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To the outside world, deal making in the technology sector can often appear irrational, exuberant, and even insane. In what other industry would a five-year-old startup with reported revenues of US$10 million and fewer than 100 employees garner a $22 billion price tag? That's how much Facebook paid in February 2014 for WhatsApp, a messaging service that allows users to exchange text messages without paying for SMS.

It's easy to disparage the extravagance of such a megadeal. Indeed, the tenor of the discussion within the business community and in the media at the time of the announcement veered from disbelief to dismay about tech valuation bubbles. "Facebook Buying WhatsApp Is a Desperate Move," screamed a headline at Fox Business News.

But for established technology firms, the only thing worse than paying too much for a promising tech startup is failing to pay enough to acquire it. Generations of innovation gurus and consultants have lambasted IBM for missing the significance of the personal computer operating system and thereby enabling Microsoft to grow from a junior partner into a titan. Analysts have also criticized Microsoft for failing to purchase Yahoo, dinged Yahoo for missing the opportunity to acquire Google in the late 1990s, and chastised Google for not pursuing Facebook. To be sure, not every technology deal is like WhatsApp. But in technology, an industry unlike any other, a handful of people working in a garage can transform a market in the blink of an eye.

A New Megadeal Taxonomy

The unusual nature of deal making in the technology sector, particularly deals involving headline-grabbing transactions such as Facebook's WhatsApp purchase and Microsoft's $8.5 billion acquisition of Skype in 2011, demands a closer look. How should company leaders consider the value creation potential inherent in such deals? And how can they manage integration to ensure success and avoid destroying value? To get a handle on the megadeal universe, we examined 131 technology deals of at least $1 billion in size made over the past five years, with a collective value of $388 billion. The deals fell into four discrete categories.

Consolidation. These deals involve competitors, value chain participants, or companies with closely adjacent products and overlapping customers. The motivation in these transactions is focused less on growth and more on unlocking tremendous value by cutting costs and improving efficiencies. These deals tend to be highly successful because the companies know each other well and the synergy potential is significant and obvious. According to our analysis, more than 60 percent (or just over $25 billion) of the value of megadeals in the semiconductor subsector was related to consolidation (*see Exhibit 1*). Notable examples include Texas Instruments' $6.5 billion acquisition of National Semiconductor in 2011 and Avago Technologies' $6.6 billion purchase of LSI in 2013. Google's 2012 acquisition of the patent portfolio of Motorola Mobility stands as an example of value chain consolidation. Google held on to the patent assets after divesting the set-top box and mobile device assets it received as part of the $12.4 billion deal.

Capabilities extension. Deals that fall into this category — the biggest of the four by value —

Illustration by Lars Leetaru

typically involve two large, mature companies. In general, the buyer is seeking new products, new talent, or new customers in a large, tangential market where it doesn't already possess the capabilities to compete. Capabilities extension transactions accounted for 40 percent of the total value of tech megadeals over the last five years (*see Exhibit 2*). Examples include SAP's $8.3 billion acquisition of travel-expense specialist Concur Technologies in 2014, Oracle's $7.5 billion purchase of Sun Microsystems in 2010, and Microsoft's 2014 $7.2 billion acquisition of Nokia's device and services business.

Technology-driven market transformation. Facebook's aggressive move to buy WhatsApp typifies this category. Although these transactions constitute only 18 percent of tech megadeals, they tend to garner significant headlines. Why? Because they involve a new technology that is driving customer behavior in ways that could rapidly threaten established business models and transform existing markets, or that represent the potential for the convergence of existing markets. These deals tend to involve larger companies dishing out huge sums to buy small upstarts whose technology has great disruptive potential. Not surprisingly, these deals are most prevalent in the Internet subsector, in which they accounted for more than half of the total deal value from 2010 to 2014 (*see Exhibit 1*). Other examples include Google's 2014 purchase of smart home products maker Nest Labs ($3.2 billion), Facebook's swoop for virtual reality company Oculus ($2 billion), and Intel's 2011 acquisition of security software firm McAfee for $7.6 billion.

Going private. The fourth technology deal category consists of transactions in which private equity firms take companies private. In our analysis, these deals accounted for 23.5 percent of the total technology megadeals, and included the single biggest transaction: the 2013 deal that took Dell private for $24.3 billion. Such deals can occur for a variety of reasons. Because this article is addressing the unique considerations for strategic acquirers evaluating megadeals, we will discuss only the first three categories.

