ALLEN & OVERY

Digitalisation and innovation provide new fuel for M&A deals

Businesses across sectors are responding to the threat of digital disruption, looking to build, buy and/or collaborate to transform their organisations. The disruptors are increasingly busy too. Deal flow across the world, already moving quickly, looks set to get faster.

The disruptive power of technology is being felt right across the business landscape and across the world, but the last year has seen an acceleration of activity by traditional industry as companies set about transforming their operations for the digital age.

Pick almost any sector – from car making to financial services, from retail to mining and resources – and similar patterns of activity are playing out, as established players look for the best way to put digital technology to work to meet changing customer needs, cut costs and improve efficiency.

At the same time the giants of the tech industry are accelerating their efforts to project themselves into new markets and new sectors, making multiple investments and each aiming to put their technology platform at the heart of an expanding ecosystem. These technology enabled disruptors are able to quickly deploy technology platforms to address global problems and are structured to sit outside of the existing regulatory purview.

This strategy, particularly apparent in online payment systems and e-commerce, has been successfully used by the likes of Google and Facebook for some time. Now it is being put powerfully into action by some of China's biggest tech companies.

Given that background, 2018 has seen a sharp increase in investment activity, and there is every prospect that this will translate into increased deal flow. As competition intensifies, we expect deal flow to accelerate.

Tech companies make multiple bets

As the biggest tech companies look to move into new markets and new product areas they are often making multiple bets, investing in a range of emerging companies to try to establish which ones will emerge as category leaders or local champions.

We've seen a series of big investment rounds in Asia's booming tech sector, for example, with foreign capital, principally from China and the U.S., pouring into the region's growing band of unicorn businesses – companies that have grown rapidly from start-up to achieve multi-billion dollar valuations.

Where payment systems are concerned, the investment strategy is to build partnerships with adjacent businesses, to drive captive customer volumes and create exclusive non-bank payment arrangements to lock out competitors.

E-commerce is also a fertile area for investment, particularly as bricks and mortar retailers are responding to the rise of e-commerce. Partnerships between bricks and mortar retailers and established e-commerce players are starting to emerge, as traditional retail moves to omni-channel, with clear industrial logic behind pairing world class technology platforms with brand presence and distribution.

The last year has also seen Asian unicorns continue to build on their capital-light, tech-enabled business models to continue growing, fuelled by outside investment and the rapid increase in consumer take up. Indonesia, for instance, now has one of the highest e-commerce penetration rates of any country, thanks to the development of super-apps offering customers access to an increasingly large range of products and services through their smart phones.

Go-Jek, for example, has transformed itself from a ridesharing service into a broad-based lifestyle app and is continuing to expand its offering, setting up a studio to produce local digital content, as well as its own venture fund. It is also moving into new markets, including Singapore, Vietnam and the Philippines, and investing newly raised capital at an accelerating pace as it expands its footprint and offerings.

Traditional players fight back

Despite this, established players in traditional sectors are also powering the recent sharp increase in investment activity, as they look for the best way to harness the transformational power of digital technology and data.

Here the challenges of disruption are significant. How do you transform the culture of your organisation to deliver real change when it means completely rethinking the way you have done things for, perhaps, 50 years or more?

The car industry is a classic example of this dilemma as it confronts a range of disruptive challenges not just from technology and the pervasive power of data, but also from a radical shift in consumer attitudes, not least towards car ownership.

We are now seeing a number of the industry's major players confront the challenge of digitalisation and innovation head on. Toyota, for instance, is pushing ahead with a wide-ranging digital strategy that will transform it from being a car manufacturer to a global provider of tech-enabled mobility services.

As this strategy has unfolded over the last 18 months, we have seen Toyota pursue an ambitious investment strategy. It has set up the Monet Technologies joint venture with SoftBank, invested USD1 billion in Grab, another leading South East Asian ridesharing company, and ploughed USD500m into developing on-demand, driverless vehicles with Uber.

Meanwhile its venture capital arm, Toyota AI Ventures, armed with a USD100m war chest, is focusing on making minority investments in a wide range of carefully selected start-ups. The aim is to identify breakthrough technologies in such fields as robotics, AI, autonomous driving and data.

It's a path being followed by other carmakers too. In February, for instance, BMW announced a EUR1bn joint venture to create a single mobility services portfolio, including self-driving cars, car-share schemes and electric vehicles, to head off disruptive challenges from ridesharing and other tech companies.

Build, buy or collaborate

Three main options are available to traditional players as they plan their digitalisation and innovation strategies, each presenting significant challenges as well as opportunities.

Build – Firstly, they can opt to build technology platforms by themselves relying on their own resources to change the way their products are made and services delivered. But this is a risky option, vulnerable to enormous cost escalation and to the danger of backing the wrong technology solution.

Buy – Another approach is to buy into an early-stage business or foster growth through corporate venturing or accelerator programmes, which allows incumbent players to get a clear view of what is happening in key areas of technology and, perhaps, the opportunity ultimately to make a full blown acquisition. To do so successfully means developing a new set of skills in corporate venturing, which are often very different from the capabilities required to execute big-ticket M&A transactions.

Collaborate – Finally, partnering with a player who can bring in the know-how and the technology to help speed the process of digitalisation. This collaborative approach has proved highly successful for some. But these collaboration and partnership agreements can be very complex, particularly when they are in relation to new products or developing areas, the future direction of which can be hard to predict. They contain many moving parts, including mechanisms for unwinding the venture if it does not live up to its promise.

But the truth is that no one route offers a guaranteed path to success at the kind of speed needed to meet the fast-changing challenges of disruption. Many players will look to use all three approaches – build, buy and collaborate – as part of a broad-based digitalisation strategy.

Continued pressures driving change

Across sectors, digitalisation and innovation are being accelerated not just to meet changing consumer needs or to fend off incursions into the market by disruptive tech companies, but also for sound operational reasons. Established businesses recognise that by harnessing digital technology and data they can drive down costs, increase efficiency and sustain profitable growth.

That's now a focus for companies in many markets, including high-growth economies in Asia where, in the past, there has been less attention paid to the bottom line. Now it is increasingly common to see businesses setting up dedicated business transformation offices, to manage the complexities of digitalisation and innovation and ensure they deliver the right outcomes.

The companies that do it well are those that really empower people within the business to bring about meaningful cultural change. They have an ability to look beyond the technology to ensure that the process of digitalisation and transformation is ultimately driven by customer and business needs.

Transactions supporting this activity are by their nature complex. But the need to stay in touch with customers and ahead of rivals in a fiercely competitive environment requires heavy investment – an investment many companies, new and established, are clearly willing to make.

That, we think, makes it highly likely that disruption will increasingly become a significant catalyst for ventures, partnerships and, increasingly, full M&A transactions in the months and years ahead.

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