Strategic acquisitions

An acquisition could increase the size and profitability of your business overnight. It might enable you to take advantage of new economies of scale, or diversify into new areas. You might be able to acquire a bigger and better customer base, or strengthen your management team.

But an acquisition can also bring problems, draining financial and management resources from your original business.

You need to work out whether the acquisition will add value to your business, after making realistic allowances for all the hidden costs. To be successful, it will need to bring a number of benefits to your business. This briefing covers:

- The arguments for making a business acquisition.
- How to use an acquisition to expand your business.
- How to use an acquisition to reduce costs and risks.
- Acquisition pitfalls and how to avoid them.

1 Defining your aims

Acquisitions are more risky than organic growth.

Be clear about what you need, and what you expect an acquisition to do for you, before investigating possible takeovers.

1.1 What are your **strengths**? Can you complement them? Can you afford to risk diluting them?

- How good are your employees?
- How good are your products, your market position and your market share?
- Do you have financial muscle? For example, money in the bank, or shares in your own company which can be sold.
- Do you have advantages in technology or production processes?

1.2 What are your **weaknesses**, and how could you rectify them?

- Is your market position vulnerable?
- Are your finances overstretched? Are your overheads taking too high a proportion of your income?
- Do you have any management weaknesses?

1.3 Analyse your **opportunities**, and how you might be able to take advantage of them.

- Do you have a solid market position, good

products or a reputation that could be more fully exploited?
- Do you have a capable management team, with experience in turning round underperforming companies?
- Do you have underutilised resources? For example, money, plant, premises or your distribution network.
- Are your competitors vulnerable?

1.4 Assess the **threats** to your current position.

How can you neutralise them?

- Are you facing new and aggressive competitors?
- Is your market static or declining?
- Are you over dependent in a critical area — for example, on a particular employee or customer?
- Are you subject to cost pressures that you cannot pass on to your customers?

Having completed this SWOT analysis, you can compare the benefits and risks of an acquisition (see **2**–**8**) to the alternatives (see **9**).

Acquiring to diversify

Your business may be well balanced and cash positive today, but offer poor long-term growth prospects. If so, look elsewhere.

A Look for an **undervalued** business.

- Companies at or near the bottom of the business cycle are often undervalued.
- Businesses with underused or redundant assets may offer opportunities for you.
- You might be able to spot a company that would do better if it relocated.

B Look for an **underperforming** business — if you have the management resources to cope with turning it around.

- Consider transferring effective business methods from your own industry.
- You improve your chances considerably if you already have experience in turning companies round.

  Businesses normally underperform because of either poor management or underinvestment. The better a company is performing, the more you will have to pay for it — and the less advantage there will be in the deal for you.

Do not overvalue the company or its potential. Get an independent opinion.

2 Expanding your business

If you integrate another business into yours, both could benefit from the expansion.

2.1 There may be opportunities to **cross-sell** to each other's customers.

- This may be difficult if the two businesses have conflicting cultures and systems. For example, if you sell equipment to NHS hospitals and you acquire a company which makes quick one-off sales of equipment to medical practices. The length of the normal sales cycle customers are used to can be a major cultural factor.

2.2 You could improve public **perception** of your company.

- Bigger companies are often believed to be more reliable, and you should get better brand recognition.

2.3 You should benefit from opportunities to **develop** other products.

- A wider customer base makes successful new product launches more likely.

3 Reducing your costs

With a higher volume of activity, you should be able to achieve substantial economies of scale.

3.1 You can make better use of **overheads**.

- Make savings in central functions, such as finance, administration and personnel.
- Look for similar savings on premises, distribution, sales and marketing.
- If the companies are in the same line of business, you might make savings on manufacturing or assembly facilities. It may also be possible to cut out some management salaries. But be careful — you may be cutting out talent which your business could use (see **8**).

3.2 The increased size of your business should give greater negotiating power when it comes to **purchasing**.

- You should get better prices when buying in greater volume (bulk-buying). Ask your existing suppliers for quotes, so you can judge the potential savings.
- You may be able to negotiate better terms from your bank.

3.3 You may enjoy some of these benefits even if you buy a business in an **unrelated area**.

- You can still share some resources, such as premises and distribution.
- If the product is different but the technology involved is similar, you may be able to share production facilities.

Stay open-minded about the kind of business you might acquire. However, the more closely related two businesses are, the more scope there will be for major benefits.

If there is no overlap at all, the acquisition is unlikely to make sense strategically.

4 Diversifying to cut risks

An acquisition could help you limit or offset the risks in your existing business.

