



# Building value through mergers and acquisitions

Perspective on value creation

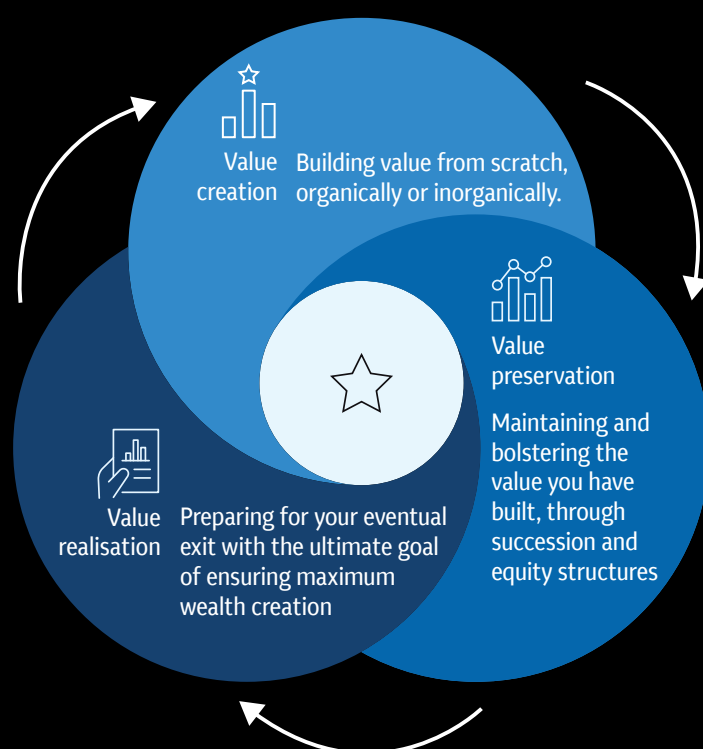
**Macquarie Banking and Financial Services**

# Perspective on value

If your goal is to develop a business with long-term, sustainable success, it's important to plan for and build value throughout its lifecycle: from origin, through to your eventual exit.

It's our point of view that looking at your business' value trajectory as a continuous, cyclical process embeds the building of value into how you do business.

We've broken down the lifecycle of business value into three phases:



At the intersection of the three phases of value lies your business prosperity and longevity.

Our Perspective on Value series explores these life cycles in depth, with a focus on the most common avenues we see our clients successfully harness when embedding value growth in their businesses. We've pooled knowledge and experience from across our Macquarie ecosystem to bring you a detailed outlook on the market for business growth, what we're seeing across our clients' industries, and best practice indicators for success.

## Value creation

Constant creation of value throughout the life cycle of your business is critical to lasting success.

In our experience, the businesses that can execute a strategic combination of organic and inorganic growth strategies to scale their operations tend to create the highest, and most sustainable, value.



## Foreword

Merger and acquisition (M&A) activity is currently strong in several industries that Macquarie associates with.

At face value, mergers and acquisitions are a fast and effective path to growth, allowing you to absorb the finances, structures, talent and strategies of competitors, and combine forces to advance your growth trajectories.

To execute a successful merger or acquisition, you need a proven strategy, careful and extensive planning, and a host of trusted advisers to guide the process.

We believe that, before getting swept up in the excitement of the deal, it's critical to first:

- Consider whether M&A is aligned with your business goals
- Map out your M&A strategy based on those goals, plus financials, resource, and risk.

Without this, the deal can impose costs, rather than add value, for key stakeholders. The process carries substantial risk due to legal, financial, economic and human factors, which require thorough consideration.

At Macquarie, we have extensive experience in supporting businesses, from small to medium enterprise to commercial and institutional level, through the M&A process, and in executing successful deals that bring long-term benefits for both buyer and seller.

When executed well, M&A can open up a host of new opportunities, from enabling growth and expansion, and boosting staff retention efforts, to building value in your business for future sale or exit.

This report will discuss when M&A is the right path to take, and will explore our proven framework for preparing, executing and sustaining a successful M&A deal.

It has been immensely rewarding to work with business owners in creating, growing, and realising the value of their life's work. Now, the market is ripe for growth and innovation, with an abundance of opportunity. How you prepare for and capitalise on this is key. Whatever your goals may be, our teams would be delighted to work with you.

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# The growth journey

## The case for scale

Innovation is essential for profitable business growth that can withstand the current pace of change. In high-performing businesses, there is usually a drive for scale, with goals to become more saleable and efficient. For many business owners, it is core to their strategy.

