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Framing

What will you learn?

M&A success arises from five principles for acquisition excellence

1. External R&D via M&A complements internal R&D.
2. Serial acquirers create shareholder value.
3. "Bolt on" and "extension" deals leverage core strengths at home and abroad.
4. Balance capital allocation among acquisitions and shareholders.
5. Seek deals that are accretive to growth.

What is the evidence?

These recommendations draw from research on business growth, together with executive experience at multiple life sciences businesses.

Links: Article pdf | [Slide](#)

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Introduction

Markets reward firms that achieve ongoing profitable growth. Despite the conventional wisdom in the popular press that M&A destroys value for acquirers, and so damage a buyer's ability to achieve profitable growth, recent research demonstrates a strong complementarity between internally and externally driven growth strategies. Laurence Capron and Will Mitchell's book "Build, Borrow, or Buy" (HBS Press, 2012) highlights the value of pursuing a balanced strategy of seeking resources both internally and externally. At the core, multiple studies find that firms that know when and how to use both internal development and M&A gain advantages for innovation, growth, profitability, and long term survival.

The benefits of balanced resource seeking arise strongly in the commercial life sciences sector. Health care and life sciences leaders such as Johnson & Johnson, Siemens Healthcare, GE Healthcare, Hitachi Medical Systems, and many others have built decades-long strength by both investing heavily in internal projects while also actively seeking acquisition targets that provide new products and capabilities. This article highlights the lessons learned at one of the leaders in the life sciences sector, Stryker Corporation.

Background: Stryker Corporation

Stryker is a medical technology company headquartered in Kalamazoo, Michigan. The company was founded based on innovation in mobile hospital beds in 1941. Stryker now offers products and services through three business segments: Orthopaedics, MedSurg, and Neurotechnology-Spine. In 2016, the company had ~33,000 employees, total revenue of \$11.3 billion, and total assets of \$20.4 billion, with net profit of 14.5% of sales (8.1% of assets). Stryker entered the Fortune 500 in 2002; in 2016, the company was ranked at

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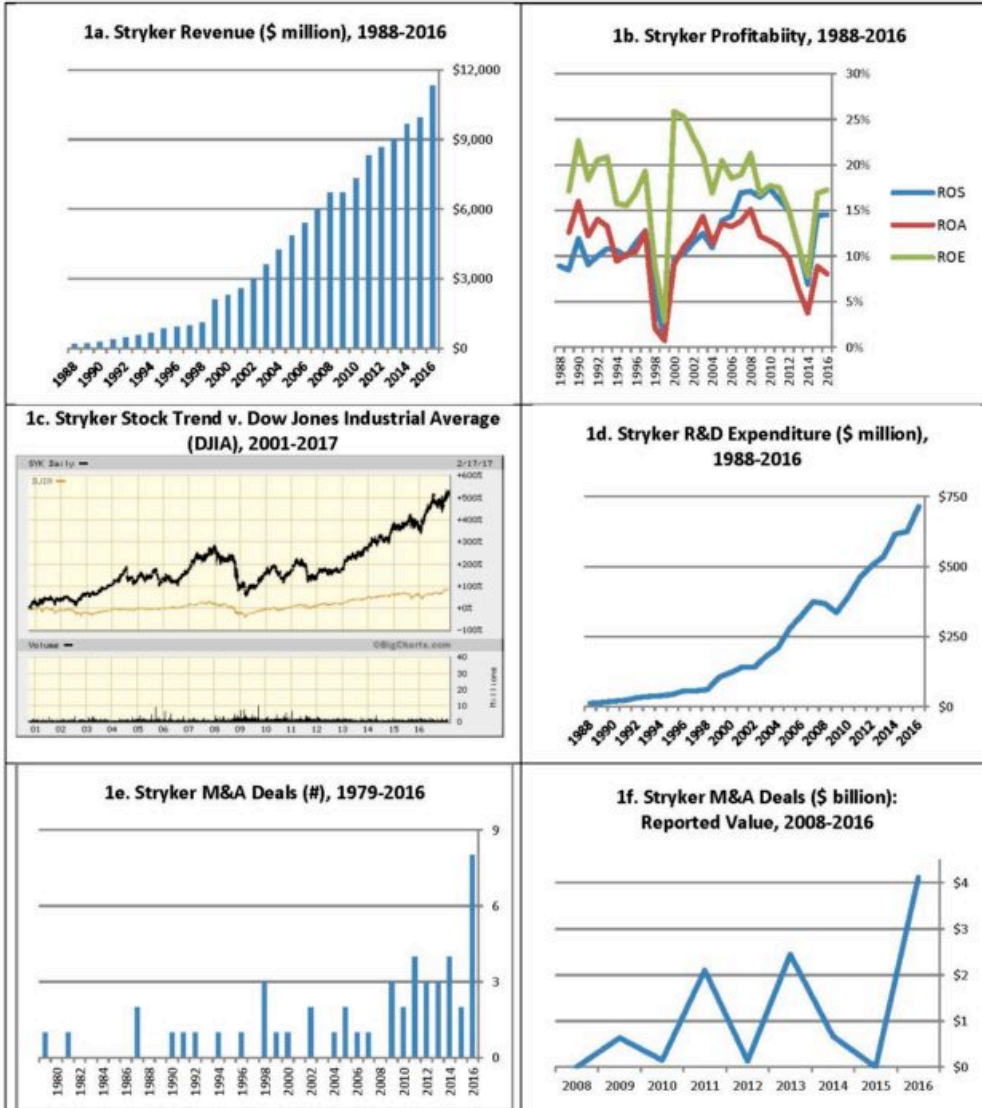
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#287. For many years, Stryker has regularly shown up on U.S. and international listings of highly admired companies in terms of innovativeness, shareholder returns, and employment.

