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Business Growth through Acquisition

The strategic Objectives:

In today's increasingly competitive business climate traditional growth is more difficult and expensive then ever before.
Mature markets and the high cost of attracting new customers make *Growth by Acquisition* an attractive alternative.

Buying companies can be an expensive and time consuming process. A well organized acquisition strategy can save a great deal of time and money plus it will significantly increase the acquirer's chance of making a successful acquisition.

However business managers often make the fundamental mistake of evaluating acquisitions primarily as financial decisions. Much like a manager of a diverse stock or share portfolio, they get caught up in detail of the deal structure and lose sight of the strategic operating and people issues, which ultimately determine the success or failure of any business.

If an acquisition does not help realize strategic goals, financial models however sophisticated will not transform a poor strategic fit into a good arrangement.
That is why business managers not financial executives or outside deal specialist, take charge of the acquisition process.

The business manager will learn how to control the M&A process and how to best utilize deal specialist whether they are: investment bankers, lawyers, accountants or other professionals.
These specialist can make a valuable contribution to the optimum structuring of a deal but the business manager must always remain in charge of the process and not become a captive of the deal maker who may be driven by transaction fees.

The primary objective of strategic acquisitions is to enhance the proprietary value of a business unit by building competitive advantage.

Stay in control:

The most frequent used word in corporate announcements of acquisitions is ***synergy*** but one plus one will not be greater then two unless the acquisition flows from a detailed strategic planning and competitive analysis process.

By structuring the M&A activity within a competitive overall business planning process, the business manager will avoid the traps of pursuing acquisitions as ends in themselves rather then means to an end.
The business manager can easily get caught up in the excitement of: doing a deal and rationalising the acquisition that makes no strategic sense but may appear to represent an attractive financial opportunity.

The Benefit:

There is a fundamental difference between a financial buyer whom is essentially a manager of a portfolio of assets and a business manager: who makes an acquisition decision on the basis of: Competitive strengths and weaknesses, Possible savings from consolidation Other operating measures is to study companies that have successful acquisition programmes and to examine specific transactions to identify the underlying causes of success and failure

Financial measure cannot be ignored. Ultimately a dollar value is attached to the cost of an acquisition and financial projections are critical. But the basis for these calculations is the responsibility of the business manager, not outside deal makers.

The first step in achieving benefits from strategic acquisitions is to develop a strategic plan.

A strategic acquisition is one that facilitates a Strategic Plan:

A machine tool company who has purchased a fast food franchise has probably not made a strategic acquisition as it does not affect the machine tool business.

But if the acquiring company owns a property portfolio company and purchase's the same fast food franchise, because they know were the best competitive locations are for new restaurants they have then made a strategic acquisition.

A machine tool company is unlikely to argument the restaurants ability to compete in the market place

The property portfolio company on the other hand brings a critical competitive advantage to the restaurant – a great location.

The expected return from the machine tool company acquisition of a restaurant would be similar to any other investment.

The property portfolio company's acquisition however can be expected to generate exceptional financial returns since the addition of a great location to the franchise restaurant represents a significant trading advantage.

When to use strategic acquisitions:

Too often we have seen business's pursue strategic acquisitions when thy do not have adequate financial resources to complete them. Likewise good strategic acquisitions have failed because there were not adequate management available even to support existing business and none to support the acquisition

To ensure success in the acquisition process a company needs a suitable acquisition candidate, an adequate management infrastructure and sufficient financial resources to complete the proposed transaction.

A genuine strategic need is one that permits a company to achieve real plan objectives and produce substantial financial returns.

Acquisitions are significant one-time expenditures and are difficult to reverse. The acquisition must satisfy strategic needs that are real not imagined in order to justify the expenditure.

As part of the strategic review the acquiring company should consider amongst other matters that the change made by a strategic acquisition must be considerable, and the need to react to changing market needs must be obvious and in addition the need to

execute a new acquisition initiative must be pressing in order to warrant the cost of an acquisition.

The parties involved in the process of acquiring a company may liken it to jumping over the Grand Canyon – one can't do it in small steps and failure is a painful experience

Creating Value in an Acquisition:

Acquisitions can reinforce and change a company direction….principally through synergy, and by managing the acquisition, synergies occur when capabilities transferred between firms improve a company's competitive position and consequently its performance i.e.

Combination Benefit: Market power and increased purchasing power come from the leverage that size itself allows over customers, suppliers, distribution channels and smaller competitors.

Resource Sharing: Sharing distribution channels and sales forces is a goal of acquiring business's seeking economies of scope.