Our point of view is that scale enables your business to:



**Grow in capacity and capture new opportunities**



**Diversify and expand across new disciplines, business models, or geographies**



**Adapt to wider business and economic landscapes**



**Build business capability**

Scale justifies expansion of roles, and investment in technology



**Attract and retain talent**

Larger businesses may have greater capability to offer stronger employer branding and career opportunities



**Reduce key person risk**

Scale enables owners to reduce their time in the business, spending more time focusing on strategy and succession



**Create a liquidity event**

Capture the opportunity to extract value from your business, potentially borrowing from lenders on more favourable terms



**Share equity, or create profit share models**

This may attract investors or directors

When executed correctly, M&A can be a valuable strategy for accelerating your scale ambitions. However, the implications are substantial, with both risks and benefits at play. Your growth strategies need to be carefully planned and managed, with adequate and appropriate finance to minimise risk in the face of unforeseen outcomes.

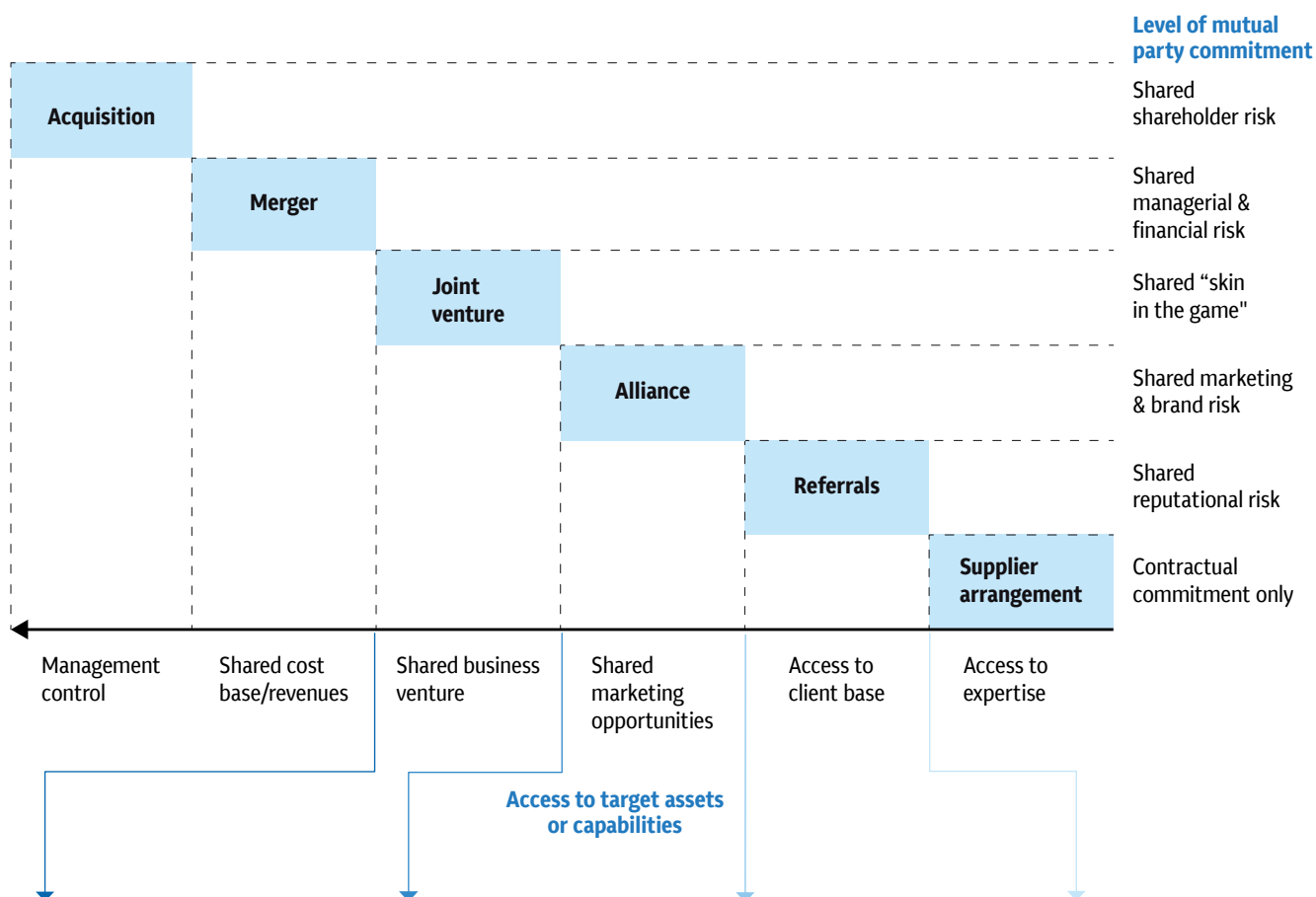
## Ways to grow

M&A is just one of the pivot points to growth and scale. It's important to understand all the options available to you, so that the path you choose best aligns with your goals and the nature of your business.