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EXHIBIT 1. STRYKER CORPORATION FINANCIALS AND ACQUISITION TRENDS



Growth at Stryker Corporation: Based on Internal R&D and Acquisitions

Stryker is a growth company. Since going public in 1979, Stryker has had 37 consecutive years of sales growth; Exhibit 1a depicts the steady growth in revenue since 1988. The company has also been reliably profitable (Exhibit 1b). Due to the combination of growth and profitability, the market has driven Stryker's stock price up at several multiples over the Dow Jones Industrial Average over the past two decades (Exhibit 1c).

The core question is what strategies have driven the profitable growth that the market has rewarded?

At heart, Stryker's growth strategy relies on two major levers: organic growth based on investments in internal R&D and marketing, complemented by supporting growth based on acquiring whole or parts of businesses. Exhibit 1d reports the growth of R&D since 1988. R&D now exceeds \$700 million annually (more than 6% of sales). In parallel, Exhibits 1e and 1f highlight examples of Stryker's acquisition activity; both numbers of deals and reported value have increased in recent years.

Opportunities to grow based on internal investments in R&D will come as no surprise to our readers. The gains from greenfield investments in existing skills are central to most growth prescriptions - compared to external sourcing, internal investment often offers benefits of greater control, deeper understanding, and faster projects.

But those benefits arise primarily if the internal projects build directly from existing strengths. Attempting to jump start even moderately exploratory new products through internal initiatives frequently ends up with projects that are slow and flawed, leaving firms lagging more successful competitors.

This is where "external development" via acquisitions complements gains from internal R&D. Buying via M&A offers a means of gaining faster and more effective access to new products, new markets, and new skills. The advances can reach far beyond a firm's ability to build internally.

Critically, internal R&D and M&A are not substitutes in this balanced approach to growth. Rather, they are complementary strategies. Stryker's combination of continued growth of investment in R&D at the same time as it has increased its acquisition activity is a strong example of this complement.

Yet simply buying targets is no guarantee of M&A success. The conventional wisdom that acquisitions destroy value stems from highly visible deals that failed dismally, because buyers bought in the wrong conditions, over-paid, and could not integrate the targets effectively. What then is the magic of successful M&A strategy?

Starting Points: Four Basic Rules for Acquisition

In part, M&A success stems from a few long-standing rules.

1. First, know the strategic value that you want to achieve from a deal and establish major milestones for getting there.
2. Second, undertake deep due diligence of both the financial value of a target and the strategic value of a deal.
3. Third, know who the key people from both the target and acquirer will be in achieving the strategic value - and make sure they have motivations to stay.
4. Fourth, have the discipline to walk away from a deal, either because the price is too high, the strategic value is too low, or the people you need are likely to leave. Quite simply, let your competitors do the bad deals.

Stryker pays close attention to these four basic rules. Yet following the basic rules, as obvious as they may seem, is often difficult. Stryker's experience highlights several themes that help firms follow the basic rules, while building an even more nuanced acquisition strategy. In the remainder of this article, we discuss five key principles for making acquisitions a part of a successful growth strategy.

Beyond the Basics: Five Principles for Acquisition Excellence

Stryker adheres to five principles for its acquisition activity.

Principle 1: External R&D via M&A complements internal R&D

We made the central point of this first principle earlier. The core issue is that no company or division will ever have enough resources to fund all ideas or enough knowledge to explore all paths. Even financially strong and intellectually rich companies face real constraints in funding longer-term bets internally through the profit and loss statement. Acquisitions help avoid P&L burn.

