



Toward transaction excellence

Ernst & Young's 2011 corporate
development study

Executive summary

To deliver value in today's tough market, corporate development teams must focus on aligning deal strategy with corporate strategy, follow formalized processes and forge strong relationships throughout the company. Effective corporate development leaders excel in these areas.

What makes the difference between leaders and laggards in corporate development? A new Ernst & Young study shows that success depends on the level of attention paid to three areas: strategic alignment, formalized deal processes and strong internal relationships. Leaders exhibit a heavy focus on – and excellence in – all three areas, enhancing performance across the entire transactions lifecycle.

Our ongoing research on corporate development explores such issues as the role, effectiveness and structure of the corporate development function (CDF). In 2011, we embarked on a global study of current practices, an update of similar studies conducted in 2004 and 2007. For this latest study, we surveyed more than 200 executives from major global companies. Our respondents were the most senior individuals in terms of responsibility for transactions, usually corporate development officers (CDOs).

Our most notable finding is that three attributes consistently lead to stronger performance in corporate development – and heightened deal satisfaction.

These are:

1. Transaction teams and strategies that are fully aligned with corporate strategy
2. Transaction processes that are stringently formalized, repeatable and continuously improving
3. Corporate development teams that forge and sustain strong relationships throughout the company

Certainly, businesses are introducing greater rigor into the evaluation and continuous improvement of their corporate development activities. But leaders do more than merely pursue the above objectives. Those companies expressing the highest degrees of satisfaction with their transaction results also report higher than average success delivering on the three conditions. ■





Driven by capital

The CDF is expanding, participating more broadly across the whole of the transaction lifecycle as opposed to focusing on one-off transactions. Accordingly, the CDO is gaining greater responsibility.

This means that the CDO and the CDF play key roles in their organization's deployment and utilization of capital. The most successful businesses take steps to actively evaluate and manage their capital bases. As our capital agenda framework illustrates, this requires devoting appropriate resources and focus to raising, investing, optimizing and preserving capital (see Table 1).

The CDO is particularly active in both investing and optimizing capital. Acquisitions, mergers, joint ventures (JVs) and partnerships are just a few of the areas where the CDO plays a leading role in decisions and actions that commit enterprise capital. In these instances, the CDF's investment focus includes everything from identifying targets and executing transactions to asset valuation, synergy identification and tax planning. Our study results show that a majority (87%) of CDOs either lead and perform (52%), lead only (23%) or perform only (12%) investing activities (see Table 1). Alternatively, 13% of the respondents

show as not involved because CDOs often do not get involved in investor relations (59%), tax planning (26%) and transaction measurement (19%).

Similarly, the CDF plays a vital role in optimizing corporate capital deployment. A full 69% of respondents say they lead and perform (34%), lead only (19%) or perform only (16%) these activities. The leading practice is to view corporate holdings in portfolio terms. A strong CDO will continually evaluate asset values in an effort to identify opportunities to enhance return on invested capital (ROIC). This is a decidedly strategic activity, requiring the executive to evaluate how any given asset will perform in current hands versus by a change in ownership.

