that playing the long game was best for all of Allergan's stockholders.

**Deloitte:** Do you think all CEOs and boards should be prepared for a battle like this?

**DP:** M&A activity is pretty much at a record level currently in 2015, driven by waves of cheap money, as well as investors appropriately looking for returns. So, I think no matter how big the company, any board of directors, any management team should assume there could be a knock on the door, either from a hostile strategic party, or an activist, or somebody who just wants to create change and pressure for better returns. No one is spared.

**Deloitte:** And what advice do you give those who face them?

First one is to ask yourself: "How do we prepare?" It starts with having a good list of outside advisors; hopefully people you've worked really hard with before. You also want to have a clear idea of how you'd move from day zero through the next couple of weeks.

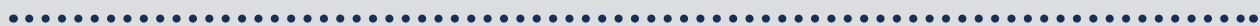
Second, and more important, is the strategic viewpoint. It's incumbent upon a board to say: "If we were that critical outside party—whether it's an activist, or an unhappy investor, or an acquirer—how would we look at ourselves?" There are a few basic questions within that: Are there parts of the business that a third party could say don't belong to the portfolio? Are there underperforming assets? Is there excess real estate? Has the company done a good enough job on cost management? A lot of that can be done in advance.

**Deloitte:** The threat of outside agitation at times prevents companies from taking risks in M&A. How can large companies tap into the innovation ecosystem without exposing themselves to undue criticism?

**DP:** I think it very much depends on the state of the market and the clarity around the technology. Sometimes, we've been willing to go very early and take enormous risks because we thought the technology was good and the payoff was large. On other occasions, we'd rather just watch and wait—and pay up if it works.

A good example is where we had a start-up company with a new drug delivery technology that could deliver drugs to the back of the eye. Allergan was an early-stage investor in this start-up, and we could've bought the whole company for \$20 million at the time. Instead, we waited, and once the tests came through two years later that showed the delivery system really worked, we paid \$220 million. Some people asked if I was upset, and I said, "No, I'm delighted!" We were not an expert in that particular field of technology, so we were willing to wait and pay up. And I'm happy to say that product is embedded inside approved drugs now.

The biggest thing in all companies is not only to nurture the successful investments, but also to be able to say, "This program just isn't delivering," whether it's taking too long or the financial returns no longer make sense, or just plain "it doesn't work." And of course, it's very hard for people within teams to admit that it doesn't work. It requires really good oversight by senior management, and that means focus—which gets harder the more investments you have.



# Investor relations

## Corporate development’s hidden asset

**C**AREFULLY negotiating a deal, only to watch its announcement tank the company’s stock, is every corporate development executive’s nightmare. Yet, as the persistent increase in shareholder activism shows, today’s investors have strong opinions and are not afraid to share them. In this environment, aligning with shareholders may end up being nearly as important as coming to terms with the target, when it comes to executing a successful deal.

So how can companies avoid post-deal surprises? The answer lies in creating a robust feedback loop with investors, from understanding and aligning with their priorities to considering their investment objectives in the deal-making process and proactively sharing the right information at the right time. However, Deloitte’s Corporate Development Survey suggests that dealmakers are underutilizing the employees who are best positioned to create this loop: investor relations (IR) professionals.

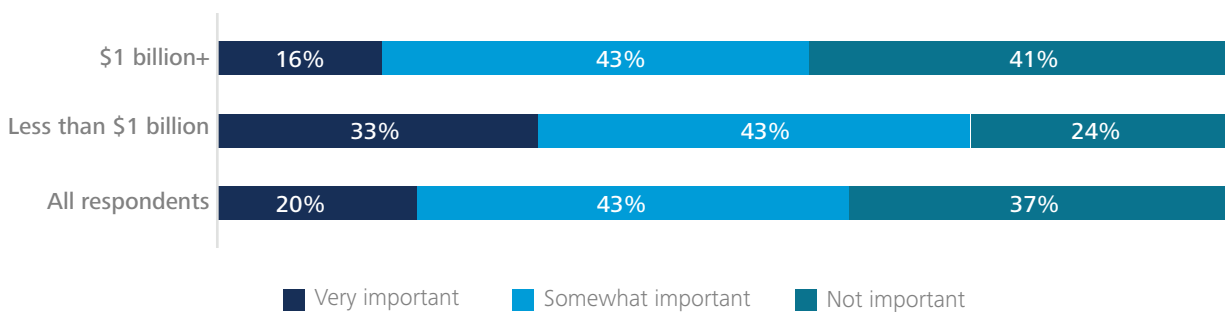
According to Deloitte’s survey, IR teams are usually pulled into the deal process fairly late in the game. Only 20 percent of corporate

development executives say that IR is very involved in deal deliberations (39 percent state IR is not involved at all). Even fewer (10 percent) involve IR before a target is approached; the majority (80 percent) involve IR after the approach, but before the announcement. Perhaps not surprisingly, a similarly small proportion (20 percent) say IR is critical to achieving deal targets (figure 11).