So, how do you determine which growth strategy is right for your business?

	Useful for businesses who want to...	Less useful for businesses who want to avoid...
<b>Organic</b> Expanding business through internal resources, capabilities, and reinvestment of profits	<ul style="list-style-type: none"> <li>• Maintain control over decisions</li> <li>• Grow at their own pace</li> <li>• Build on existing strengths</li> <li>• Attract more aligned clients through disciplined 'bullseye client' filtering</li> </ul>	<ul style="list-style-type: none"> <li>• Slower growth</li> <li>• Reliance on internal resources and capabilities</li> <li>• Competitive saturation</li> <li>• Limited diversification</li> </ul>
<b>Merger</b> Joining with a business with complementary strengths to increase scale	<ul style="list-style-type: none"> <li>• Increase market power and scale</li> <li>• Diversify product or service offering</li> <li>• Pool resources, expertise, technology, and risk</li> <li>• Consider strategic realignment</li> <li>• Enhance financial strength: balance sheet, borrowing capacity</li> </ul>	<ul style="list-style-type: none"> <li>• Cultural and management integration challenges</li> <li>• A lengthy and complex deal process</li> <li>• Distraction from core business operations</li> <li>• Additional financial risk and regulatory scrutiny</li> </ul>
<b>Acquisition</b> Purchasing existing businesses and incorporating them into your business	<ul style="list-style-type: none"> <li>• Add scale and value to their existing business</li> <li>• Bring in new expertise or technologies</li> <li>• Enter new markets, sectors or geographies</li> <li>• Expand client relationships</li> </ul>	<ul style="list-style-type: none"> <li>• Significant restructuring to systems, operations, and cultures</li> <li>• Additional financial risk and regulatory scrutiny</li> </ul>
<b>Bolt-on</b> Usually smaller, more strategically aligned acquisitions that can more quickly be integrated into the existing business	<ul style="list-style-type: none"> <li>• Add complementary products, services, capabilities or client base, to enhance core business</li> <li>• Execute a smoother transition</li> <li>• Quickly gain assets or market share</li> </ul>	<ul style="list-style-type: none"> <li>• Incremental gains rather than transformational</li> <li>• Additional financial risk and regulatory scrutiny</li> </ul>
<b>Succession and equity plans</b> Preparing for principals' transition and/or exit to sustain maximum business value	<ul style="list-style-type: none"> <li>• Pave a path for leadership continuity</li> <li>• Attract and retain high quality talent</li> <li>• Incentivise high performance and engagement</li> </ul>	<ul style="list-style-type: none"> <li>• Dilution of ownership</li> <li>• Regulatory, tax and compliance hurdles</li> <li>• Dependence on internal talent</li> </ul>

## The trade-off spectrum



### Joint venture

Creation of a new, separate company jointly owned by each partner



### Alliance

Collaboration and resource-sharing to leverage each entity's strengths and capabilities, without full integration or ownership



### Referrals

Agreement to share existing relationships and networks between parties



### Supplier arrangement

Mutually beneficial relationship with suppliers on a contractual or fixed-term basis

There's more than one way to reach your goals. Before going down the path of M&A, consider whether a more accessible organic growth option might work for you.

Organic choices provide less access to the target's assets and capabilities, in exchange for less of a commitment to their business – your level of risk.

M&A is at the top of the commitment/access curve: They offer the highest levels of access and control, but also require the highest levels of commitment, and not just financially. While it may be the best option, ensure you've also considered the alternatives and the trade-offs that they entail.

