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How one approach to M&A is more likely to create value than all others

Two decades of research show that, while large deals still have their place, programmatic M&A strategies continue to create gains in excess total returns to shareholders, at lower levels of risk.

by Paul Daume, Tobias Lundberg, Patrick McCurdy, Jeff Rudnicki, and Liz Wol

M&A is having a moment—again. The US Federal Trade Commission (FTC) has had to adjust its premerger review process to manage the tidal wave of filings coming its way.[1] And according to some sources, deal value rose more than 300 percent in the first half of 2021 compared with the first half of 2020, and "was virtually equivalent to the total value recorded in all of 2020."[2]

Activity is surging as companies use M&A to manage the still-unpredictable economic effects of the COVID-19 pandemic and find their strategic footing. They are pursuing deals to streamline their assets, establish or extend their digital capabilities, acquire top talent, and otherwise strengthen their competitive positions. None of this is news to those companies that have adopted a through-cycle mindset to M&A; alliances, partnerships, and other transactions have been top of mind for them all along.

What might interest *all* executives, however, is a reminder of what really works when it comes to deal making. Our empirical research, which analyzes more than 20 years of data, confirms, once again, that programmatic M&A is the strategy that is most likely to create the most value for companies. That is, carefully choreographing a series of deals around a specific business case or M&A theme—rather than relying on episodic "big bang" transactions—is far more likely than other approaches to lead to stronger performance and less risk.[3]

Indeed, our most recent survey data, which we'll explore in this article, reveal other facts about the impact of programmatic M&A across sectors, during downturns, and in the context of large deals. (Hint: large deals are not always value-destroying, especially when complemented by some form of programmatic M&A.) We'll examine which M&A strategies create the most value, why programmatic still reigns over other approaches to M&A, and how programmatic acquirers do what they do.

Proof of efficacy aside, it's critical for executives to remember that programmatic M&A is not purely a volume play; it's a strategy for systematically building new businesses, services, and capabilities. The companies that use a programmatic approach create deal flows linked to their conviction in their corporate strategy, understanding of their competitive advantage, and confidence in their capacity to execute. They manage their growth strategies proactively. And their approach to M&A does not change, regardless of the success or failure of any single deal.

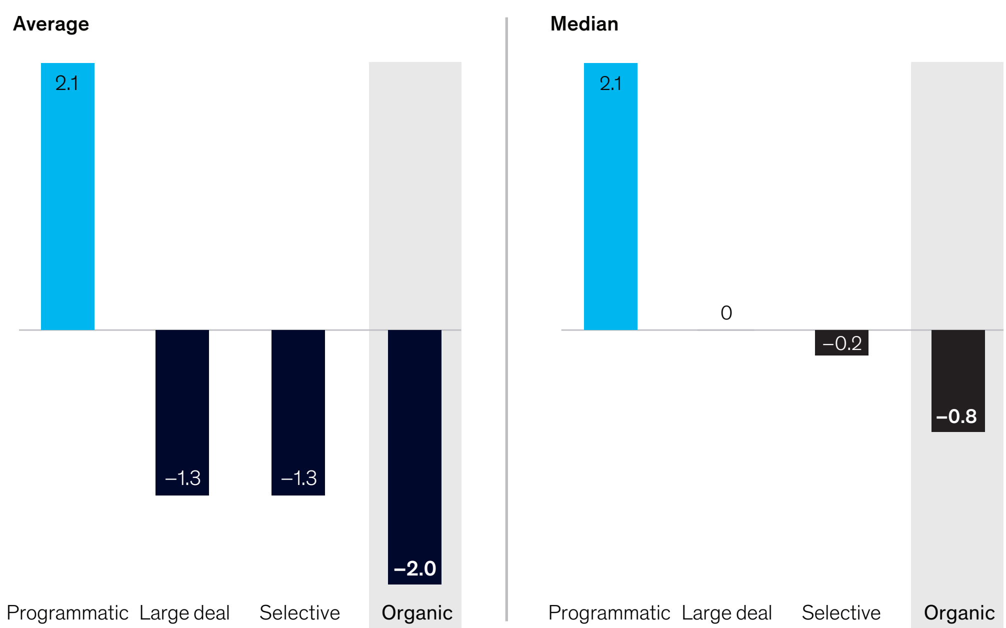
Which M&A strategies create the most value?