Yet acquisitions are not a means of "saving" a weak division. Stryker requires strong

internal R&D and marketing organizations to make its acquisition strategy work. Before a deal, internal personnel are critical for assessing targets, helping separate the wheat from the chaff. After a deal, internal staff members become even more important, in engaging and integrating the products and capabilities that come with the target. Hence, even as Stryker has increased the pace of its acquisitions in the past five years, internal R&D has risen over 100 basis points, from about 5% of sales to more than 6% of sales. Selling, general, and administrative expenses, meanwhile, also have increased substantially in magnitude (to almost \$4 billion in 2016) while becoming more efficient, falling from 37% of sales in 2011 to under 35% of sales in 2016.

Principal 2: Serial acquirers create shareholder value

Research by Bain & Company (2012) shows that serial acquirers create more value than ad-hoc buyers. Firms that regularly undertake acquisitions learn how to seize the gains while avoiding pitfalls. Quite simply, repetition of similar activities creates value. Stryker has built strongly on this lesson.

Drawing from its experience, Stryker has developed a playbook that has improved the company's acquisition batting average. Codifying the experience in the playbook helps achieve more thorough due diligence, underlies strong negotiations and bid strategy, drives superior integration planning and implementation during the critical first 100 days of a deal, and gives a due diligence team confidence to walk away from a deal.. At its core, the experience-based playbook helps the company adhere to the basic rules we described above, while providing deeper nuance beyond the basics.

Stryker also has learned to pace its flow of serial acquisitions. As Exhibit 1f highlights, after a burst of acquisition value, the company typically takes a year or more "digestion period" before seeking another large meal. Even a company with extensive acquisition experience and a strong acquisition playbook faces limits in time and personnel to devote to due diligence and integration. The slower pace of deals allows experienced staff to focus on making sure that recent larger deals succeed.

In turn, success in integrating the serial flow of acquisitions has increased the flow of companies approaching Stryker seeking buy-outs. Potential targets know that they have a better chance of success within Stryker than within many of its competitors. Many value the potential growth for their products and the continued opportunities for employees if they become part of Stryker.

Principal 3. Seek “bolt on” and “extension” deals that leverage core strengths at home and abroad

Most of Stryker’s deals provide new products and capabilities that leverage existing core strengths. The company has a strong sales organization in its U.S. home market, with marketing competencies and contracting capabilities that go far beyond the skills of smaller targets. Existing sales staff, complemented by new team members from the targets, drive value by selling new products that come from the deals. Thus, leveraging existing market strength via “bolt on” deals has been highly effective for the company.

The principle of leveraging core strengths goes beyond bolt on deals that add scale to existing product lines, also providing support for “extension” deals. The company’s three main business units – Orthopaedics, MedSurg, and Neurotechnology-Spine – each have a dedicated R&D group. The development staff in each unit can build on new capabilities that arrive with acquisition targets, quickly iterating new products that provide stronger customer solutions than either Stryker or its target could have achieved alone.

Beyond its home market, Stryker has growing global presence. The geographic scope provides global opportunities for both “bolt on” and “extension” deals. International breadth allows the company to gain competitive advantage by taking U.S. technologies abroad. In parallel, the growing number of ex-U.S. deals creates opportunities to bring international technology and products into U.S. markets. Together, the mix of “bolt on” and “extension” acquisitions in the U.S. and worldwide provide innovative products globally, as well as job growth in the company’s home market.

Stryker engages in far fewer “white space” deals that explore market and technological space far beyond the company’s current core. While the occasional white space acquisition is valuable in opening up new markets and potentially creating new divisions, these deals are far more challenging than bolt on and extension deals. One of the lessons of the serial acquisition experience is to reserve white space deals for a small number of exploratory initiatives. These deals are typically smaller experiments that provide potential launching pads for path-breaking growth, but will not damage the core business if they struggle to take flight.

Principal 4. Balance capital allocation among acquisitions and shareholders

Investing most available resources in growth is tempting, particularly for a successful firm

in a dynamic industry, but also risks making long-term shareholders nervous about when they will receive payouts. Stryker's annual capital allocation typically devotes somewhat more than 50% to acquisitions, with the remainder to dividends and share repurchases. The strong investment in targets to obtain new products and capabilities helps fuel the growth engine. At the same time, using current success to provide ongoing financial rewards to shareholders helps build loyalty and support for the company's vision for its future

Principal 5. Seek deals that are accretive to growth

Big bets with long horizons are tempting, but often take so long to pay off that they draw down resources and constrain the ability to play the next round. Stryker most often seeks deals that offer near-term pay-offs as well as the potential for long-term wins. The early pay-offs in reduced costs and new revenue, typically aiming for milestones within the first year, maintain market confidence in the company's growth strategy. Just as importantly, the pay-offs provide resources for investing in organic R&D and marketing initiatives.