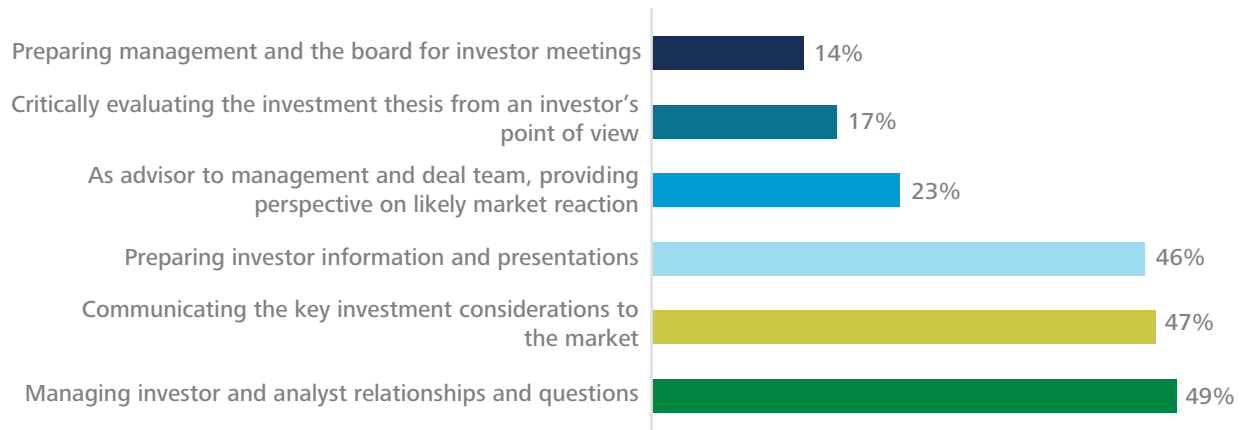
Overall, corporate development executives mainly see IR as a corporate mouthpiece, rather than a business partner, and may be underutilizing an important resource. Close to half consider its primary role to center around releasing information and answering questions from shareholders; fewer than 25 percent see it providing an advisory function or critically evaluating a deal from an investor perspective (figure 12).

Yet, to the extent these trends hold sway, companies are missing out on opportunities both to give and get information through IR. On the giving side, closer connections between IR and dealmakers can allow IR professionals to fully understand transactions so that they are equipped to satisfy investors’ information

**Figure 11. Importance of effective investor relations achieving deal targets, by company revenue\***



\* Calculated on a base of respondents at publicly traded companies (N=190).

**Figure 12. Most important roles of investor relations in M&A transactions**

Graphic: Deloitte University Press | DUPress.com

requirements and build investor confidence in a deal or strategy. On the receiving side, companies can gain valuable insight into investor sentiment by elevating IR to a more consultative role that becomes involved earlier in the deal process. Confidentiality is always of paramount importance in M&A, but the decision of when to bring IR under the tent should be evaluated relative to the value IR can bring in helping to communicate overall M&A strategy, shape the investment thesis, understand and assuage investor concerns, provide a viewpoint on possible market reaction, and develop a strategy to build market confidence so that the full value of the deal is reflected in the acquirer's stock price.

Last year, Deloitte interviewed IR leaders<sup>6</sup> from companies known for leading practices in IR, as designated by the *Institutional Investor* magazine. At these leading organizations, IR has a seat at the table from the earliest stages of deal activity, and regularly helps dealmakers consider the viewpoints and likely reactions of shareholders to various elements of transactions.

“At the highest level of effectiveness, the IR group in a large company needs to be viewed by the investment community as a very good,

trusted proxy for senior management,” noted Charles Triano, SVP of IR for Pfizer.<sup>7</sup> “In order to gain that kind of credibility and trust externally, IR needs to have a strong standing internally, starting with senior leaders who understand and value what IR does.”