McKinsey's Global 2,000 research had previously demonstrated that companies that use a programmatic approach to M&A—versus organic, selective, or big-deal approaches—

Exhibit 1

The organic approach to M&A is more risky than other approaches.

Global 2,000[1] excess total returns to shareholders by program type, Jan 2010–Dec 2019, %



[1]Companies that were among the top 2,000 companies by market cap (>$2 billion) on Dec 31, 2009, and were still trading as of Dec 31, 2019. Excludes companies headquartered in Africa and Latin America.

Source: Deal Patterns 2019; S&P Capital IQ; Corporate Performance Analytics by McKinsey

generally outperform their peers.[4] These companies are able to build lasting, distinctive capabilities in M&A precisely because they do deals frequently and systematically.

Fast-forward to 2021, and the results of our ongoing M&A research are even more compelling. Data from the most recent decade reconfirm that companies that regularly and systematically pursue moderate-size M&A opportunities deliver better shareholder returns than companies that do not. For instance, programmatic acquirers, on average, delivered about 2 percent more in excess total returns to shareholders (TRS) annually as compared with their peers. By contrast, none of the other approaches to M&A (organic, selective, big deal) created any excess TRS, on average, for the cohort of companies.

But the following five new pieces of information emerged for the first time.

Finding 1: Organic-growth strategies are now—on average—the worst performing of all M&A approaches

In the past, our data have shown the limitations of both selective-acquisition and organic-growth[5] (or not pursuing M&A) strategies; both had, on average, created notable losses in excess TRS relative to the other two approaches (programmatic and large-deal programs). However, our most recent numbers show that, of the four types of programs studied, organic-growth strategies are now the worst performing and the most risky, while the large-deal approach to M&A essentially amounts to a coin flip (Exhibit 1).

Exhibit 2

Programmatic M&A leads to higher performance across most sectors.

Global 2,000[1] median excess total returns to shareholders by M&A type, Jan 2010–Dec 2019, %

Outperformance, percentage points

–2.4 –2.0 –0.1 0 0.1 2.0 5.9

	Programmatic	Selective	Large deal	Organic
Advanced industries	5.9	–0.5	–0.4	–0.8
Transport, logistics, and infrastructure	2.0	0.0	–1.9	0.0
Consumer packaged goods and retail	1.1	–0.7	–0.7	0.3
Financial services	1.2	0.0	0.6	–0.1
Energy and materials	2.2	0.3	–0.1	–1.7
Pharmaceutical and medical products	1.2	–0.3	–0.6	0.9
Healthcare systems and services	1.0	–1.8[2]	–1.3	–1.8[2]
Technology, media, and telecommunications	1.3	–2.2	1.7	–2.4

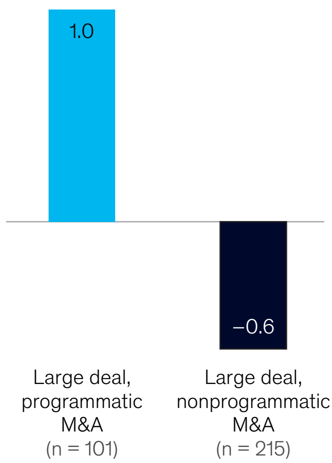
[1]Companies that were among the top 2,000 companies by market cap (>$2 billion) on Dec 31, 2009, and were still trading as of Dec 31, 2019. Excludes companies headquartered in Africa and Latin America.
[2]Small sample size (n = 5).

Source: Deal Patterns 2019; S&P Capital IQ; Corporate Performance Analytics by McKinsey

Exhibit 3

Companies using a large-deal approach to M&A can improve their performance by also engaging in programmatic M&A.