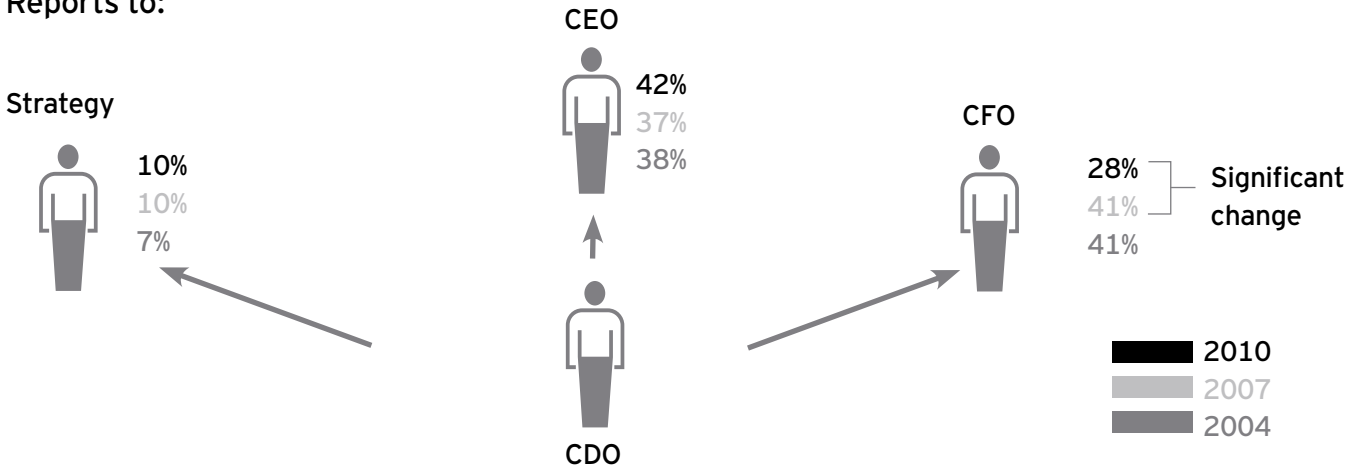
Such analysis can drive all manner of transactions. For example, a CDO might recommend that the company divest, spin off or otherwise restructure an underperforming or undervalued business unit or subsidiary – all highly strategic moves and a testament to the increasing visibility of the CDO. Today, 42% of CDOs report directly to the CEO, up from 38% in the 2004 study (see Table 2). ■

Table 1: Corporate development involvement in the capital agenda



Table 2: CDO reporting structure

Reports to:



Gaps in deal satisfaction

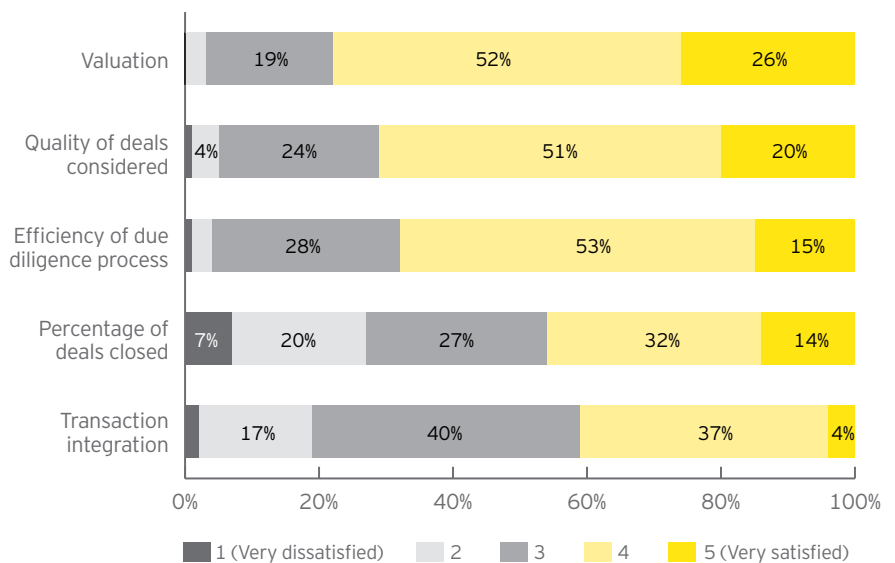
At first glance, it might appear that most companies believe they are doing an adequate job of closing deals. For example, 78% of respondents say they are either very satisfied (26%) or satisfied (52%) with valuation. In terms of the quality of deals considered, 71% say they are either very satisfied (20%) or satisfied (51%). The majority of companies are also reasonably satisfied with the efficiency of their deal-related due diligence processes (see Table 3).

