

2. Why Companies Pursue M&A: Strategic Rationale and Capital Allocation



M&A as Capital Allocation Decision

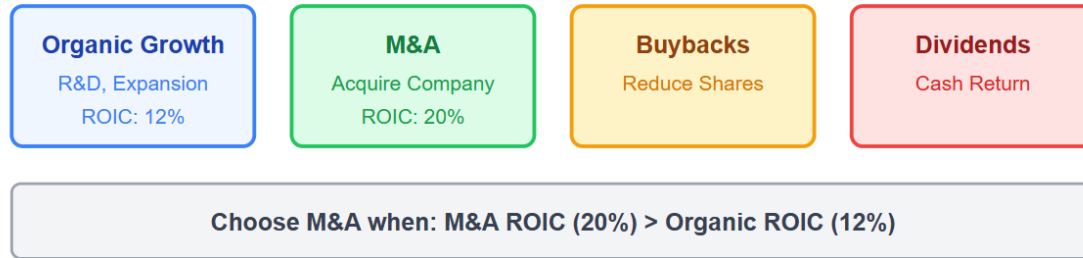
- Companies pursue M&A when inorganic returns exceed alternative uses.
- CFOs evaluate four primary options for distributing free cash flow.
- First option involves reinvesting in organic growth via R&D.
- Second option is acquiring companies to accelerate growth.
- Third option returns capital via stock buybacks reducing shares.
- Fourth option pays dividends directly to equity holders.
- Boards approve M&A when returns exceed organic hurdles.
- Successful acquirers reject deals failing to exceed organic returns.
- Framework compares acquisition NPV against internal building NPV.
- M&A is preferred when acquisition ROIC (20%) > organic ROIC (18%).
- Strategic acquirers like Cisco require specific financial return criteria.
- Private equity firms apply stricter return thresholds due to agreements.



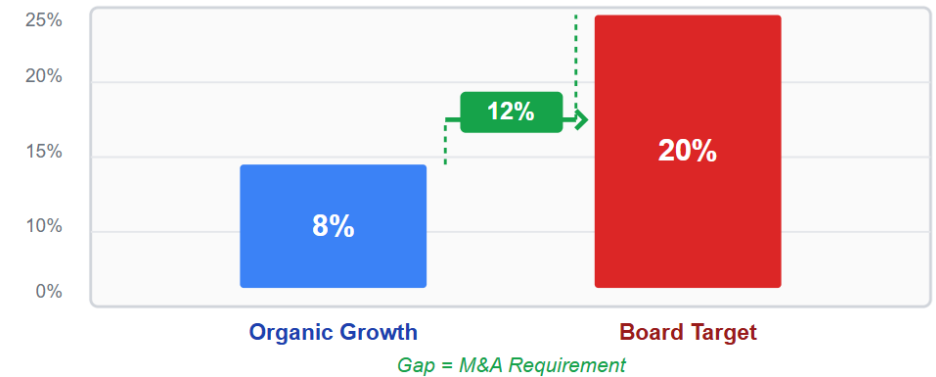
Quantifying the Growth Gap

- Growth gap is difference between board targets and organic rates.
- Management presents 3-year revenue targets based on market expectations.
- Finance teams model maximum achievable organic growth scenarios.
- The delta between target and organic growth drives M&A.
- Company with 8% organic growth needs 12% inorganic contribution.
- This 12% gap determines required acquisition pipeline and sizing.
- Companies calculate acquisition size needed to close performance gap.

Capital Allocation Framework



The Growth Gap



2. Why Companies Pursue M&A? [Part 2]

Industry Life Cycle Determines M&As



Growth-Stage Industries: Market Share Consolidation

- High-growth companies use M&A to consolidate share and eliminate competition.
- Facebook's acquisition of Instagram for \$1B and WhatsApp for \$19B exemplifies this.
- Deals aimed to consolidate markets before competitors could establish dominance.
- Growth-stage M&A expands core business, not unrelated markets.
- Strategy emphasizes user acquisition, tech integration, and positioning.
- Buyers pay premiums justified by future growth potential.



Mature Industries: Market Expansion and Efficiency

- Mature companies use M&A for scale and efficiency.
- Consolidation creates cost synergies through closures and reductions.
- AB InBev acquired SABMiller for \$107B, exemplifying mature consolidation.
- The deal combined networks and eliminated duplicate overhead.
- M&A generates value through cost reduction, not growth.



Declining Industries: Portfolio Diversification

- Declining companies use M&A to enter growing markets.
- Philip Morris acquired Kraft Foods due to declining tobacco consumption.
- Acquisition provided stable revenue offsetting tobacco business deterioration.
- Media companies acquired digital properties as print collapsed.
- M&A represents strategic transformation rather than core expansion.
- Deals face high execution risk in unfamiliar markets.

Industry Life Cycle & M&A Strategy Alignment

GROWTH STAGE	Objective	Primary M&A Purpose	Value Driver	Risk Level
	Expand dominance	Market share consolidation	Revenue growth	Medium
MATURE STAGE	Objective	Primary M&A Purpose	Value Driver	Risk Level
	Protect margins	Scale and efficiency	Cost synergies	Low
DECLINING STAGE	Objective	Primary M&A Purpose	Value Driver	Risk Level
	Survive and transform	Portfolio diversification	Business mix shift	High

2. Why Companies Pursue M&A? [Part 3]



Market Cycle Considerations

- M&A activity concentrates during specific conditions creating deal pressure.
- Low interest rates reduce financing costs making larger deals feasible.
- Strong equity markets provide currency for stock-based transactions.
- Sellers pursue exits during valuation peaks before market corrections.
- Buyers must execute deals before competitors acquire attractive targets.



Competitive Response Imperatives

- Competitor acquisitions force reactive M&A for competitive parity.
- Amazon's \$13.7 billion Whole Foods deal created immediate strategic pressure.
- Walmart responded by acquiring Jet.com demonstrating competitive response pattern.
- First-mover advantages create urgency for lagging industry competitors.
- Companies delaying strategic acquisitions risk permanent market position loss.



Technological Disruption Defense

- Companies acquire tech capabilities they cannot develop internally in time.
- Traditional automakers acquired EV startups responding to Tesla's disruption.
- GM acquired Cruise Automation for \$1 billion gaining self-driving tech.
- Legacy companies use M&A as faster alternative to internal development.



How Advisors Frame Investment Thesis

- Advisors present M&A rationale to Boards using structured frameworks.
- The investment thesis quantifies growth gaps and compares build versus buy economics.
- Board materials include sensitivity analysis across multiple integration scenarios.
- Advisors emphasize strategic fit, returns, execution risk, and competitive necessity.