Global 2,000[1] median excess total returns to shareholders by program type, Jan 2010–Dec 2019, %



[1]Companies that were among the top 2,000 companies by market cap (>$2 billion) on Dec 31, 2009, and were still trading as of Dec 31, 2019. Excludes companies headquartered in Africa and Latin America.

Source: Deal Patterns 2019; S&P Capital IQ; Corporate Performance Analytics by McKinsey

According to our analysis, programmatic M&A remains the least risky approach with the smallest deviation in performance and the largest share of companies that generate positive excess TRS (65 percent). In other words, two out of the three companies that practice programmatic M&A outperformed against their peers.

Finding 2: The programmatic approach succeeds across nearly all sectors of the economy

Our close look at how global companies in various sectors performed (again, keying in on excess TRS created) shows that a programmatic approach wins the day—particularly in advanced industries and the energy and materials sectors (Exhibit 2).

Finding 3: The large-deal approach to M&A does not necessarily destroy value

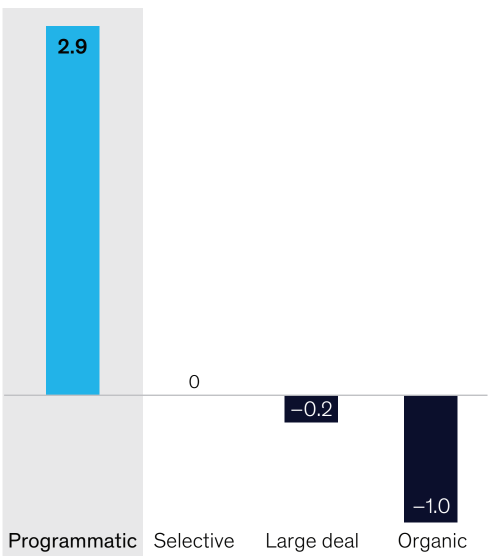
For companies using a large-deal approach to M&A—that is, pursuing deals in which the target company's market cap is greater than or equal to 30 percent of the acquirer's market cap—our research confirms that such pursuits are, as mentioned earlier, the equivalent of a coin toss. But companies can increase the odds of success with this approach by complementing it with a programmatic strategy. The data show that companies that pursued large deals early during the 2010s, but augmented this approach with programmatic M&A, generated 1 percent more annually in TRS (on average) than their peers did. They in fact won the coin toss (Exhibit 3).

Take one medical-device company, for example: between 2000 and 2009, it completed around one deal a year, and its excess TRS over the period was –1.5 percent. Between 2010 and 2019, the company went through a leadership change and adopted more of a programmatic model. It was then completing about six deals per year, including some larger targets (up to 10 percent of the company's own market capitalization). Most of the deals were focused on expanding the medical-device-company's

Exhibit 4

Programmatic M&A outperformed other M&A strategies during the COVID-19 pandemic.

Median excess total returns to shareholders,[1] Jan 2019–Dec 2020, %



[1]Companies that were among the top 2,000 companies by market cap (>$2 billion) on Dec 31, 2009, and were still trading as of Dec 31, 2019. Excludes companies headquartered in Africa and Latin America.

Source: Deal Patterns 2019; S&P Capital IQ; Corporate Performance Analytics by McKinsey

geographic footprint. In part because of its new approach to M&A, the company's excess TRS over the decade averaged 2.7 percent per year above that of its peers.

Finding 4: The programmatic approach can withstand periods of high economic volatility
Even during the COVID-19 pandemic, programmatic acquirers' performance far outpaced that of their peers using other approaches to M&A, which is consistent with patterns we have seen in prior downturns. What's more, the numbers show a widening performance gap between programmatic acquirers and companies using other approaches to M&A (Exhibit 4).

Finding 5: Changing course remains difficult
Despite all the evidence in favor of a programmatic approach, more than 50 percent of companies in our research base have kept the same M&A strategy over the past 20 years (Exhibit 5).