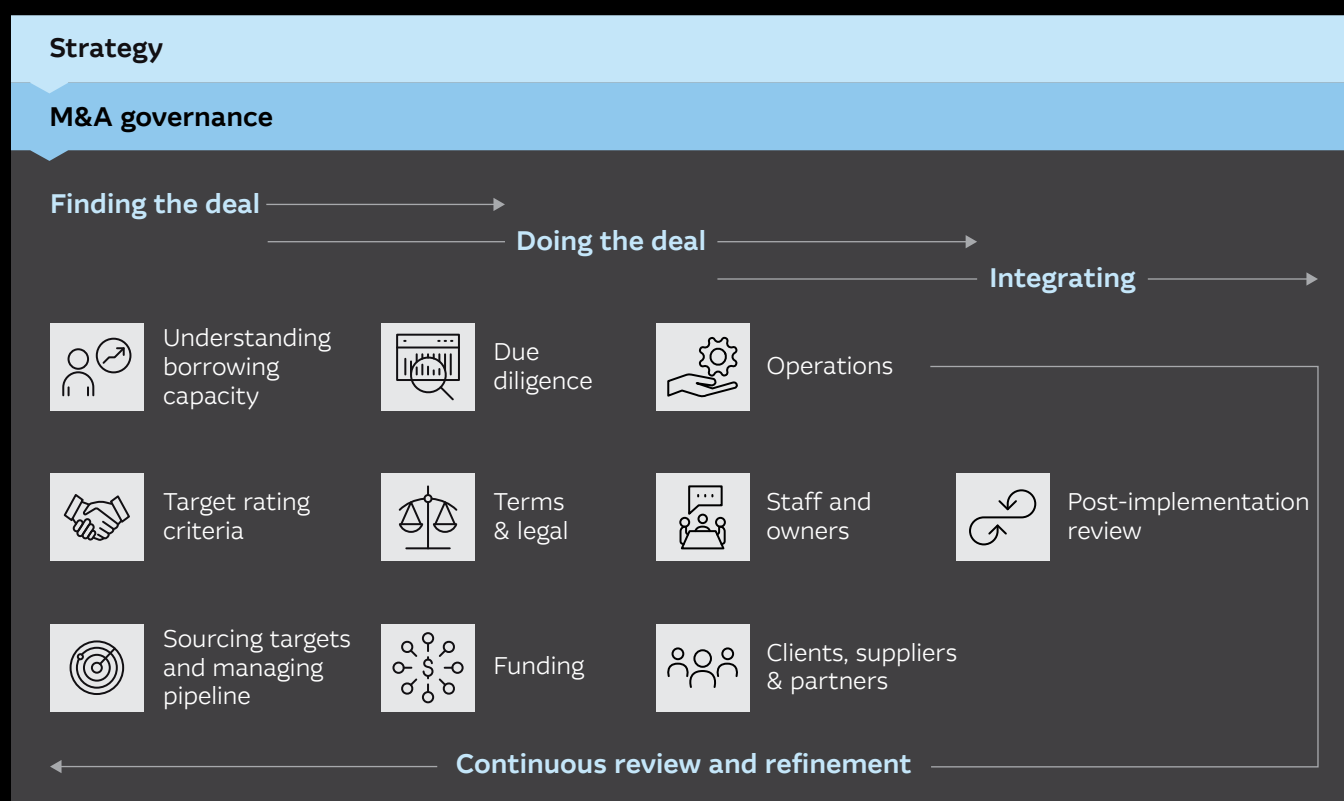
# The M&A framework

“Typically, 70% - 90% of acquisitions are abysmal failures”<sup>1</sup>

If you undertake your merger or acquisition for the wrong reasons, or without a well-defined strategy, the deal is likely to be unsuccessful.

A strong framework is essential to success. Many of your competing buyers will have such a framework in place.

Our framework reflects the approach that we have seen be most successful in practice, and is based on the growing complexity around M&A in market today: competition, compliance, due diligence, and a growing number of well-resourced, well-prepared investors all complicate the deal.



1. Roger Martin, “M&A: The One Thing You Need to Get Right”, HBR, June 2016.



## Strategy

Before committing to the M&A process, you should have a sound strategic rationale in mind.

What is your overall business objective in undertaking an acquisition? Your goal should always tie back to adding **meaningful** scale, increasing profitability and justifying a higher value.

Businesses can, and have, undergone an M&A strategy for the wrong reasons. Make sure you're buying or merging for logical reasons.



### The right reasons

Unlocking unrealised potential in a target

Accessing new clients, markets or expertise

Acquiring fresh talent or intellectual property

Increasing economies of scale

Creating a succession or exit strategy



### The wrong reasons

Buying growth or revenue, without growing profitability

Attractive valuation is 'too good to pass up'

Unproven positive synergies

Shareholders demand it

Everyone else is doing it

The bottom line is that M&A needs to grow owners' or shareholder value. The right deal benefits both you and the seller, where both of you help the other achieve its potential, and share in the value it creates:



### You bring something unique to the target

Their business is integrated into a larger, thriving entity, increasing its value and benefiting the principals, their staff, and their customer.



### The target brings something unique to you

Talent or capabilities, geographic expansion, diversification into new markets, a successor who can take over when you exit the business.



## Governance

You need to govern your M&A efforts deliberately, aligning your activity with your strategy. Disciplined governance will ensure you are driving the right activity to achieve consistent results.



