

M&A strategies in a down market

During a downturn, a thoughtful acquisition strategy is particularly important—but many companies don't have one.

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**Article
at a
glance**

Rough economic periods can create good opportunities for companies to buy undervalued assets.

McKinsey research indicates, however, that many do just the opposite: they are more likely to undertake divestments during downturns (and buy new businesses when times are good).

Earning better returns, though, requires discipline, a willingness to run against the crowd, and careful balance-sheet management that makes it feasible to invest when times are tough.

It's gut-check time for CEOs. As the credit crunch threatens to become a global downturn, corporate leaders have a choice: pull in their horns and ride out the storm or look for opportunities to pick up bargain-basement assets that will help them grow and create future value for shareholders. If past is prologue, more will follow the first course—which is a mistake.

Our research indicates that although most executives know and pay lip service to the maxim “Invest in a downturn,” few act on it. For our recent book, *The Granularity of Growth*,¹ we created a database of roughly 200 global companies and decomposed the most important sources of growth (market momentum, mergers, and share gains), not just for each company, but also for finer-grained market segments. Then we identified segments that had experienced significant upturns or downturns and looked at the strategies companies adopted during those periods.² Finally, we computed each company's total returns to shareholders so we could compare performance across growth sources, segments, and strategies.

Two sets of results stuck out. First, of the potential strategic moves companies can take to grow in a downturn—divest, acquire, invest to gain share—an effective acquisition strategy (defined as growth through M&A at a rate higher than that of 75 percent of a company's peers) created significant value for shareholders. During an upturn, on the other hand, divestments created slightly more value than acquisitions did.

Second, companies often behave in counterproductive ways (exhibit). Fewer than half as many companies in the segments we studied made acquisitions in downturns rather than in periods of economic growth. Significantly more divested businesses in those market segments in downturns than in upturns.

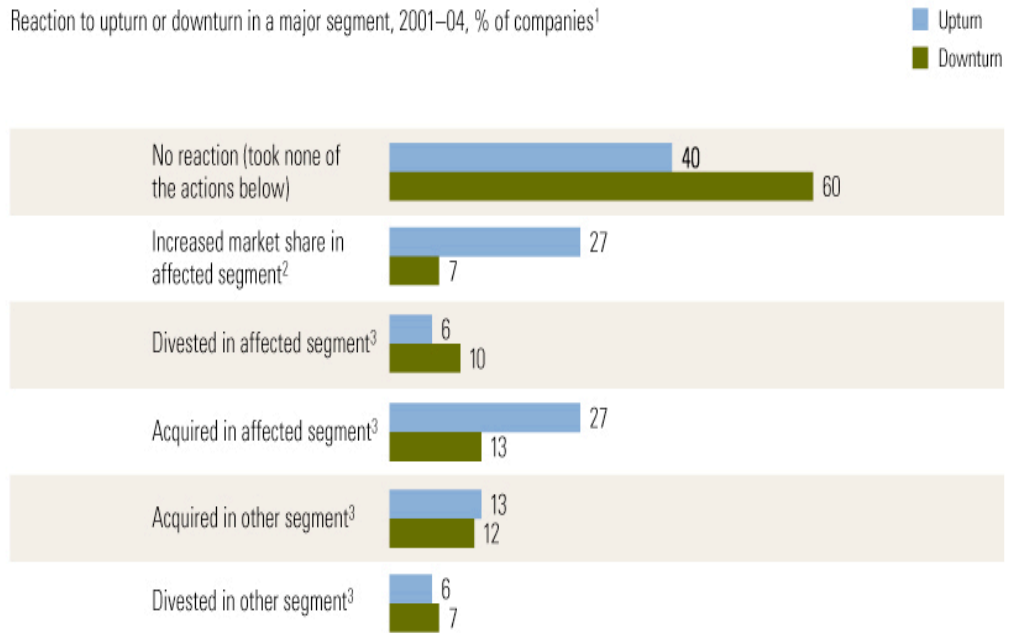
All of this is understandable. As revenues slow and margins are squeezed, management naturally switches its focus to cutting costs and maintaining earnings. The company protects its balance sheet—an approach leading to the deferral of growth and of low-priority investments, the shelving of large acquisitions, and the sale of assets. Many companies simply freeze: 60 percent of those in our database made no portfolio moves at all in downturns, compared with only 40 percent that made no moves in upturns.

The best growth companies take a different approach. They view a downturn as a time to increase their leads and make acquisitions. They pounce on the opportunities it creates with an alacrity that is the stuff of legends: think of GE's speedy dispatch of an army of deal makers to Asia after the financial markets took a downturn in 1998.

EXHIBIT

Downturns induce paralysis


Reaction to upturn or downturn in a major segment, 2001–04, % of companies¹



¹ 537 segments (from 187 companies) that had experienced significant upturns or downturns and that represented >10% of company sales; figures do not sum to 100%, because companies could have more than 1 reaction.

² Assumes share gain at rate better than 75% of sample.

³ For segments in period 2002–04, sum of acquisitions corresponds to 2.5 years of acquisitions at an inorganic-growth rate better than 75% of sample; sum of divestitures corresponds to 3 years of divestments.

We’re not saying companies should go on a spending spree in a downturn and tighten their belts in an upturn. Nor are we unaware that some companies simply aren’t in a financial position to exploit the opportunities downturns present. But for large numbers of healthy companies and their CEOs, we hope our research findings are a useful counterweight to the natural tendency, which is likely to harm shareholders. Simply put, countercyclical investment can separate the leaders from the also-rans. Arguments that growth is risky in a downturn overstate the case. 

About the Authors

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Notes

¹ Patrick Viguerie, Sven Smit, and Mehrdad Baghai, *The Granularity of Growth: How to Identify the Sources of Growth and Drive Enduring Company Performance*, Hoboken, NJ: Wiley Publishing, 2008.

²From our granular growth decomposition database, we identified the companies that had made significant moves during the period under measurement. We then made detailed segmented decompositions. Of the segments we identified, we focused on those that accounted for at least 10 percent of company sales. We then identified “upturn” segments that had market growth in 2002 and 2003 of at least 40 percent and three percentage points above the average for 2000 and 2001. We also identified “downturn” segments using a mirrored set of criteria.

This article was updated on September 12 to reflect new research on the relationship between divestitures and shareholder value during downturns. A previous version reported that active divestment strategies destroyed shareholder value, an assertion that was not supported by the new research.

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