Functional skill transfer: One firm improves its competitive position from learning through the transfer of functional skills, e.g., manufacturing process skills.

General Management skill transfer: It occurs when one firm can make another more competitive by improving the range of depth of its general management skills.

The strategic Acquisition:

If an acquisition does not help realise strategic goals; financial models however sophisticated will not transform a poor strategic fit into a good arrangement.

Strategic business objectives will result in a business competitive advantage or remove a competitive disadvantage such as acquiring a superior distribution system or acquiring a unique production capability and conversely, divesting an irrelevant or inferior product.

Only after a strategic plan has been developed ~~would~~ a strategic acquisition be initiated.

For example: Often a company should retreat from mature or declining markets, by selling divisions in order to:

Build market share.

Enter new geographic markets.

Probe new markets by making strategic acquisitions.

Strategic Planning:

Strategic Planning is the process of identifying and qualifying Strengths and Weakness. The M&A process should target only those companies and industries in which an entry will both exploit strength and shore up weakness.

The planning bought about through the M&A process will in itself create opportunities in that it pursues only those opportunities that will fit with its chosen strategy.

Planning of this sort greatly reduces the cost of analyzing randomly submitted opportunities.

Do they fit?

Given a number of competing opportunities, it will rank order them against each other by degree of desirability.

This ranking is another way of defining risk and will be a factor in pricing

Only a systems approach to strategic planning can encompass them all, isolate the key variables and use them

One of the principal benefits of having a strategy for acquisition in place is to prevent disastrous decisions made with random “whyncha process” [whyncha is what “why don’t you” sounds like when said real fast]

Filing Cabinets / Ostrich Farming:

The CEO of a cash-rich manufacturing Company making filing cabinet sits by chance next to an M&A Broker on a plane and mentions that his company is looking for “growth” acquisitions. His seatmate says, Ostrich farming. That’s the ticket! It’s hot stuff, Breeding Ostriches, Quills, Feather Dusters; they’re even breeding Ostriches in incubators!

Whyncha get into ostrich farming, it just so happens that that I know of an Ostrich farm for sale.

Well the CEO, bored by 30 years of pounding out filing cabinets, is soon hooked on ostrich farming, and in short order the company’s managers forget about buying a company that can use their manufacturing know how and their file cabinet sales and distribution system and instead start looking at Ostrich farms.

They wind up paying top dollar for a large, money loosing farm at the peak of the Ostrich farming boom and its trouble, trouble, trouble from then on in Ostrich farming city. They don’t know anything about Ostrich farming and while they’re learning it, the file cabinet business suddenly turns to custard.

Pre-agreed Criteria:

Such poor decisions would not happen in a company where strategic thinking is ingrained in the board of directors and in the executive team that has made the strategic plan

The plan resulting in strategic thinking, once installed, acts as a discipline force on every one at the decision-making level.

Instead of 100’s of in-house and out-of-house ideas and acquisition suggestions coming up for detailed evaluation at great expense, any proposed area of entry can simply be matched against pre-agreed criteria that describes the company strategy. If it doesn’t meet the majority of those criteria it is turned down forthwith with little executive time diverted away from day-to-day business.

Strategic planning levels?

The six level strategy plan approach developed by the Hay group [merchant bankers] is probably most suited for the largest companies; it can be reduced to four or even three levels but probably not below that even for the smallest company.

Enterprise strategy:

Developed at board-of-director level, asks the question Why are we in this business (or these core businesses) anyway?’

And is there something out there that can better use our cash flows?

Corporate strategy:

Calls for putting together under common management several group of strategic business units (SBU) that have some common operating elements, technology, marketing, geographic location.

Cash flows from the group members are reallocated internally to maximise long term returns.

Sector or group strategy:

Calls for assembling, under one corporate or operating group, the separate business units (SBU) that have some commonality to them. Then as in the corporate strategy, cash

flows are allocated and reallocated back out to the individual business units or into new internal or external investments.

Business unit strategy:

Deals with assembling under common management those product lines most likely manufacturing or marketing that have some commonality

Product line strategy:

Is a process that deals with product life cycles-supplementing or replacing mature or aging products with new product?

Functional strategy:

Deals with alternative methods of manufacturing-changing from aluminum die castings to plastic injection molding, or switching from the manufacturing of boats in wood to fiberglass

How to succeed at Strategic Acquisitions:

To succeed at strategic acquisitions the acquiring company must have both adequate management and financial resource, and must focus those resources on a clear strategic need.