Avoiding the Megadeal Pitfalls

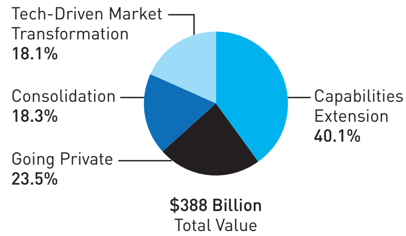
Corporate leaders experienced in mergers and acquisitions are well aware of the risks that come with transactions of all sizes. Many have honed deal-related processes and playbooks that serve them well when executing relatively small to midsized deals. However, we have observed that megadeals in the technology sector pose a unique set of challenges. They thus create barriers to success that are often unfamiliar even to executives with significant acquisition and integration experience.

Indeed, many of the large spin-offs and divestitures occurring in the technology sector today are the consequence of past megadeals that either did not pan out or no longer fit strategically. From the outset, these deals faced challenges in capturing expected synergies and moving the parties seamlessly toward becoming a single company. Today, faced with the need to focus on core capabilities or invest in new technologies — such as cloud computing, social media, and mobile technologies — many leaders are shedding prior investments.

Not all megadeals fail, of course. Indeed, when executed correctly, these transactions can propel

Exhibit 2: **Motivating Factors**

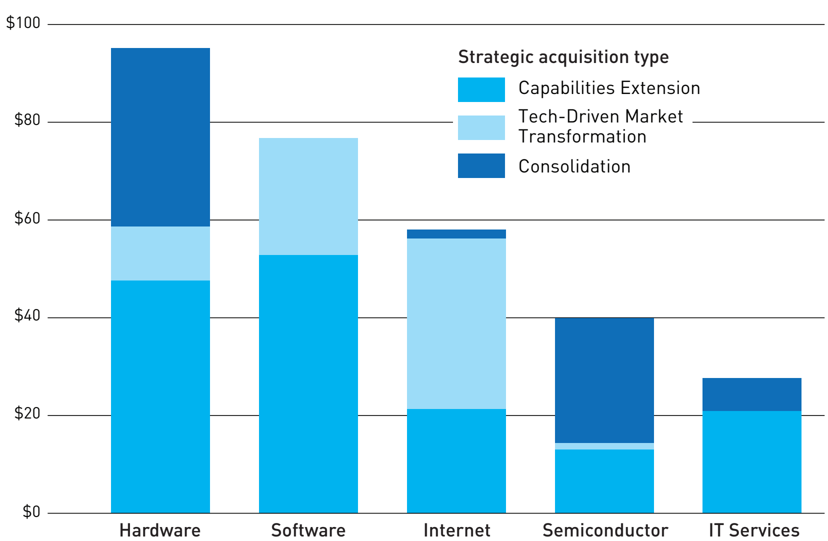
Megadeal value share by type, 2010–14



Source: Strategy&

Exhibit 1: **Coming Together**

Megadeals by sector and type, 2010–14, in US$ billions



Note: Does not include "going private" type of megadeals.
Source: Strategy&

purchasers ahead of their competition by creating formidable capability platforms, realizing significant operational efficiencies, and opening up new avenues for growth. To succeed, experienced leaders need to make adjustments and address certain challenges.

We've identified seven critical challenges to megadeals, and have developed strategies to cope with them. All seven apply to the three technology deal types under consideration — consolidation, capabilities extension, and technology-driven market transformation — although the degree of the challenge varies by deal type.

1. Assigning accountability. In a best-case acquisition scenario, a business unit (BU) leader is charged with driving the transaction because the acquired operations fall within his or her current scope. The BU leader evaluates the technology, the customers, the marketplace, and core business functions. What's more, the BU leader may take ownership of the integration and the combined performance plan. Consolidation-oriented deals tend naturally to include strong BU accountability because of the high degree of operational overlap.

However, in capabilities extension megadeals, almost by definition, BU accountability doesn't exist. In this vacuum, the chief executive officer often becomes solely accountable for the deal's business success. And that presents significant challenges to evaluating the business logic and post-close execution.