However, only 14% are very satisfied, and only 32% satisfied with the percentage of deals that reach a successful close. Perhaps even more distressing, only 41% of companies are either very satisfied (4%) or satisfied (37%) with their workstream results in transaction integration. And yet the median response is neutral – neither satisfied nor dissatisfied with integration – a view held by 40% of respondents.

Such a lukewarm response is particularly worrisome given the critical role played by integration in the realization of transaction

value. A deal can have all of the elements necessary for success, but if the company aspires to a merely acceptable standard of integration, it heightens the risk of significant value erosion. Those respondents who express greater satisfaction with the quality of their deals exhibit significantly greater focus on three vital areas: strategic alignment, formalized deal processes and strong internal relationships throughout the enterprise. ■

Table 3: Overall satisfaction of transaction workstream





Study results

1. Strategic alignment

The most successful CDOs do their utmost to align deal strategy with broader corporate strategy. This begins with a close working relationship with not only the CEO but also other members of the senior management team, as well as key business unit, subsidiary and other geographic and functional leaders. The CDO needs to provide the senior management team with fact-based assessments of performance. They must answer questions such as: Is the asset base as currently configured generating adequate ROIC? Are business units or other asset combinations delivering adequate return? Given these realities, is the company following appropriate strategies?

It is also the role of the CDO to stay abreast, if not one step ahead, of industry trends: are evolving technologies, societal preferences or competitor actions presenting risks or opportunities? A CDO can inform and advise the enterprise on transaction opportunities that can enhance the strategic vision. Overall, a strong CDO not only seeks deals to complement or advance current business strategy but also seeks to inform and advise on potential strategic course corrections.

Once a CDF is operating in alignment with the broader strategy, a number of distinctive characteristics, practices and outcomes become evident. Most notably, proposed deals will focus more acutely on the delivery of key elements of corporate strategy. Instead of expending resources evaluating whatever deal comes along, the CDF will have a clearer transaction focus. So team members will be able to decide quickly whether a deal is worth pursuing or whether it deviates from core corporate strategy.

This orientation has follow-on benefits throughout the transaction lifecycle. A CDF that is in alignment with core strategies will possess a clearer idea of how to design deal models. Analysis will focus on how any given transaction might enhance, enable or even detract from core corporate strategies. Similarly, deal teams will be better able to pinpoint strategic synergies as well as concentrate integration planning and execution on the realization of tangible benefits.

Strategic alignment helps the company pursue the right deals for the right reasons. And then, strategic alignment helps guide organizational focus toward achieving any given deal's full strategic promise. ■



Key insights:

Alignment between business strategy and transaction strategy ensures a focus on executing the right deals.

- ▶ Understand the value drivers
- ▶ Build and use business models to validate diligence
- ▶ Align diligence with opportunity analysis – commercial, operations, financial

This leads to enhanced opportunities for generating value and realizing returns.

Key questions to ask:

- ▶ Does the company tend to pursue a wide range of transaction opportunities, or are the deals considered and executed around core strategic objectives?
- ▶ What mechanisms are in place to ensure strategic alignment? What could or should be done to generate closer alignment?
- ▶ What roles do the CDO and the CDF play in shaping corporate strategy? Should they play larger or smaller roles?
- ▶ To what extent does the organization continually and critically evaluate its investment portfolio? Are the CDO and the CDF routinely called upon to evaluate the deployment of capital?



Study results

2. Formalized deal processes

For those respondents with formalized deal processes, satisfaction is significantly greater, both in terms of the number of deals closed and performance in integration. Formalized processes and deal satisfaction are highly correlated, if not inextricably linked. Most companies say that they always or often use formalized processes for the majority of standard deal-related tasks. Core examples include due diligence, valuation, board and stakeholder approvals and transaction documentation (see Table 4).

