News release

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PwC's *Doing the right deals* study: Capabilities fit is a winning formula for M&A as playing field shifts due to COVID-19

22 October 2021 – Ensuring there is a capabilities fit between buyer and target is key to delivering a high-performing deal, according to a new PwC study of 800 corporate acquisitions.

The study finds that capabilities-driven deals generated a significant annual total shareholder return (TSR) premium (equal to 14.2%) over deals lacking a capabilities fit.

Companies adapting to a pandemic-changed world are rushing to reconfigure their businesses, fuelling M&A activity. However, our research has shown that 53% of corporate acquirers underperformed their industry peers.

The need to move quickly increases the pressure to do deals at pace – and thereby the risk of failing to evaluate capabilities fit with enough care. **Ensuring such capabilities fit, however, dramatically increases the chances of your deal creating value.**

> **James Ferris, PwC Bermuda Advisory partner, said**:
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> "The M&A playing field has shifted due to the pandemic, reflecting a heightened need for new and different capabilities if an organisation is to generate value and create sustained outcomes.
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> "Our analysis confirms that focusing on building and complementing your existing offering can lead to enhanced shareholder value. An acquisition that builds on the buyer's capabilities is shown to deliver business benefits. We see this approach in the insurance industry, where established players are making acquisitions in the tech space, as insurers seek to enhance the current product offering through buying complementary businesses. Our analysis suggests that the increase in value from a capabilities driven deal is often greater to those aimed at consolidation, diversification or entering new markets."

Ferris notes that the frequency of capabilities-driven deals (enhancement and leverage) differs widely across industries—from 38% of deals in oil and gas to 68% in insurance and 92% in pharma and life sciences. Yet despite the variance, a positive capabilities premium was found in *all* 16 industries analysed.

The "Doing the right deals" study looks at the 50 largest deals with publicly-listed buyers in each of 16 industries and evaluates the characteristics that delivered superior financial outcomes for the buyers, as measured by annual TSR.

A capability is defined as the specific combination of processes, tools, technologies, skills, and behaviours that allows the company to deliver unique value to its customers.

Two types of deals were found to outperform the market: capabilities enhancement deals – in which the buyer acquires a target for a capability it needs -- and capabilities leverage deals – in which the buyer uses its capabilities to generate value from the target. These represent a true engine of value creation, delivering average annual TSR that was 3.3 percentage points above local market indices. Deals without these characteristics - limited-fit deals - had an average annual TSR of (minus) -10.9% compared to the local market indices.

While 73% of the largest 800 deals analysed sought to combine businesses that did fit from a capabilities perspective, 27% were limited-fit deals. The analysis shows that for every dollar spent on M&A, roughly 25 cents were spent on such limited-fit deals that in many cases destroyed shareholder value.

Capabilities fit delivers shareholder value across industries

The capabilities premium was found to be positive across all of the 16 industries studied. The share of capabilities-driven deals was highest in pharma & life sciences (92%), an industry where deals often combine one company's innovation capabilities with another's strength in distribution. Other leading industries in capabilities fit deals were health services and telecommunications (both with 90% capabilities-driven deals) and automotive (86%). Limited fit deals were found to be most prevalent in the oil & gas industry (62%), where asset acquisition can play an important role in addition to capabilities fit.

The analysis shows that the stated strategic intent of a deal, as defined in corporate announcements and regulatory filings, has little to no impact on value creation. Whether a deal fits or not depends less on stated goals of consolidation, diversification or entering new markets. What matters is whether there is a capabilities fit between the buyer and the target. Deals aiming for geographic expansion notably stood out as performing less well than others, largely because many of them (34%) were limited-fit deals.

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Notes to editors

About the Study

PwC examined 800 deals completed between 2010 and 2018 – the 50 largest deals involving publicly-listed buyers in 16 industries. The deals were evaluated through a capabilities lens to determine which characteristics helped generate the highest total annual shareholder return (TSR). Our examination was based on research (including the identification of acquisitions and analysis of deal performance) conducted by Bayes Business School of City, University of London (formerly Cass Business School). To measure deal success, the report authors determined the buyer's annualized TSR over a period ranging from just before announcement to one year post closing, against the performance of the leading local market index over the same period of time.

About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 156 countries with over 295,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com.