We have seen CEOs take a number of approaches to these deals and have generally observed that the more effective deals tend to involve a combination of the following:

- *Imposing enhanced functional accountability.* C-suite leaders in technology, sales and marketing, manufacturing and distribution, and corporate functions are empowered with acquisition ownership. And it is made clear that they are accountable for the quantification, execution, and delivery of synergies.
- *Increasing board governance.* Risks arise in transactions that are championed or led directly by the CEO. That warrants greater involvement by the board. Either a board member assumes a co-leadership role or the board more actively participates throughout the acquisition process. This may also require a greater use of external experts during the evaluation and execution phase.

A strong conclusion emerges that cost synergies are much more achievable than revenue synergies.

In general, each of these approaches distributes focus and accountability, augments capabilities, or provides for greater objectivity and transparency to guard against deal biases.

2. Relying on acquired management. This is particularly important for technology-driven market transformation deals in which knowledge about the new technology is held by a small group of creative or technology leaders. It's also important for capabilities extension deals in which the company is buying large operating units and needs experienced managers in place from Day One to ensure that these operating units continue to run smoothly.

This reliance on acquired management poses a dilemma because most of the senior team from an acquired company can afford to leave after the deal closes and will have other opportunities. They may also simply dislike the idea of running a business unit in the new company after having run the acquired company.

Given this reality, the acquiring company needs to assess how much it will rely on these senior managers and for how long. Retaining people contractually is often just a short-term solution; it's important to be mindful that retention does not always correlate with performance. Leaders need to judge whether newly acquired talent will keep their heads in the game, and put a succession plan in place for when they do leave. This process will involve significant relationship building, particularly with deputies and other sub-line leaders at the acquired company who might be able to step in and run the business unit over a longer term.

3. Valuing cost and revenue synergies. A strong conclusion that emerges from our study is that cost synergies are much more achievable than revenue synergies. So when evaluating targets, it is essential to assign more weight to cost opportunities and less weight to revenue opportunities. This is particularly true for consolidation plays, in which two mature companies come together and the cost synergies are apparent, quantifiable, and attainable. For example, when NXP Semiconductors announced in March 2015 its acquisition of Freescale Semiconductor, industry consolidation was the rationale. NXP CEO Rick Clemmer stated that the company anticipated $200 million in cost synergies in the first year, and $500 million to follow.

It is particularly difficult to achieve revenue synergies tied to a big new strategic vision, or to long-term assumptions that require integrating technology or changing customer behavior over many months or years. Such assumptions, which many times are baked into capabilities extension deals, don't often materialize, or materialize more slowly than expected, or materialize on a smaller scale than was envisioned. If the acquisition thesis is dependent on revenue, leaders must push for truly granular detail during due diligence, design a separate process within the integration to carefully manage revenue goals, and focus intently on driving revenue synergies as quickly as possible.

That said, revenue synergies cannot be completely discounted, especially when it comes to technology-driven market transformation deals. In 2006, when Google paid $1.7 billion in stock for YouTube, the price seemed high. However, YouTube has delivered tremendous growth. It posted revenues of about $4 billion in 2014, up from $3 billion in 2013. Buyers of today's hottest startups, such as Instagram, must take revenue synergies into account or they can never arrive at a competitive valuation. We have observed companies failing to get the most from capabilities extension transactions because they are reluctant to prioritize revenue synergies. And that can prevent the product or solution transformation needed to address converging technologies or shifting customer propositions.

4. Tailoring the playbook. Most acquisitive technology companies have developed extensive M&A playbooks and invested in internal capabilities to execute and integrate smaller "tuck-in" deals. But these playbooks may not be useful for megadeals. In particular, technology-driven market transformation deals, with their huge valuations, narrow focus, tiny revenues, and entrepreneurial management, may force an acquirer to toss out its playbook. Nothing in its recent corporate history would have prepared Facebook to pencil out a $22 billion purchase of an app. Not every deal will require such a leap of faith, but some will; it's the nature of the technology industry.

sophisticated institutional investors, legions of regulators, and audited books, have less to hide than small companies and thus require less due diligence. Or senior leaders worry about losing momentum by digging too deeply. Confidentiality issues are also cited as a reason to curtail due diligence, and leaders can be uncertain about the depth of due diligence that is legally permitted.

The net result is that companies involved in megadeals may know surprisingly little about each other. A lack of due diligence may not matter too much in the case of a technology-driven market transformation deal, because the target company is small and the potential for due diligence is limited. But a

Companies involved in megadeals may know surprisingly little about each other.