Why? Change is hard, and the programmatic model may not be the right fit for every company: some businesses may have to contend with organizational limitations or industry-specific obstacles. Nevertheless, it can be instructive for companies with any type of M&A program to take lessons from those that are changing course.

Consider a large brewing company: it increased its average annual deal count from about 1.5 (2000–09) to about three (2010–19) deals per year, and, perhaps more important, the size of the deals increased. In the first period, the deals targeted less than 2 percent of the brewing company's own market cap. In the second period, the deals targeted more than 5 percent of the company's market cap, with some acquisitions targeting 15 percent above its market cap. In part because of this change in approach, the brewing company's annual excess TRS grew from –6 percent in 2000–09 to +2 percent in 2010–19.

What do programmatic acquirers do differently?

M&A is not "an event," and it is not something that "happens" to a company. It is a capability that is essential for creating outsize value, and like any capability, it requires sufficient attention and resources to grow. Our decades of research on companies' M&A approaches and underlying capabilities point to three critical focus areas for success—what we've dubbed the three C's of M&A: competitive advantage, conviction, and capacity. The programmatic acquirers in our research base are particularly adept in each of these areas.

Competitive advantage

Our most recent data show that programmatic acquirers are more likely than their peers to understand how economic shocks, such as the COVID-19 pandemic, affect their competitive advantage and how to modify their corporate and M&A strategies and initiatives accordingly. Programmatic acquirers are also more likely than their peers to develop a robust M&A blueprint that explicitly defines how M&A will contribute to corporate strategy and guide proactive deal sourcing.

For instance, our 2021 survey revealed that programmatic acquirers are:

- 1.5 times more likely than peers to strongly agree that they have a clear understanding of their source of competitive advantage
- 1.4 times more likely than peers to strongly agree that they are aligned on the industry and market trends they want to pursue
- 1.4 times more likely than peers to strongly agree that they understand which assets they need to acquire to meet the company's M&A aspirations

Exhibit 5

Most companies stick with the same M&A strategy.

Global 2,000[1] companies

Starting program As of Jan 2008–Dec 2017

What happened to the cohort in the Jan 2010–Dec 2019 period, %

Kept starting M&A program (highlighted, bold) / Changed to other M&A program

Starting program	Programmatic	Selective	Large deal	Organic	Dropped out of Global 2,000
Programmatic	**57**	16	11	2	13
Selective	9	**54**	9	14	14
Large deal	9	19	**50**	7	17
Organic	1	29	3	**51**	16

Note: Figures may not sum to 100%, because of rounding.

[1]Companies that were among the top 2,000 companies by market cap (>$2 billion) on Dec 31, 2009, and were still trading as of Dec 31, 2019. Excludes companies headquartered in Africa and Latin America.

Source: Deal Patterns 2019; S&P Capital IQ; Corporate Performance Analytics by McKinsey

These companies have a trusted process for generating multiple financial and operational scenarios and leaning into them as they unfold, adjusting their strategies (including their M&A strategies) as they go. Previous McKinsey research points to the large TRS gains resilient companies achieved as a result of careful actions taken before, during, and after the 2008 credit crisis.[6] With a focus on competitive advantage during the latest economic shock, it is likely that programmatic acquirers have similarly positioned themselves ahead of their competition for several years.

Conviction

Programmatic acquirers continually assess and update their central M&A themes, so they can build conviction for targeted deals and act quickly when opportunities emerge. All too often, companies dedicate less time and attention to assessing an M&A opportunity than they would an internal deployment of capital—which is ironic, given how much larger M&A investments can be compared with most internal investments. Our research shows that programmatic acquirers are about 1.2 times more likely than their peers to build comprehensive business cases around potential M&A targets. By doing so, they can persuade senior managers and board directors to buy into the deal relatively quickly; they can also create a strong M&A narrative that can be shared with prospective targets, investors, the market, and others.

