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Advisory Alert: Growing your business through acquisition

Introduction

As the economy continues in economic downturn, businesses are looking for answers to achieve growth, and simply looking to grow the bottom line is not enough anymore. As a business owner, you want to take a more holistic approach to growth—identifying new business opportunities, extending existing customer relationships and/or improving internally. Perhaps this is an opportunity to make an acquisition that can boost your competitive advantage in the long run. Growth through strategic acquisition is a great way to build value and position a business for future success.

Targeting the right acquisition, valuation, tax structure, financing structure, due diligence, corporate integration: these are just a few of the issues involved. And no matter how well, and how intimately, an owner understands his/her own business, assessing the market value of competitors or of businesses in parallel markets can be a complex undertaking.

For these reasons, the desire to grow often remains frustrated. Owners may be daunted by the complexity of the task at hand, not knowing how to proceed, or they may forge ahead on their own and, because of one or two poor decisions, either lose a deal or acquire a business that may fail. Owners who are in a growth mode need to understand the acquisition process—from targeting to structuring the new business entity to integration.

Pre-integration

Getting your own house in order

When we think of grooming a business, we usually think of preparing it for sale. Similar to the planning process for selling your house, it's important to make sure everything is in the best shape possible in order to increase buyer appeal and maximize the sale price. Though it's not always sufficiently emphasized, it's just as crucial that you get your house in order before you make an acquisition, and this could take from six months to several years.

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You must be sure that your organization is strong enough to absorb another company. Management depth and capacity, capital availability, tax issues and balance sheet strength: these are just some of the areas that should be addressed in preparation for acquiring a business. If an acquisition plan fails, it may not just mean that the new company fails and things revert to the way they were; once the integration process has been undertaken and systems, procedures and structures have been merged, failure could impact the original business as well.

Often, seller appeal is an issue too. A vendor will be more inclined to sell his/her life's work and business legacy to an organization felt that can carry it on successfully.

Issues can mean opportunity

From an acquisition standpoint, opportunities become available when target businesses face issues, such as succession or a need for capital, that encourage, force or trigger a sale. The proportion of businesses expecting a change in ownership in the next three years rose from 11% to 14% over the past year. Although the rise is mainly seen in mature economies such as North America where it rose to 21% from 11% in last year, businesses in Latin America also expect change with 12% of businesses planning to sell up in the next three years[1].

Acquisition as an exit strategy

While there are relatively obvious reasons to grow your business—increasing earnings/income and maintaining competitive advantage, for example—the idea of growing your business as part of a long-term exit strategy is often overlooked. Growth is an important part of a company's history that needs to be told to a potential acquirer in order to attract interest. Growth through acquisition not only adds scale to a business, it demonstrates that the company's management team has the wherewithal to properly implement a growth strategy. Companies that are perceived as stable corporate entities—that have depth of management, intellectual property and barriers to entry, for example—stand to command higher selling prices.

The acquisition process

Once you've evaluated your motivations for acquiring a business and have made sure your current business is strong enough to absorb another company—what's next? There are a number of steps in the often complicated process of acquiring a business, but here are some of the key considerations you'll want to be aware of:

Targeting

Successfully targeting the right acquisition starts with an industry analysis, followed by an assessment of specific targets according to a number of criteria, including size, geographic location, profitability, growth rate, products and services, and management strengths and weaknesses. This process is one way of avoiding simply growing for growth's sake. It helps to ensure that the target has the capacity to both add to the acquiring company's strengths and mitigate its weaknesses.