The emphasis on accretion is central to the ability to support both internal and external resource sourcing. Internal resources that arise from accretive deals help the company avoid falling into the trap in which acquisitions suck resources away from internal activity. Instead, accretion supports the virtuous cycle of balanced growth in both internal development and acquisition activity.

Conclusion

The commercial life sciences sector is dynamic and uncertain, with rapid pace across products, markets, technologies, and competitors. Many once-leading firms have disappeared, missing changes in their core markets and being absorbed by more effective competitors. Stryker is one of the few firms that have thrived year after year in the midst of market and technological turmoil. At the core, the company's dual growth strategy of internal development and active acquisitions underlies the ongoing success.

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EXHIBIT 1. STRYKER CORPORATION FINANCIALS AND ACQUISITION TRENDS

1c. Stryker Stock Trend v. Dow Jones Industrial Average (DJIA), 2001-2017

EXHIBIT 2. EXAMPLES OF STRYKER ACQUISITIONS, 1979-2016

Year	Value (\$ million)	Target company / product lines	Country	Key products and capabilities
2016	\$2,775	Sage Products	US	Medical supplies
2016	\$1,280	Physio-Control	US	Urgent patient care
2016	\$51	Stanmore Implants Worldwide	UK	Orthopaedic oncology
2016		CareFusion products (Becton, Dickinson)	US	Vertebral compression fracture products
2016		Ivy Sports Medicine	US	Meniscal repair
2016		Synergetics Neuro portfolio (Valeant)	US	Neurosurgical instruments
2016		Restore Surgical / Instratek	US	Implants for feet, ankles, and upper extremities

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2016		SafeWire LLC Product Portfolio	US	Minimally invasive spine surgery instruments
2015		Muka Metal	Turkey	Patient room furniture
2015		CHG Hospital Beds	Canada	Hospital beds
2014	\$375	Small Bone Innovations	US	Joint replacement
2014	\$172	Berchtold Holding	Germany	Hospital equipment
2014	\$120	Patient Safety Technologies / SurgiCount	US	Operating room compliance software
2014		Pivot Medical	US	Hip instruments & implants
2013	\$1,650	MAKO Surgical	US	Robotics
2013	\$764	Trauson Holdings	China	Spinal instruments
2013	\$30	ActiViews Ltd	Israel	CT-Guide navigation
2012	\$135	Surpass Medical	Israel	Stent technology
2012		Innovative Infusions	US	Infusion services
2012		P.M.F. SAS	France	Spine surgery
2011	\$1,500	Neurovasco (Boston Scientific)	US	Neurovascular technology
2011	\$316	Orthovita Inc	US	Orthobiologic and biosurgery products
2011	\$150	Memometal Technologies	France	Podiatric surgery
2011	\$135	Concentric Medical	US	Interventional neurovascular
2010	\$150	Gaymar Industries	US	Pressure ulcer management
2010		Porex Surgical	US	Bioimplantable porous polyethylene products
2009	~\$55	OtisMed Corp	US	Implant software support
2009	~\$55	Sonopet ultrasonic controls (Mutoh)	Japan	Ultrasonic support for bone surgery

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2009	\$525	Ascent Healthcare Solutions	US	Remanufacturing of medical devices
2007		Everest Biomedical Instruments	US	Handheld diagnostics
2006	\$140	Sightline Technologies	Israel	Gastro-intestinal endoscopes
2005	\$50	eTrauma	US	Picture Archive and Communications Systems
2005	\$18	PlasmaSol	US	Sterilization equipment
2004	\$360	SpineCore	US	Spinal disc technology
2002	\$135	Surgical Dynamics (Tyco)	US	Spinal implants
2002		Dekompressor (Pain Concepts)	US	Interventional pain technology and products
2000	\$12	Image Guided Technologies	US	Surgical navigation
1999		Infomedix	US	Medical image communication
1998	\$1,650	Howmedica (Pfizer)	US	Orthopedic products
1998	\$20	Creative BioMolecules rights	US	Orthopaedic reconstruction production rights
1998		Bertec Medical	Canada	Medical beds
1996		Osteo Holdings	Switzerland	Orthopedic trauma
1994	\$600	Matsumoto Medical Instruments	Japan	Medical distribution
1992	\$11	Dimso	France	Spinal fixation
1991		Prab Robots plants	US	Robotics facilities
1990		Quintron-Driskell product line	US	Dental implant products
1987		Hexcel Medical	US	Medical composites and polymers
1987		Adel Medical	US	Labor and delivery stretchers

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1981	SynOptics	US	Endoscopy
1979	Osteonics	US	Orthopedic implants

Note: All data in exhibits 1 and 2 are drawn from public sources, including company annual reports, corporate histories, Thomson SDC Platinum, and the ReCap IQ database.