### **Roles and responsibilities**

Define accountability measures for the people and resources you're committing to the effort.



### **Activity targets**

Define the levels of activity and outcomes your team should achieve, setting realistic targets and performance expectations to maintain accountability.



### **Strategy alignment**

Keep track of how your process aligns with your overall strategy.



### **Target value proposition**

Create a value proposition, covering key concerns: clients, staff, financial outcome, reputation, rapport and trust.



### **Resourcing**

Ensure you have a team that is resourced enough to commit time to pipeline efforts and change management.

## Finding the deal

With clarity on why you're acquiring, and what you're looking for, you can now begin to consider your funding options and systematically find appropriate targets.

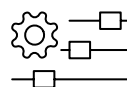
### Your borrowing capacity

If you have clear understanding of your access to capital before sourcing targets, you'll find your search will be more focused, more efficient, and supported by a clear vision of what the ideal target looks like. It will also ensure you're investing your time in viable opportunities.

The mix of finance you choose will determine:



**The cost of capital**



**The amount of control you surrender**

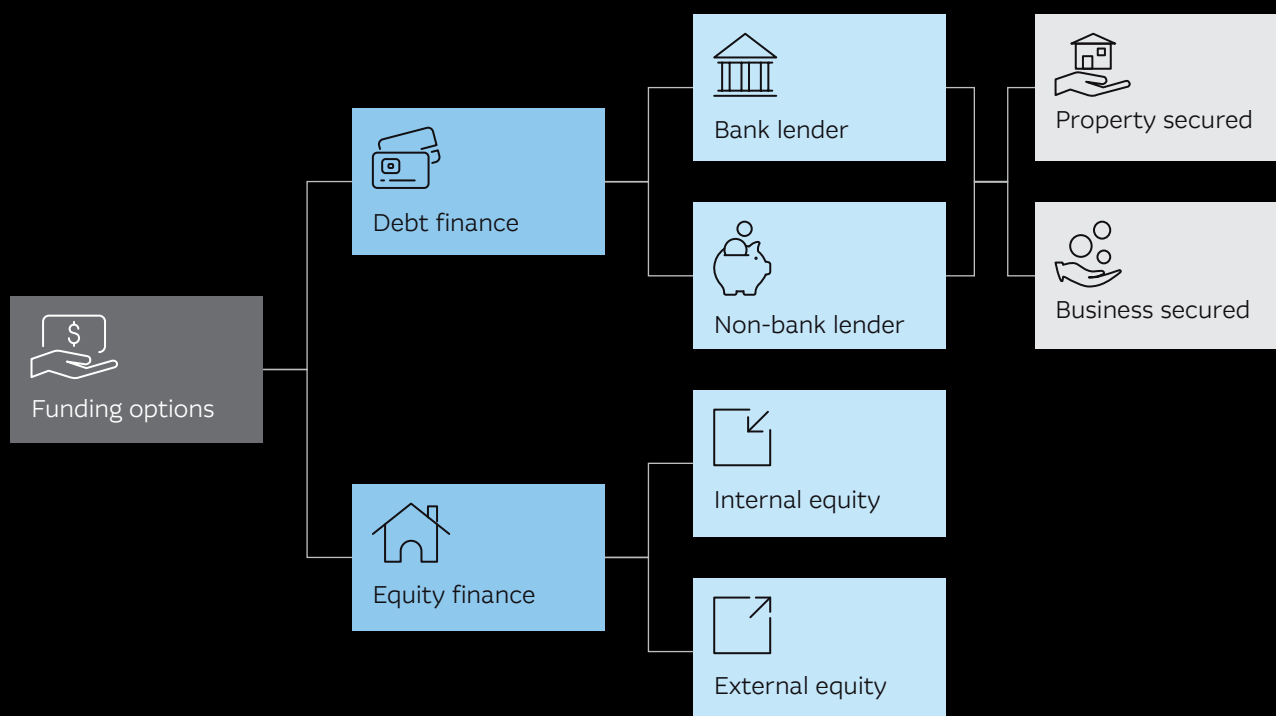