4.1 You may want to diversify your **product** line.

- You may rely too heavily on one product.
- Some of your products may be coming to the end of their product life cycles.

4.2 You might also want to consider **market** diversification.

- An acquisition could help you open up export sales, or reduce your dependence on just a few customers.

Bypassing barriers to entry

Acquisitions can be particularly useful where there would otherwise be significant barriers preventing you from entering the business.

A **Technology** may be protected by patent or licence.

- For example, you might not want (or be able) to buy the company that owns the brand. But you might be able to buy a company that holds a licence to use it. If you alienate the brand owner (eg by threatening to compete), you may still be denied the use of the brand.

B Your ambitions may be blocked by **public policy restrictions**.

- For example, you may not be able to get planning permission for an outlet where you want one. But you may be able to buy a business already operating there.

4.3 Acquisition could help even out workloads, if you have a **seasonal** peak in activities.

- For example, if you cater for the Christmas trade, buying a company which makes goods for the summer could add balance to your activities and improve your cashflow.

5 A short cut to assets

An acquisition could save you time and money when building your business.

5.1 You might be able to acquire **assets** at a relatively low price.

- For example, buying a competitor might give you access to specialist machinery and knowledge.

5.2 You might be able to acquire a good **distribution network**.

- You could cut the time and effort involved in building a sales force, or establishing sales outlets from scratch.

5.3 An acquisition could also be a quick route to building an **employee skill base**.

- Be careful, as employees do not have to stay on after the acquisition.

6 Defensive strategies

You can use acquisitions strategically, to block your competitors and to protect your allies.

6.1 If you acquire a direct **competitor**, you remove a potential brake on prices.

- You may be able to put your own prices up, or at least hold them steady.

6.2 If you acquire a business that competes for **resources** with yours, you may be able to limit the growth in costs.

- For example, an agency that takes over a rival supplying IT staff should find it easier to get qualified people onto its books.

6.3 You might consider an acquisition to protect a **trading partnership**.

7 Beefing up management

Acquisitions are often most useful when they bring in new blood — intentionally or not.

7.1 An acquisition can **fill gaps** in your management team's skills and experience.

- If selling is your strong point, an acquisition may be a good way of bringing in someone with production or administration experience — or vice versa.
- If your business' guiding light focuses on the short term, you might be able to bring in a long-term planner.

7.2 Be prepared to **spend time** with prospective partners, if you are planning to utilise their management skills.

You need to ensure your methods and objectives fit together.

- People who seem like the perfect complementary talents can turn out to have a totally different agenda from yours.

8 Takeover traps

If an acquisition is going to fail, it is usually because there was inadequate investigation beforehand, or no clear, agreed plan for what should happen afterwards.

Failure can be extremely expensive. Consider the possible pitfalls before making any move.

8.1 Your **own business** may suffer.

- Your management may be tied up with the acquisition and overlook problems closer to home.
- You may well find you have increased your exposure to risk (for example, if you have borrowed heavily to fund the acquisition).
- You may have acquired assets you can neither use nor sell.

It pays to make extensive checks before buying another business.

8.2 The acquired business may **underperform**.

- Your management skills may not be transferable to the acquired business.
- Key employees might leave.
  Try to 'lock them in' with a contract using bonuses linked to agreed profit or contribution targets.
- Hidden problems may emerge after the acquisition. For example, suppliers may raise their prices or the market might turn against the business.

8.3 You may run into difficulties in achieving your expected **economies of scale**.

- Key staff may be unwilling to relocate.
- Making redundancies may be expensive, and will unsettle people you want to keep.
- Trying to merge two cultures can be a long, drawn-out, disruptive process.

Be sure to allow for rationalisation costs when calculating the benefits you expect from any merging of operations.

8.4 Some acquisitions **backfire** spectacularly.

- Beware that buying out your competitors may not be as ideal as it seems.
  Ensure the sale and purchase agreement includes terms and conditions preventing the former business owners from setting up a similar venture again.
  It is important to rule out a similar new business in close proximity to the one you take over. Otherwise you risk them winning back former employees and customers and regaining their market share.

9 Examining the alternatives

An acquisition may often look like an attractive short cut to success. But you should also consider other routes to expansion.

9.1 **Build up** another business from scratch.

- It may be cheaper and simpler in the long run.

9.2 **Sign up** long-term contracts with another company.

- For example, rather than buying a company for its distribution network, contract it to distribute your products on your behalf and get the benefits without the risks.

9.3 Form a **joint venture**.

- It is often cheaper to get out of a joint venture than offload a failed acquisition.
- A joint venture gives you access to the other party's management and employee skill base, without the need to contribute to the overheads.

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