The acquiring company must find suitable candidates that satisfy a clear strategic need in order to:

Modify their competitive position within their identified market place and to help them react to Market Maturity caused by product saturation, changes in plant technology, market alternatives or their need to execute a strategic initiative in a way not possible except through an acquisition.

Strategic acquisitions are used to facilitate a strategic plan based on the acquiring company's market plan assessment.

Freight & Custom Agency Business's [case study]

The freight and customs agency business is an industry where the market for products and services exhibits a high degree of market maturity.

Whereby: Prices charged are extremely competitive amongst the Agencies and were a high standard of service is expected and indeed provided.

Under those conditions of trading customer loyalty is strong whereby the loyal customer is typically tolerant of minor differences in product pricing or performance and will prove difficult for a competitor to attract away from that business.

Markets with a high degree of supplier loyalty require overwhelming competitive advantage to win new loyal customers and the industry is marked by some degree of market inertia.

The transient customer may be easier to attract to your business but is usually a one-time buyer who will move to the competitor offering the slightest advantage in price or performance.

Are transient customers the only ones you attracting upon entering a new market? These are the questions you must resolve in describing you market in order to develop a winning business strategy.

In the Agency business it is not possible to be even more competitive on pricing or to attract additional customers through offering ever increasingly higher standards of service.

Where these conditions exist within the industry, business acquisitions, mergers and alliances will continue to dominate that sector as has been the case particularly since the freeing of import restrictions evidenced from the early 1980's.

Common Mistakes in the Buy-side M&A:

The following observations about common mistakes in the buy-side M&A as highlighted By Tom Dipped Senior Vice President The Nassau Group, Investment Bankers Westport, Connecticut.

Analysis Paralysis:

By acquiring companies in industries with little or no prior experience failing to complete:

- Spending too much time analyzing the industry.
- Loosing confidence from the seller.
- Outperformed by another more knowledgeable buyer.

Not Enough Human Resources:

A buy-side project is all-consuming and requires continued pursuit and follow-up.

Not Having Enough Targets:

A Buyer should have a moderate number of target companies.

Being too Vague too Long:

While a brief courtship is mandatory in completed transactions, it is imperative to address the potential deal killers as soon as possible.

Focus, Focus, Focus:

The more specific the better for acquisition search i.e. Healthcare services is too broad a category but outsourced IT services for hospitals would be sufficiently focused.

Communicate Effectively:

The more you can convey your knowledge about the target Co the better. Check Web site, industry directories, also in communicating with the company use the words “strategic partnership” rather then acquisition.

Understand the Sensitivities of a Private Business Owner:

Many companies are sold to Buyers that offered less money than a competitive bid, simply because the culture and business philosophy was more important to the seller then the highest price.

Talk the Talk:

If the Buyer is an industry player but not necessarily a competitor it helps to share common concern and or share names of mutual friends.

Patience and Pouncing: Time is your Friend and Your Enemy:

When approaching not for sale companies, the acquisition process generally takes longer then when a company is already in play. Under the former conditions, the fastest time to complete a transaction would be six months while a normalized period would be between 12 to 18 months. Some targeted companies that initially decline the opportunity to discuss the sale of their company, reconsider six months latter. Conversely when the right opportunity is at hand… the acquirer should pounce on the situation and move with utmost alacrity

Some business people say: the integration step is never done.

For a strategic integration we can say it is completed when an acquirer has successfully achieved their strategic business objective.
Which Is?

> To enhance enterprise value of a business unit by building competitive advantage”

No amount of financial or operative control can tell an acquirer how to motivate and inspire their people in the acquired company to work with them to achieve their business objectives.

The people issues are often the most important factor in the success or failure of an acquisition.
If the acquirer is not sensitive to the individual and collective needs of the employee in the acquired company their acquisition will be likely to fail.

Financial control is essential for them to measure and direct the activities of the acquired company towards their strategic objective.
Which Is?

> To enhance enterprise value of a business unit by building competitive advantage

INVESTOR BUSINESS BROKERS LIMITED

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- Past President Auckland Business Brokers Association

Eighteen years: c*orporate experience: administration, financial, management, Engineering, Contracting, Warehousing and Distribution.*
Twenty–Five years: *specialist broker assisting in the wealth transfer of ownership in closely held family companies. In excess of 236 companies sold.*

Industry Specialties:

- Medium sized: Manufacturing, Distribution & Marketing Companies
- Importer's & Wholesalers
- Service based Business's

Representing: ***[IN COMPLETE CONFIDENCE]***

- Mid sized closely held family companies
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