For consolidation and technology-driven market transformation deals, companies need to put their standard M&A playbook on steroids. Given the size and complexity of these deals, their unpredictability, and the higher volume of requirements across the enterprise necessary to execute them successfully, leaders need to step back, start with a clean sheet of paper, and tailor the integration approach to the specifics of the deal at hand. They must ensure that sufficient resources have been devoted to the undertaking.

5. Doing *more* diligence. Despite the size and complexity of megadeals, companies sometimes feel pressure to skimp on due diligence. An attitude often prevails that big public companies, with their

lack of due diligence can be quite damaging for capabilities extension deals if cost and revenue assumptions are not properly vetted.

Indeed, many of the megadeals completed over the past several years are unraveling today for the simple reason that the original due diligence did not uncover the barriers to success it should have. As a result, the hoped-for synergies never materialized. Before signing on the dotted line, CEOs and their teams should always consider what they didn't validate, and be sure they can live with the risk.

The adequacy of pre-acquisition due diligence should naturally be a critical focus area for the board. In other surveys and board seminars, we have noted a number of leading practices for boards approving large transactions, such as approving diligence priorities and "non-negotiables"; reviewing detailed (versus highly summarized) diligence findings; interacting with third-party due diligence advisors on topics including scope, access, and key findings; and reviewing pre-announcement integration plans and budgets.

6. Communicating effectively. Good communication is critical for all categories of tech deals from the moment a deal is announced. Investors, employees, and customers must all understand the goals, the integration activities necessary to achieve those goals, the metrics used to measure whether those goals are being met, and who is responsible for delivering on those goals.

However, the emphasis of that communication may vary by type of deal. For example, consolidation deals tend to create a lot of anxiety and dysfunction among employees worried that *cost synergies* translates into *lost jobs*. Since they're not entirely wrong, the senior executives need to have laid out the integration strategy for themselves in a detailed way so they can communicate confidently to employees — especially key employees whose jobs are secure. An inability to clearly communicate intentions inevitably creates uncertainty. Instead of focusing on deal execution, people begin to focus on personal survival.

By comparison, employees in technology-driven market transformation deals are often less concerned about job security; after all, they hold the critical intellectual capital the acquiring company needs to retain. In these deals, a greater emphasis may be placed on communicating with investors and Wall Street, which may be confused and upset by a very high price tag. Facebook CEO Mark Zuckerberg used a statement to explain the WhatsApp deal to investors. "WhatsApp is a simple, fast, and reliable mobile messaging service that is used by over 450 million people on every major mobile platform," he noted. "More than 1 million people sign up for WhatsApp every day and it is on its way to connecting 1 billion people. More and more people rely on WhatsApp to communicate with all of their contacts every day."

7. Managing the transaction as a business process. The larger the transaction, the more challenging the integration and the greater the need for a well-defined business process to focus resources and capital on the right activities at the right times and to capture cost and revenue synergies as quickly as possible. This is especially true for both consolidation and capabilities extension deals wherein two big companies are coming together with a large number of employees and customers.

It's helpful to remember that the deal process has an inherent flaw that a fit-for-purpose business process can mitigate. The original valuation is by necessity based on many assumptions. After the deal is announced, those assumptions cannot be automatically accepted as fact. Once the company gains access to people and additional information at the target company, the acquirer must put a tailored business process in place with the requisite accountability and transparency to get data and test assumptions with fact-based analyses, and then make further decisions.

The business process for these types of deals must include a clear set of guiding principles and goals connected to sustaining everyday operations and capturing synergies, and relentlessly focus on quantifying, reporting, and executing on value capture opportunities. What's more, the process must empower leaders to keep the integration on track by giving them latitude to make quick decisions regarding organization, people, customers, and priorities — and hold these leaders responsible for communicating those decisions to customers, employees, shareholders, and partners.

However, in the case of a technology-driven market transformation deal, the integration should be handled more like a relationship and less like a business process. That's because the smaller, more entrepreneurial team from the target company usually needs a more personal touch to stay engaged post-close.

The challenges associated with technology megadeals are significant and vary with the type of deal. Even so, we believe that megadeals are worth doing as long as the acquirer acknowledges these challenges and tackles them head-on. When executed correctly, these transactions can boost efficiencies, increase revenues, and propel a company ahead of competitors. They can even reshape an industry. +

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