When relationships between dealmakers and IR are solid, the announcement of major shifts such as a transaction can be much more successful. For one, the IR function at Pfizer

**Overall, corporate development executives mainly see IR as a corporate mouthpiece, rather than a business partner, and may be underutilizing an important resource.**

helps leadership see how analysts and shareholders might react to news of a transaction, based on their ongoing conversation with those parties. Further, “including IR in those discussions also provides that deeper level of understanding that helps [us] to communicate the change to the investment community,” according to Triano.

To be sure, the cadence of IR's role varies by company size and deal experience, as well as by size and industry. In general, the larger and more experience a company has with deals, the less likely IR is to have a prominent role. Only about 16 percent of executives with frequent dealmakers say that IR is very involved in internal M&A deliberations, compared with 24 percent at less frequent dealmakers. Similarly, dealmakers at large companies (\$1 billion plus in revenues) are half as likely as their small-company colleagues to consider IR very important to achieving deal targets.

These data suggest that large and frequent dealmakers may have the furthest to go in fully utilizing all that IR has to offer. We believe that simply providing investors more information is not always the solution. Paradoxically, “deal

machines”—companies that execute three or more transactions a year—are the least likely to provide post-acquisition updates, with about a third saying they never offer them. That's likely due to the fact that they've done a good job priming investors for a series of often small or bolt-on acquisitions, and have listened to them enough to know what is—and what isn't—surprising to them.

Getting the right message out at the right time is essential for a company to effectively get credit for the value embedded in a deal. However, tuning your communication strategy to investor desires takes more than simply putting a mouthpiece in place; it takes thoughtful two-way partnership and a new level of respect for those who know shareholders best.

## Next steps

Actions for leaders to consider include:

1. Take a hard look at when IR gets involved in the deal-making process. Is there value for your company in having it join in earlier? What are the downsides, if any, to including it in key meetings about deal strategy and any specific transactions on the horizon?
2. Consider developing a team of IR professionals who have diverse experience with deals to gain a better understanding of how shareholders formulate their agendas. A dream team would include members with strong deal experience, who know the company and industry well, as well as others who have seen deals from an outsider's view—for example, a Wall Street securities analyst or investment banker.
3. Assess which elements of a feedback loop with shareholders are in place and which may be missing. Step one is often to share the company's broad deal strategy with them—for example, “We've earmarked \$1 billion for acquisitions this year, with a primary goal of expanding internationally.” As IR brings back reactions to this general news, dealmakers can then use it to inform specific transactions, which IR can then communicate back to shareholders with specific information about how their concerns are being addressed.

# Appendix

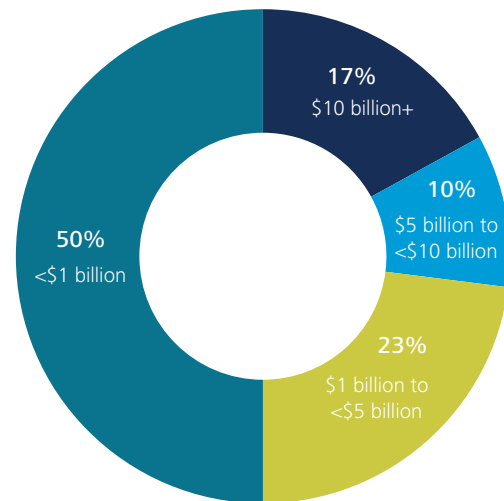
## Profile of survey respondents

**T**HIS survey polled professionals involved in corporate development decisions at their organizations. It was conducted online during August to September 2015, and was completed by 357 respondents.

Thirty-one percent were heads of corporate development and another 14 percent were corporate development executives or staff (figure 13). In addition, 9 percent of respondents were CEOs or presidents and 11 percent were CFOs. The remainder included board directors, heads of business units or divisions, and executives in finance, strategy, tax, accounting, and other functions involved in M&A.