Our research also shows that programmatic acquirers are 1.4 times more likely than their peers to proactively reach out to prospective targets, and about 20 percent more likely than their peers to reallocate capital in line with corporate strategy. Notably, only 13 percent of programmatic acquirers paused their M&A activity in 2020 amid the COVID-19 pandemic, compared with 31 percent of nonprogrammatic acquirers.

Capacity

A company's ability to execute on its strategy often comes down to whether it has enough financial, talent, and organizational capacity. Programmatic acquirers tend to have a strong sense of that capacity given their well-developed M&A operating model. Because they don't have to reinvent the wheel for every due-diligence process or integration plan, for instance, they can execute more transactions while creating more value from each.

According to our 2021 survey, programmatic acquirers are:

- 1.9 times more likely than peers to strongly agree that they have the right capabilities (tools and talent) to execute their M&A strategy
- 1.4 times more likely than peers to strongly agree that they have clearly defined processes for all dimensions of a due-diligence process (financial, legal/risk, operations, culture, and talent)
- 1.6 times more likely than peers to strongly agree that they have a clear process for designing a new, integrated organizational structure

These and other data confirm that a programmatic approach to M&A and a focus on the three C's can lead to outperformance. But the proof is not just in the numbers; it's in the stories of businesses that have differentiated themselves through their ability to source the deals that align most with their overall corporate strategy—and to act quickly because of the knowledge, infrastructures, and capabilities they have built up around M&A.

The lessons come from, for instance, the luxury-goods company that has been able to generate outsize returns over the past ten years—and has continued do so, even during the COVID-19 pandemic. Between 2010 and 2020, the company completed nearly 50 deals and achieved excess TRS of 15.2 percent. Most of the targeted deals have been small (less than 5 percent of the company's market cap) although several have been larger (nearly 30 percent of its market cap). Through these acquisitions, the company has been able to build out product segments and expand its geographical reach. Given the high volume of deals the company has pursued, M&A has become a full-fledged capability—along the lines of R&D or marketing.

The case for a programmatic approach to M&A has long been established. But newer findings about its compatibility with the large-deal approach to M&A; its effectiveness in multiple sectors of the economy, notably during times of high volatility; and how it fares against organic-growth strategies reflect the staying power of this deal-making strategy—and the opportunities for the companies that are paying attention. Those that have tested and evolved their M&A strategies toward a programmatic approach will likely have the edge moving forward. Q

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[1] *Competition Matters*, "Adjusting merger review to deal with the surge in merger filings," blog entry by Holly Vedova, August 3, 2021, ftc.gov.

[2] Michael Deyong and John Reiss, *New heights: US M&A H1 2021*, White & Case, August 2021, whitecase.com.

[3] Organic M&A entails making less than or equal to one deal every three years, where the cumulative value of deals is less than 2 percent of the acquirer's market capitalization. Selective M&A entails making less than or equal to two deals a year, where the cumulative value of deals is greater than 2 percent of the acquirer's market capitalization (and not organic). Programmatic M&A entails making more than two small or midsize deals a year, where the total market capitalization acquired is meaningful (median of 19 percent). Large-deal M&A entails making more than or equal to one deal a year, where the target market capitalization is more than 30 percent of the acquirer's market capitalization.

[4] In our ongoing Global 2,000 Survey, we track the largest 2,000 global companies (by market capitalization), measure the amount of excess TRS they created compared with industry peers, and examine the type of acquisition strategy they deployed. The data confirm that programmatic acquirers continue to perform better than industry peers across sectors; the more deals a company did, the higher the probability that it would earn excess returns. Programmatic M&A entails pursuing a minimum of two small or midsize deals a year, with meaningful market capitalization acquired (20 percent to 30 percent).

[5] Organic growth refers to the growth a company achieves by expanding its own capacity, using internal resources.

[6] Martin Hirt, Kevin Laczkowski, and Mihir Mysore, "Bubbles pop, downturns stop," *McKinsey Quarterly*, May 21, 2019, McKinsey.com.