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Mergers & Acquisitions at the Intersection of Digital and Global Interaction

The high demand for investments in digital business transformation is a driver of company focus, according to Markus Braun and Florian Graf.

MARKUS BRAUN AND FLORIAN GRAF

Swiss corporations with a global footprint have completed an astonishing number of M&A mega-transactions across all industries over the last five years. Holcim and Lafarge merged in 2014 to become the world's largest cement manufacturer. In 2016, the Chinese company ChemChina bought Syngenta for CHF 44 billion. Sabic acquired a majority stake in Clariant. Novartis listed its ophthalmology division Alcon on the stock market. Nestlé sold its CHF 10 billion skincare business to a consortium of buyers led by EQT, and in turn bought the worldwide distribution rights for coffee from Starbucks as well as a number of health food companies. More recently, ABB sold its power grid business to Hitachi and now will focus on robotics.

The strategic drivers for these mega-deals are cost synergies, the opening up of markets, and technological gains. A new trend is the acquisition-led focus on a selected core business — cement in the case of LafargeHolcim, food for Nestlé, pharmaceuticals for Novartis, and robotics for ABB.

An important driver for this focus is the high demand for investment in digital business transformation — converting an analog business model into a digital one is an expensive undertaking. By focusing on one business sector, the sale of non-core businesses can free up funds that can be used in a more targeted manner for digital transformation processes.

The digitization of a company requires various types of investment. This includes technology, often by acquiring a suitable start-up. Companies also need to invest in the market. More and more customers want to be addressed through the new digital channels. A digital business model increases transparency and, therefore, also the pressure on margins. In digital competition, "the winner takes it all."

As examples such as Amazon in the United States, Alibaba in China, and Zalando, N26, and Zur Rose in Europe demonstrate, the path from digital start-up to market leader usually includes a low-income dry spell with high investment in the market and in technology. The strategic allocation of resources to broadly diversified businesses is a thing of the past. In the current interplay between globalization and digitization, business models with a clear focus have a much better chance of succeeding.

Megatrends in digitization include…

- the real-time processing and use of big data for consumer research and marketing, as well as for security purposes,
- the rapidly growing importance of millennials as a customer group,
- the sharing economy, and
- direct digital customer contact from companies without intermediaries.

The young customer group composed of millennials prefers different media to that of older generations. Social media platforms such as Instagram, Facebook, Twitter, WhatsApp, and WeChat are communication channels used most frequently and on a daily basis by this age group to stay informed and in touch with companies. Millennials, who will soon be the largest group of consumers, feel more at home when approached through these new digital channels.

The US and China Take the Lead

Modern companies offer completely different channels of communication depending on the age and purchasing behavior of the respective target group. Florian Graf researched the consolidation forces in the luxury goods retail sector in his Master's thesis at the ZHAW School of Management and Law. In this rather conservative Swiss industry, digitization is now at the top of the to-do list for many companies; luxury watch customers do extensive online research before deciding what to buy. The younger generation, in particular, wants to find out about a dream watch in ways that are convenient, transparent, and user-friendly before making a purchase — if possible online.

Precisely for this reason, the Swiss Bucherer Group, for example, has acquired various competitors in recent years to enhance its digital capabilities and increase its global footprint. Other large companies in the luxury watch industry are investing large sums in the development and management of digital platforms, websites, e-commerce solutions, and social media.

Social media, in particular, must not be neglected. Millennial luxury watch buyers tend to allow their purchasing decisions to be influenced by social networks and a powerful global community has evolved, taking the place of family and friends in helping them decide. Today's young, potential luxury watch customer seeks acceptance and validation through digital platforms. Of course, any problem with a watch brand or criticism of a manufacturer will spread just as quickly and virulently and can damage a company's reputation.

To a varying degree, but always with a customer-centered focus, the trend of digitization is also gaining ground in all other relevant Swiss sectors, such as pharmaceuticals, retail, banking, insurance, and real estate. At the intersection of digitization and globalization, it is interesting to see the importance of large economies connected by language or common borders in achieving fast digital scaling effects.

In areas affecting end-consumers, such as e-commerce, social networks, and search engines, success has been enjoyed by four U.S. big-tech companies — Google, Amazon, Facebook and Apple (Gafa) — and three Chinese big-tech companies — Baidu, Alibaba, and Tencent (Bat). In Europe, with its many languages and regional differences, no big-tech company has yet been able to establish itself with the purchasing and sales power of these American and Chinese big-tech giants, although Europe is the largest contiguous economic area. Zalando, the largest European online retailer, is still a regional market player without a global presence.

Scaling Effects Are Key

This observation poses a significant challenge for Europe and Switzerland. Disruptive big-tech companies from the US and China, as industry outsiders, are shaking up business in various sectors. In these large economies with vast numbers of consumers, one language, a single customs and legal system, and a large corporate ecosystem, digital winners quickly gain a scaling advantage. They are better equipped to compete globally than competitors who, to outgrow their small domestic market, must operate in the lesser-known terrain of international markets. Digital "blitz scaling" is much more successful in such a constellation than in an elaborate economic set-up. After all, once digitization has arrived in an industry, it is all about scaling effects. With online transparency to thank for falling product margins, sales volumes and market leadership are crucial.

The following aspects are increasingly relevant in terms of a promising M&A strategy for Swiss companies in the digital age:

- Future-oriented business models geared towards the aspirations of millennial customers — digital experience, sharing, socializing, and transparency;
- A focused, vertically integrated value chain right down to the customer to ensure success rather than diversification across different sectors;
- Digital business models that are customer-centered; the digital transformation of individual analog process steps within the value chain is not sufficient; and
- Digital scaling effects that can trigger avalanches: "The winner takes it all."

In digital competition, the small, multilingual home market of Switzerland can be a disadvantage. This fact should not only be considered in a company's M&A strategy, it should also feed into the discussion on the Swiss framework agreement with the EU.

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