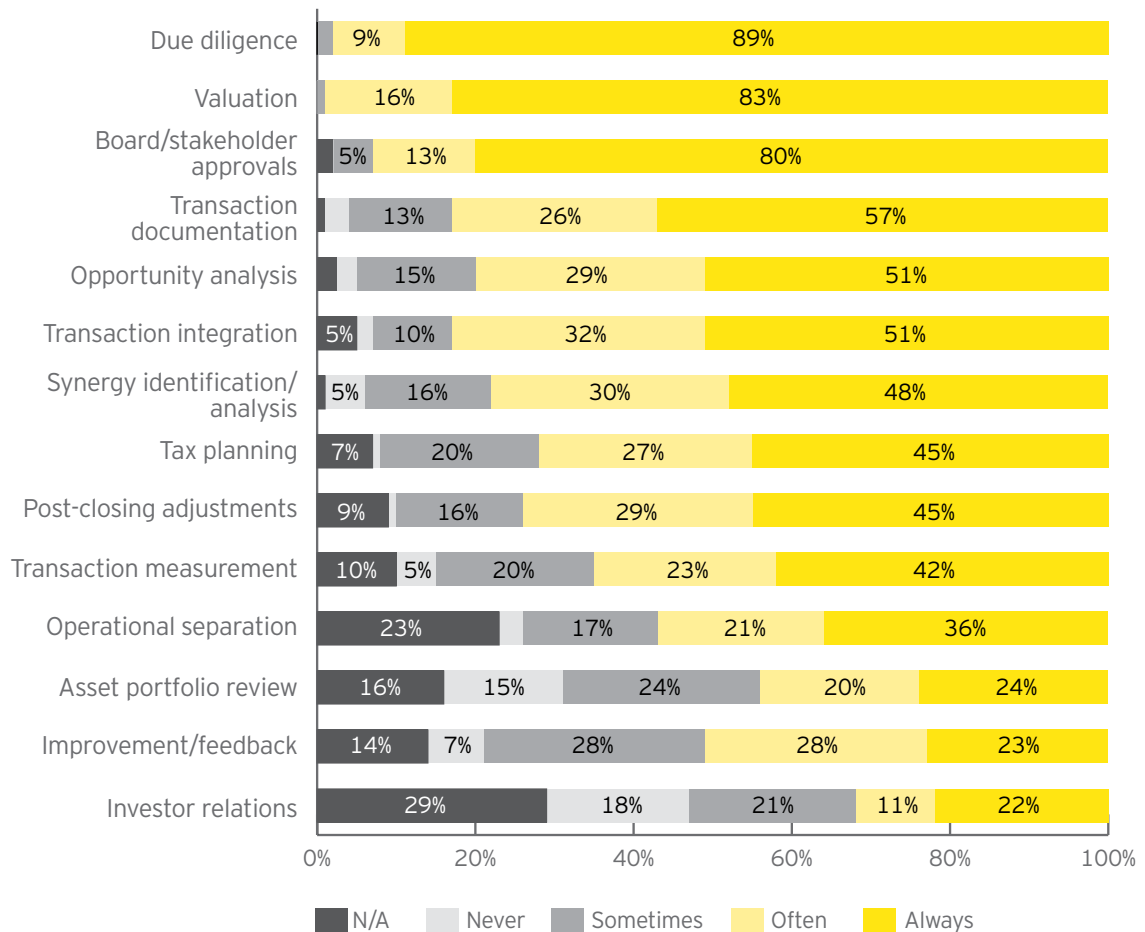
Our study shows that companies expressing the highest levels of deal satisfaction also display higher degrees of formalization in deal processes. For example, those companies with formalized processes to identify operational synergies were twice as likely to express satisfaction with performance in transaction integration as those lacking formal processes. Those with formalized processes for determining cultural fit with the target expressed significantly higher degrees of satisfaction in terms of both transaction integration and the percentage of deals closed.

But less than half, 48%, say that they always use formalized processes to conduct synergy identification and analysis. Such analysis is not only one of the most critical aspects of valuation, it is also essential to guiding the process of integration. That an activity so strategic fails to attract a more rigorous approach could be a contributor to weaker deal performance and lower satisfaction. By the time the study reaches asset portfolio review, only 44% say they always (24%) or often (20%) apply a formalized process. What this means is that a majority of companies are not routinely assessing the whole of the corporate portfolio in terms of its performance and capital allocations.