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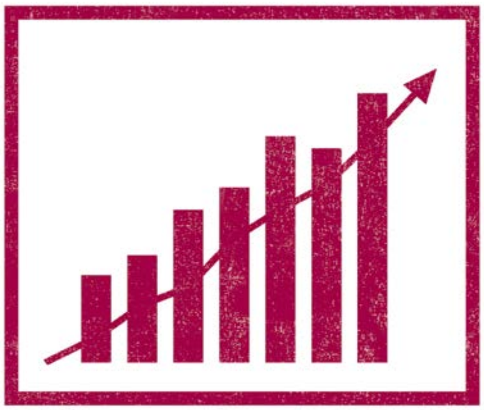
[1] *International business report 2015: Global M&A snapshot 2015. Transaction momentum building. http://www.grantthornton.global/globalassets/1.-member-firms/global/insights/ibr-charts/ibr2015_ma_report_final.pdf* Grant Thornton International, Ltd, 2015



Fit

For successful growth to take place via acquisition, the acquired business must complement the existing business or otherwise fit very closely within a well thought-out acquisition strategy. If the new business cannot be effectively integrated with the old, the benefit of the acquisition could be minimal or worse yet a corporate failure could occur. Generally, fit can be evaluated using criteria such as corporate culture and strength of management together with an assessment of complementary products, customers, geographic coverage, sales methods, technologies and potential efficiencies in the supply chain.

Valuation

Owners are often not able to objectively value other businesses relative to their own. They tend to place a much lower value on a competing business than they would on their own, even one in the same market and with virtually the same business profile. This disconnect is perhaps inevitable given the personal connection to their own company, so it's certainly wise for an owner pursuing an acquisition to gain an in-depth understanding of the market comparables and relevant valuation methodologies. A better understanding of business valuation can help an acquirer avoid making an unrealistically low bid or overpaying.

Synergies

Much is made of the idea of "synergies" when an acquisition is being negotiated. This is simply the idea that when two companies come together, the whole is greater than the sum of the two parts. It's certainly important in the valuation process: A strategic buyer who is pursuing a company that they feel will truly complement their own may, and probably should, be willing to pay more to make that happen.

Tax

As always, tax forms an integral part of most commercial transactions, and the acquisition of a business is no different. Correctly structuring the transaction from a tax perspective could yield many benefits in the future.

Financing

This is relevant where the acquisition will be debt financed. It's important to first put together a deal that makes strategic sense for your organization. If lenders are convinced that the deal is solid, financing opportunities should be easier to secure. You should understand, however, that the capital structure for the acquisition will affect the price that you'll be able to pay, as well as the future cash flow available from the acquisition.

Due diligence

Of course, a due diligence investigation must be undertaken. This process—a thorough analysis that looks at all financial, legal and operational aspects of the company in question— provides the buyer with objective evidence that the company is, in fact, what it appears to be. The information gathered also plays a key role in the valuation process.

Integration

Another aspect of acquisition which is too often overlooked is what happens after the purchase is made. You own a new business: How do you make it part of your organization? How do you incorporate your expanded resource and skill bases to maximize benefit and efficiency? Remember, post-acquisition integration is as important as the due diligence process—start early and spend time planning before the transaction closes.

Integration can be a real impediment to the success of an acquisition. No matter how good the company or how perfect a fit it seems to be, if it can't be successfully integrated into your current company, little or no benefit will be realized. There are numerous aspects to the integration process: business cultures and workforces must be merged; financial restructuring may be required; credit agreements may have to be revisited; compensation and incentives will have to be reconciled. Before you move forward with an acquisition, the integration strategy should be carefully considered and planned for.

Summing it all up

Acquiring a business is a major decision often fraught with complex issues and questions: Is this the right time to consider a business acquisition? Is my current business strong enough to absorb another business? How do I locate the right business to buy? What should I pay? How will I structure the financing? While no buyer is likely to take these decisions lightly, it's also true that the acquisition process should involve thorough and careful analysis and evaluation, from targeting a business to orchestrating the purchase to facilitating the integration process.

Whether you're looking to prepare your business for sale by building it up now or whether you're looking to build earnings/profit/income over the long term by increasing your company's competitive advantage, this may be a good time to act. It's not just something to think about—it's something to think about now.

Bibliography

Wright, G., Brunton, S., Wagner, D. (2013, May). *Growing your business through acquisition.* Adapted from Grant Thornton Canada LLP: http://www.grantthornton.ca/resources/insights/white_papers/Growing_your_business_May2013_electronic.pdf

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