**The degree of risk you accept**



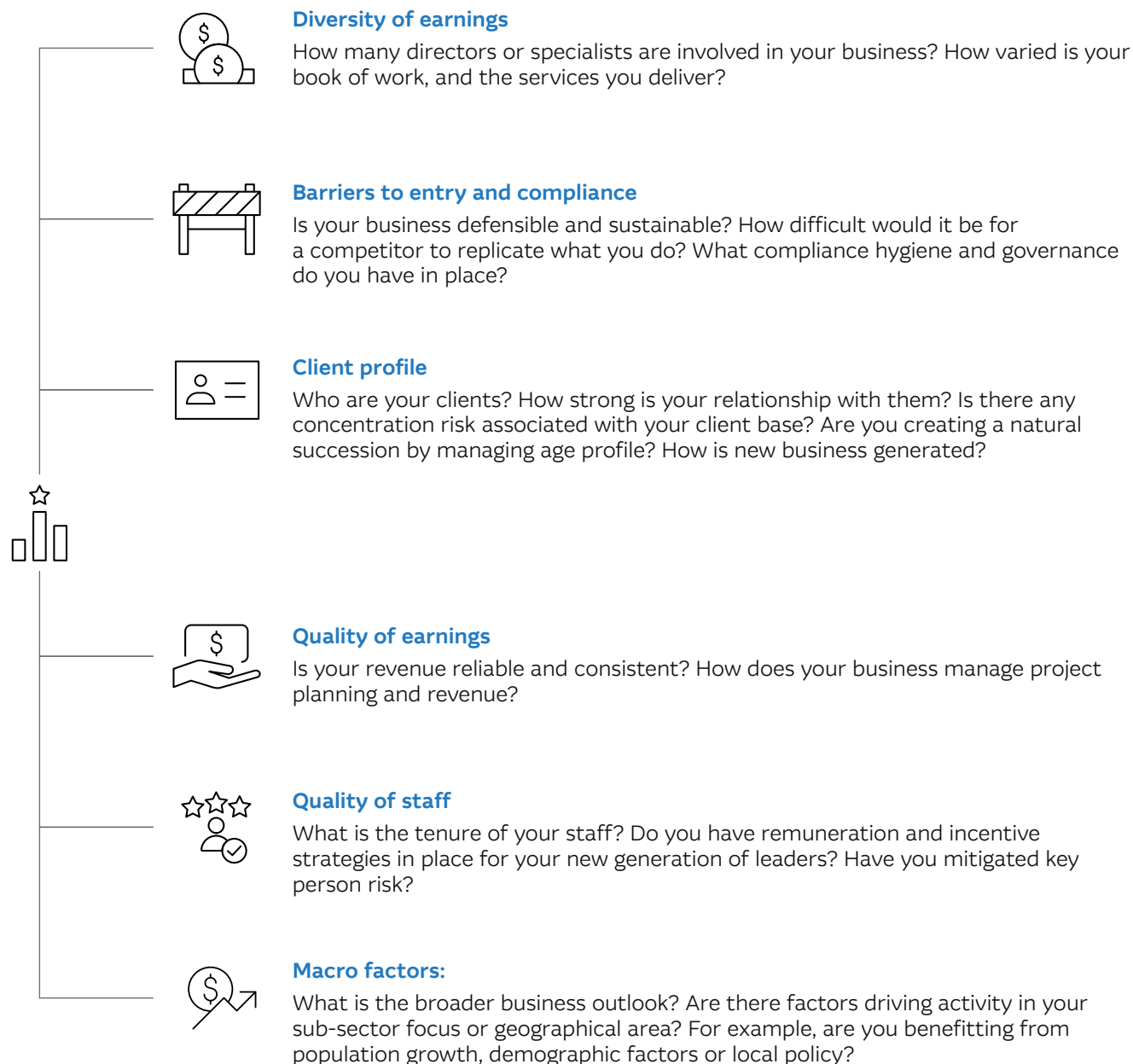
**The overall future value of the business**

### Funding options



If your goal is to extract maximum capital to support your M&A strategy, it's important to understand what lenders and equity partners look for when assessing your business. This way, you can optimise your business across all areas to attract the highest valuation possible.

## Core drivers of business value



We'll explore the next steps in the funding process later in the report.

## The ideal target

### Target rating criteria

Define strategic criteria to evaluate your targets, and weight them depending on the value or challenge to your business. This will give you an overall score of target attractiveness.

The criteria you choose will depend on your business and strategic priorities, but could include:



#### Opportunities



Proprietary technology



Sales and distribution channels



Benefits of scale



Production efficiencies



Tech stack



#### Potential challenges



Cultural alignment



Principal's role



Key person risk



Client retention



System migration and integration

## Sourcing targets

Set clear criteria for the ideal target and evaluate multiple options.

Utilise your professional network to start finding options or enlist the help of expert partners like your banker, business broker, platform and product provider, and shareholders and directors.