At its heart, a formalized deal process is repeatable and continuously improving, which makes this next statistic surprising. Only about half of companies, 51%, say they always (23%) or often (28%) conduct a review of deal performance. The gathering of feedback, the review of performance versus metrics and the comparison of deal assumptions to experience are all essential to learning and continuous improvement.



Table 4: When executing transactions, how often do you use a formalized process for the following?



Numbers may not add due to rounding.



Study results

Core transaction processes

Leading CDOs fully understand the importance of developing and documenting formalized processes across the range of transaction tasks. In this way, the steps leading to successful transactions become institutionalized and repeatable. Some of the processes requiring documentation, formalization and continuous evolution include:

- ▶ **Due diligence.** Corporate development staff should have a ready-made game plan for due diligence that is formalized and repeatable. The process should be forward-looking, focusing on the key business and valuation drivers behind any transaction, along with associated risks. Due diligence should also provide a final assessment of the thoroughness of pre-close integration planning and the likelihood of success.
- ▶ **Synergy identification.** The company should have a defined approach for identifying, modeling and evaluating as well as understanding the specific challenges to achieving deal synergies.
- ▶ **Deal modeling.** Companies should be competent in building business models that can evaluate how a transaction advances and (or) complements core business strategies and other elements of due diligence.
- ▶ **Working capital assessment.** Deal teams should be armed with a systematic approach to identifying and then realizing working capital opportunities within every transaction.
- ▶ **Integration.** Deal teams must map the actions and milestones required to achieve specific synergies and other sources of deal value.
- ▶ **Accountability.** It is not enough to identify necessary actions. A disciplined approach to transactions demands that specific actions be assigned to specific individuals.
- ▶ **Metrics.** Individuals and teams assigned specific actions must also be held accountable for timing and quality; reward structures should be aligned with the achievement of key drivers of deal value.

It will also be important to recognize that “formalized” does not imply “static.” To the contrary, one of the most important elements of a formalized approach to deal processes is that they are continuously reviewed and improved. The benefits of conducting such a review post-close should be evident.

Leading companies, however, often perform such analysis not only when a deal is completed, but also at various stages during a live transaction. By reviewing a deal in progress, companies are able to identify any shortcomings in performance in time to implement course corrections. ■

