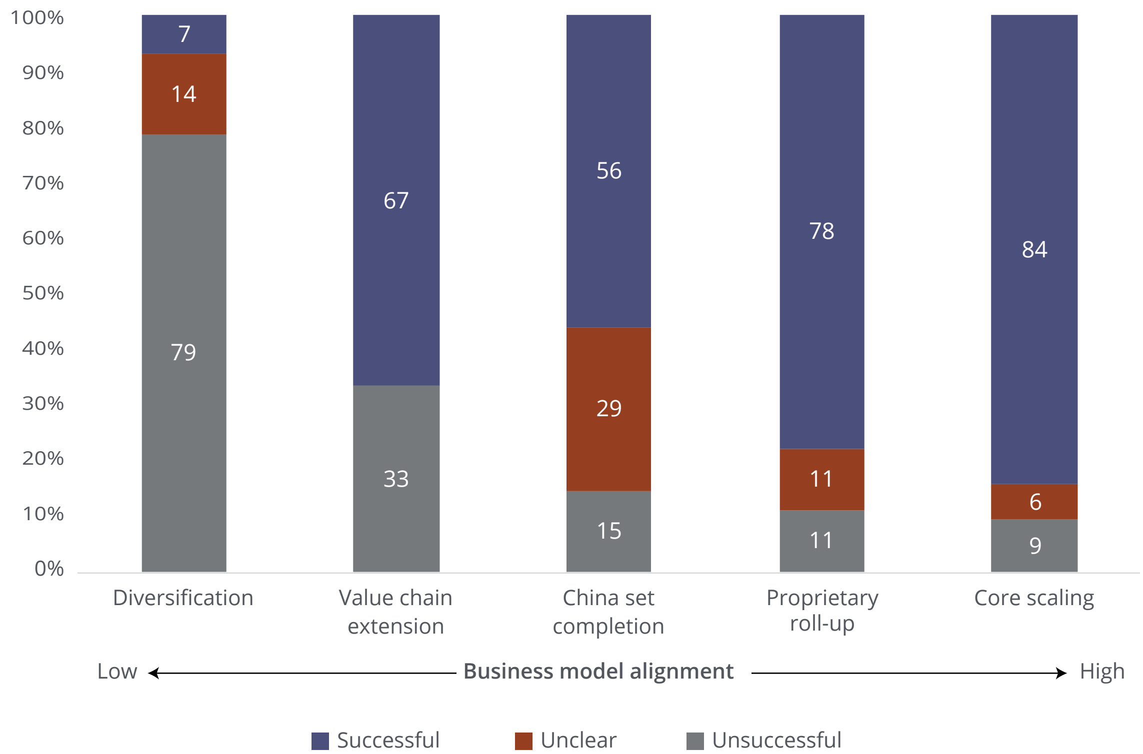
Why business model compatibility matters

WHAT'S the most important factor in the success of mergers and acquisitions (M&A)? In the aerospace and defense (A&D) industry, it may be something most leaders don't pay much attention to: business model compatibility. Our research shows it's highly related to transaction success, and failing to consider business model alignment could spell trouble for U.S. A&D companies seeking to diversify through M&A.

We examined 228 A&D deals from 2007 through March 2017, including all transactions of US$50 million or more where the acquirer was based in the United States. We then examined business model compatibility—the extent to which an acquirer's business model either is similar to the target's, *or* the extent to which accommodations have been made for any differences. Our finding? Business model compatibility showed the strongest relationship with M&A success, even more so than lawsuits, oil prices, or defense budgets (see figure).

Now, we're not claiming A&D companies shouldn't acquire organizations whose business models differ from their own, or that they can't do so successfully. And companies can and do, of course, choose to engage in multiple businesses with different business models. Yet organizations should consider thoughtfully planning for and addressing differences when evaluating and executing deals. And leaders should be aware the core business model of the acquiring company often exerts a "pull" on subsidiary businesses, resulting in the model employed by the main business, or small variants of it, applying across the board. That's why talk of adopting "best practices" from parties in a deal can be an illusion: The acquiring company's approach often becomes the default for all.

M&A outcome by deal type



Source: For deal type definitions, see Harlan Irvine, Gagan Chawla, Maryann Zeira, and Ted Sinsheimer, *Finding equilibrium: Managing business model compatibility in A&D deals*, Deloitte Insights, February 7, 2018.

What's typically required for M&A success is a willingness to find an equilibrium between the acquirer's and the target's business models—one that achieves a good fit between the markets pursued and the business models employed. To do this, be honest in evaluating the company's ability to support specific business models, and specifically address business model compatibility as a focus area for the senior executive team. Dedicate appropriate time and resources to planning how to integrate and run the acquired business in light of its degree of compatibility. And give the people in charge of executing the integration the necessary strategic understanding, decision-making authority, and operational latitude to establish a business model that works for the marketplace—whether that means completely integrating the target into the main business, setting it up as a wholly separate division, or something in between.

The path to business model equilibrium lies in understanding what business models are needed to effectively serve the markets in which one chooses to compete—and then deliberately designing each business model to fit its market. Those who do not may risk destroying value in their M&A pursuits.

To read more about business models' impact on M&A transactions, read *Finding equilibrium: Managing business model compatibility in A&D deals* on www.deloitte.com/insights.