## Pipeline management

### Establish business profiles

Business profiles should record critical information for each target, including:

- Revenue
- Services
- Location
- Decision makers
- Resources (current and future)
- Deal terms

### Establish pipeline stages

Each stage will track the status of each prospect or target, e.g.:

- Prospecting
- Understanding
- Negotiating
- Due diligence
- Signing
- Integration

### Systematise

Determine where and how you will capture all pipeline information in a uniform way.

### Manage

Ruthless pipeline management is critical. Some key strategies include:

- Regular check-ins
- Activity targets
- Clearly defined criteria for identifying when an opportunity is lost, and ceasing activity

## Doing the deal

Once you have selected a target, ensure you understand the business, contract negotiation terms, and your funding requirements, before making any decisions.

### Due diligence

Rigorous due diligence is the difference between success and failure.

#### Things to look out for<sup>2</sup>:

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#### Strategy and commercials

- What is their market position?
- Why are they selling? Have they tried to sell previously?
- How complex is the business?
- Have they achieved what they set out to achieve in previous business plans?



#### Culture and employees

- Do the principals you're negotiating with embody the culture and values of the firm? Are they open to the change that merging will bring? Can they articulate a clear culture and set of values – and does it align with yours?
- Employee sentiment, engagement and satisfaction



#### Accounting and financials

- Financial statements
- Revenue, liabilities, and assets
- Equity considerations
- Tax adherence and liabilities
- Vendor secured/unsecured charges and liabilities



#### Clients and prospects

- Beware of a disproportionate reliance on a few large clients, or many very small clients.
- What is the key customer turnover rate over the past three years?



#### Risk, compliance and legal






- Are there any hidden majority or minority investors buried in their legal structure?
- Industry-specific compliance risks
- Cybersecurity approach and risks

2. The suggestions are indicative only, and not all-inclusive. Readers should seek their own independent legal and financial advice.

## Negotiation

It's important to understand where your strengths lie in terms of negotiation. Ideally, seek independent specialist support for the process.

**We usually see negotiation centre around five key considerations:**

	<b>Price and valuation methodology</b>
	<b>Conditions</b>
	<b>Values &amp; culture</b>
	<b>Warranties and undertakings</b>
	<b>Terms</b>

## Terms and legal

When crafting your legal documentation, ensure you consider your earlier-agreed objectives for the acquisition, and what you want to achieve from it. Once you have a clear view of your goals, you'll equip your legal advisors with useful context and direction for putting together agreements and legal terms that work best for you.



## Funding

With a clear target in mind, due diligence complete, and negotiation underway, the next step is to pick up where you left off in your planning process and start accessing appropriate funding. You may be able to access some or all of the available funding options; each serves a different purpose and comes with its own benefits and drawbacks.

Ensure you enlist the support of experienced professionals when deciding on how to fund your M&A strategy, and explore a variety of options.

### Funding options

		Advantages	Limitations
Debt finance	<b>Secured</b> Underpinned by assets that are offered as security to the business loan	<ul style="list-style-type: none"> <li>• May be less expensive</li> <li>• May offer more flexibility in repayment terms</li> <li>• May enable access to greater equity</li> </ul>	<ul style="list-style-type: none"> <li>• Requires an asset as security</li> <li>• Limits choices that can be made with security assets</li> </ul>
	<b>Unsecured</b> Lending against the historical performance and profits of the business (goodwill)	<ul style="list-style-type: none"> <li>• Property assets not required to grow or scale the business</li> <li>• Can be simpler, if process is planned well</li> </ul>	<ul style="list-style-type: none"> <li>• May be more expensive</li> <li>• May come with stricter approval criteria</li> </ul>
	<b>Bank debt</b>	<ul style="list-style-type: none"> <li>• You retain ownership and decision-making control of your business</li> <li>• Likely less expensive than non-bank lenders</li> <li>• Broad suite of financial products to choose from</li> <li>• Access to an expert partner that can support your business</li> </ul>	<ul style="list-style-type: none"> <li>• Adds debt to the balance sheet</li> <li>• Implications will be a mortgage or fixed and floating charge over company assets, director guarantees and interest costs</li> </ul>
	<b>Non-bank debt</b>	<ul style="list-style-type: none"> <li>• Lender may have higher risk tolerance</li> <li>• May have faster loan application turnarounds</li> </ul>	<ul style="list-style-type: none"> <li>• May be more expensive</li> <li>• Adds debt to the balance sheet</li> <li>• Risk threshold may put business owners under increased performance hurdle pressure</li> </ul>
Equity finance	<b>Internal</b> Selling some of the equity in your business to one or more colleagues	<ul style="list-style-type: none"> <li>• Can be a strategy for retaining key staff</li> <li>• Alignment of business and personal incentives</li> </ul>	<ul style="list-style-type: none"> <li>• Equity commonly sold at a discounted valuation</li> <li>• Sharing of control and decisions</li> </ul>
	<b>External</b> Selling some of the equity in your business to a new partner or investor	<ul style="list-style-type: none"> <li>• No debt on the balance sheet</li> <li>• Potential access to outside expertise</li> </ul>	<ul style="list-style-type: none"> <li>• Dilutive to shareholders (benefits will be shared)</li> <li>• Potential loss of control</li> </ul>

## Integration

Smoothly integrating your business with the target is the most important, and most difficult, part of the M&A process.