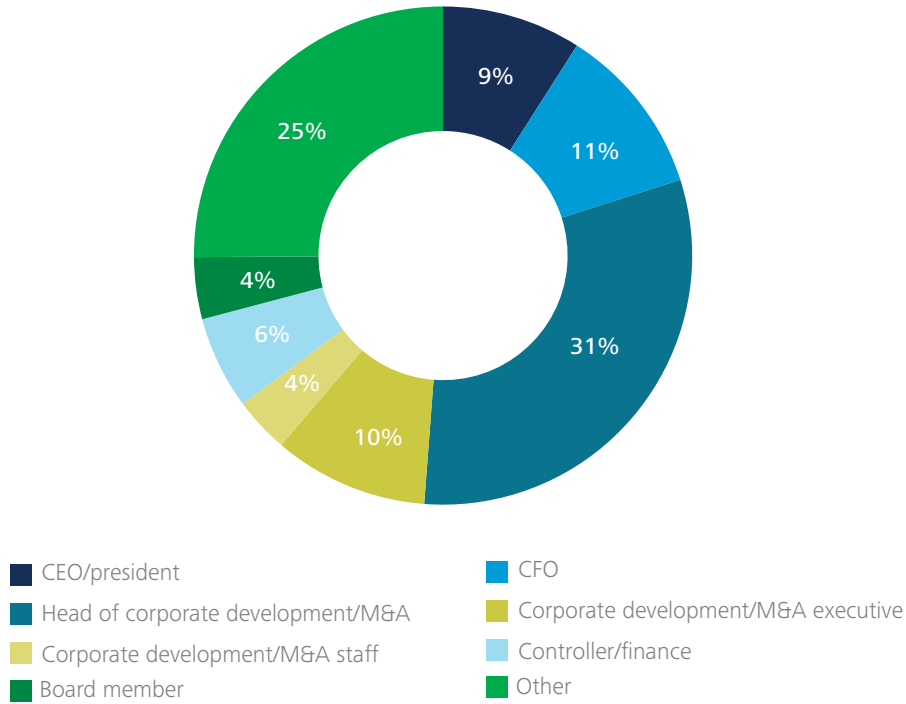
Twenty-seven percent of the professionals surveyed were from companies with annual revenues of over \$5 billion, with 23 percent having revenues of \$1 billion to \$5 billion (figure 14). There was strong representation from both public companies (53 percent) and private companies (47 percent). Respondents belonged to a wide cross-section of industries (figure 15).

**Figure 13. Respondent company revenue**



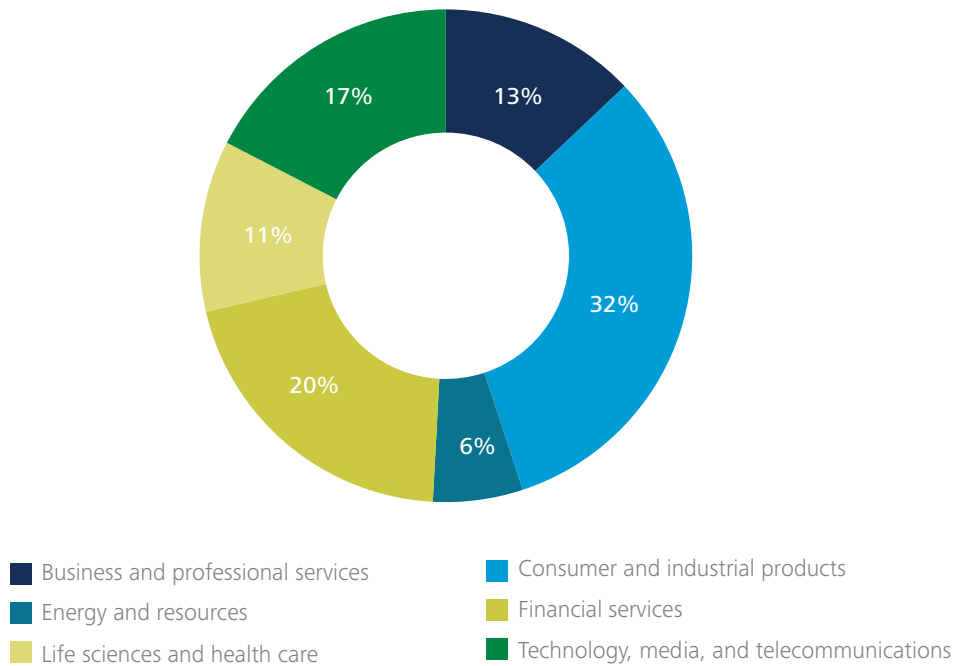
Graphic: Deloitte University Press | DUPress.com

Figure 14. Respondent role



Graphic: Deloitte University Press | DUPress.com

Figure 15. Respondent industry



Graphic: Deloitte University Press | DUPress.com



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