Study results

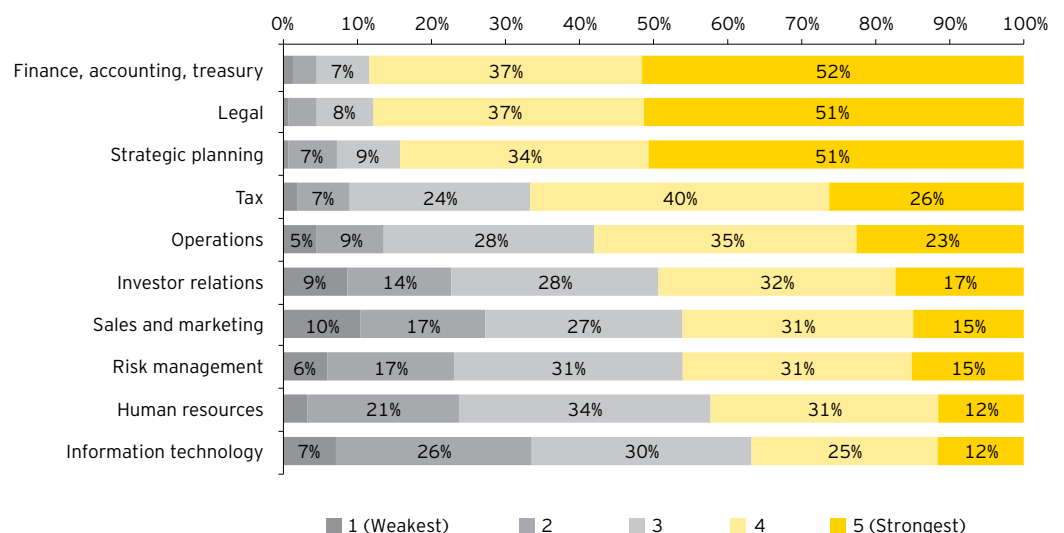
3. Strong internal relationships

Another core finding of our study is that the strength and quality of internal relationships can make all the difference. A distinction must be made between the CDF and the corporate development department. The former includes all of those managers and staff members who become closely involved in the transaction lifecycle – which in practice is a very large group. The latter are the dedicated members of the corporate development department. A typical CDO leads only a handful of direct reports, a range of mid- to senior-level executives for whom the business of corporate development is a full-time endeavor.

When a transaction enters its early phases, this core unit must begin to draw on others. Some of the first to join will likely be senior divisional, business unit or regional managers. Effective CDOs do not force transactions on such leaders. Rather, they work closely with these managers to gain insight into business objectives and challenges and therefore the sorts of deals that will likely gain traction. Such managers are typically brought in on a deal early on – and obtaining their buy-in is essential.

As a deal gains momentum, more professionals will be selected to become deal “insiders” because of their experience or functional or geographic knowledge. A key challenge for any CDO is knowing who to bring into which transaction when. Once a deal is well under way, the vast majority of the team will consist of members who do not report to the CDO and for whom transactions are not a daily pursuit. This means that managing the CDF requires not only leading-class transactions knowledge but also remarkable leadership capabilities.

Table 5: Please indicate for each of the functional areas below the strength of the working relationship between the CDO/corporate development department and the given function:



Numbers may not add due to rounding.



Strong ties drive deal satisfaction

No matter where the members of a transaction team are sourced, it is the CDO's responsibility to bring all of the components together and orchestrate a smooth and professionally managed transaction. The CDO and the immediate members of the team provide transaction experience, knowledge and consistency. It is in this core unit where deal capabilities reside and must be improved continually.

Our study shows that in nearly every instance, stronger relationships between the corporate development department and the rest of the organization lead to significantly greater deal satisfaction. For example, corporate development departments with strong ties to the finance, accounting and treasury functions score much higher than those with weak links across the full range of deal satisfaction metrics. ■

Key insights:

The strength and quality of internal relationships can make all the difference.

- ▶ CDOs must draw upon and lead a range of resources – often outside of their direct control
- ▶ Internal relationships to those with skill sets outside the corporate development department are critical
- ▶ Successful CDOs tend to display 10 key traits (see pages 12-13)

Key questions to ask:

- ▶ Does the corporate development department have sufficient standing with business units and functions to obtain assistance and attention when needed?
- ▶ What mechanisms are in place to facilitate closer relationships between the corporate development department and the senior management team? How about between the corporate development department and subsidiary or business unit management?
- ▶ Does the company use programs such as rotational assignments to instill greater awareness of the role of corporate development?
- ▶ What else could be done to improve collaboration between the corporate development department and the business at large?



CDOs

up front – teasing out, for instance, whether financial return or strategic access is most desired – is essential to evaluating deal performance. Successful CDOs are also adept at proactively managing the expectations of key stakeholders and deal participants, keeping them abreast of progress as well as of potential risks at each stage of the transaction lifecycle.

7. **Collaborate, communicate – and listen.** If virtual members of the deal team – those outside the corporate development group – are to act collaboratively, then the CDO and staff must demonstrate collaboration. It is important to listen to business unit leaders, as those who live a given business know it best. A CDO must possess the willingness to step out of the limelight and let others shine. Never take the credit; always pass the laurels to a coalition of contributors.
8. **Document and share processes.** The most effective corporate development departments define and document their workflows. What are the key tasks in commercial, market, financial, operational or other core due diligence routines? Who is responsible for what, when and under which circumstances? Which valuation tools and reporting templates are used in the process? Having a clearly documented set of processes not only makes it easier to chart progress on any given deal, it also enables faster and

more effective collaboration with the many team members for whom this deal is their first deal. In the event of an auction, those without defined processes typically lose.