**It is where many acquisitions fail for a host of reasons:**



**Deal fatigue**



**Unrealistic expectations**



**Staff retention problems**



**Misaligned management teams**



**Distraction with day-to-day operations**

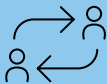
**There are three core pillars to any integration:**



### Operational

Management-style activity, project-management driven

- Scope, objectives and schema for integration activity
- Roles, responsibilities, and KPIs
- Road map for future operations that factors in teams, clients, and suppliers
- Identification and mitigation of potential risks



### Cultural

Change management-style activity

- Definition of future culture, employee value proposition and gaps to achieve
- Change activity and communication plans



### Synergy realisation

Achieving the synergies and efficiencies you set out to achieve whilst the contract is 'live' within retention timelines

- Cost synergies: headcount, premises, administration, scale
- Revenue synergies: cross-selling, pricing uplift
- Market strength/brand synergies: telling the story, reaching new audiences

## Refine and review

After your acquisition, it's important to determine what went well, and what needs to be improved. If the process was successful, the business can be ready to merge and acquire again.



### Review

- Objectives and gaps
- Team and client satisfaction
- ROI and costs
- Lessons



### Celebrate wins and milestones with the team



### Continually improve your model ahead of the next acquisition

## Ways to review



### Quantitative measurements

- Achieving targeted financial results, matching actual results with forecast budgets
- Realisation of projected synergies
- Employee measurements
  - E.g. attrition and turnover rates, satisfaction
- Client measurements
  - E.g. loyalty and retention rates, customer satisfaction
- Execution against project plan and schedules



### Qualitative measurements

- Strength of relationships
- Frequent, open communication
- “Feels” like part of acquirer
  - Employees identify as part of the new team
  - Acquirer language and concepts accepted
- Openness/freedom to ask questions
- Customer perception: customers see the business as one entity
- Values reflected in business practices

# Considerations for a successful M&A



## Finding the deal

- Network with and enlist the support of independent external experts
- Be clear on acquisition strategy to add meaningful scale
- Proactively prepare funding options
- Overestimate need for cultural alignment
- Evaluate multiple targets carefully



## Doing the deal

- Focus on measured quantitative and qualitative due diligence
- Outsource preparation and execution of commercials
- Be aware that negotiation extends into terms beyond price
- Engage a banking partner to support growth trajectory



## Integrating the deal

- Ensure leaders and teams are resourced, motivated and focused on change and integration activity
- Manage your expectations, behaviours and outcomes
- Drive continuous action and momentum
- Learn from past mistakes

# Why can M&A fail?



Limited experience



Poor or non-existent strategic reason to choose M&A as a growth plan



Culture and values mismatch



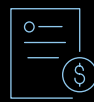
Inexhaustive target rating criteria



Insufficient due diligence



Deal terms that have made M&A economics unachievable



Entering contracts without funding support



Poor planning - not ready for the close



Employee and client retention issues



Unrealistic expectations



Misalignment of leaders and teams



Day-to-day operations overtake implementation



Lack of understanding of the financial impact of employee issues



Contract obligations



Restructuring costs



Incentives and bonuses



Legal claims



Productivity



## 4 things to do next

01

### **Start at the end (and work back)**

Having a clear vision is key to success

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02

### **Seek help**

Access specialist expertise

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03

### **Start early**

Increase your likelihood of success

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04

### **The right financing plan is critical**

A considered solution can help meet everyone's personal and business goals

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# Talk to us.

We work with business owners to:

- Add scale through a strategic merger or acquisition
- Add diversity and resilience by expanding into a new market or geography
- Extract value while growing your business by seeking outside investors
- Lock in skilled staff and ensuring a smooth succession by selling equity to internal leaders
- Seek appropriate funding options for their growth journey

**To find out more:**

**Contact your Macquarie Relationship Manager, or visit**  
**[macquarie.com.au/business](https://macquarie.com.au/business) or [macquarie.com.au/advisers](https://macquarie.com.au/advisers)**

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