9. **Are fully accountable within defined responsibilities.** A CDO must be willing to take full responsibility for the success of individual transactions as well as for the broader set of corporate development objectives. But in doing so, it is vital that the CDO also obtain the appropriate levels of authority, resources and senior management commitment to get it done.
10. **Take responsibility for training and development.** A competent CDO takes full responsibility for training his or her own team. But a leading-class CDO accepts responsibility for raising corporate development awareness and capability across the entire organization. Such training and development should be ongoing. Once a transaction is under way, it is also a leading practice to organize an intensive workshop for members of the deal team. Such one-to-three-day “boot camps” provide an opportunity to define team members’ roles and responsibilities, along with expectations about the specific deal trajectory and timeline. ■

Highlights





The DNA of the corporate development function

Corporate development is a function. At its head is the corporate development officer who leads a core team known as the corporate development department. The Ernst & Young survey provides detailed benchmarking on typical traits, membership and operating focuses. The degree to which these traits are in evidence is a critical determinant of success in corporate development. Mere aspiration is not enough. Rather, leaders in corporate development embody these traits.

What are the personal characteristics of the CDO?

- ▶ The most common educational background is an MBA.
- ▶ The majority (76%) have been in the position at least two years and usually prefer to stay in the same role.
- ▶ They are most satisfied with the range of responsibilities and ability to influence corporate strategy and least satisfied with allocation of resources and work/life balance.
- ▶ Abilities as a business analyst and industry experience are key attributes for success.

How is the corporate development department structured?

- ▶ The majority (70%) of respondents report to the CEO (42%) or CFO (28%).
- ▶ The median number of FTEs in the corporate development department is four – the median size of the virtual team is five.
- ▶ The majority (62%) expect a decrease in headcount over the next 12 months.
- ▶ Most (62%) operate without a formal budget.

What is the department's role and how does it operate?

- ▶ Most departments have a finance, accounting or treasury (96%) and (or) strategic planning (80%) professional on staff. They also maintain strong relationships with the finance, legal and strategic planning groups.
- ▶ Support personnel for the CDF are most often found in finance and accounting, sales and marketing and operations.
- ▶ CDOs spend 60% of their transaction time on execution and 40% on strategy.
- ▶ The key areas in which the CDO influences corporate strategy are: grounding M&A decisions in sound financial data, developing transaction strategy and supporting strategic planning.
- ▶ The CDO most often leads and performs planning and structuring transactions, negotiation, opportunity identification and valuation.
- ▶ Key areas where CDOs seek help outside of the company include financial diligence, legal, tax diligence and tax structuring. This support usually begins during transaction execution.
- ▶ Within the company, they turn to:
 - ▶ Legal for help with tax diligence, tax structuring and board and stakeholder approval
 - ▶ Sales and marketing for help with opportunity analysis, portfolio asset valuation review and commercial diligence
- ▶ The department is most frequently measured on the fit of deals with corporate strategy, project management and deal pipeline. ■

Traits worth emulating

The era of the ad hoc, episodic approach to transactions is long over. And while progress toward a more disciplined approach is evident, for many organizations there are still opportunities for substantial improvement. Today's leading corporations are creating deal value by committing to a disciplined, repeatable and continually improving approach.

The three distinguishing features of corporate development excellence are strategic alignment with broader business goals, well-documented transaction processes and close relationships between corporate development and the rest of the organization. While these are in evidence to at least some degree at most companies, among true leaders in corporate development, such traits are thoroughly developed. By doing more to emulate these leading practices, CDOs and their reports can improve the odds that their work will be enhancing the value of their parent businesses. ■



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