



## **Should I Grow Through Acquisition to Increase the Value of My Business?**

A transaction that fails to achieve financial independence for the seller may be unsatisfactory. If the value of a business is insufficient to meet the financial needs of the seller, other options for growth may be examined. The owner can decide to expand the business through organic growth, increasing revenue and profitability through internal investments, or through inorganic growth by means of acquisition. Acquiring another business can be one of the most efficient ways for a business to rapidly expand.

Organic growth, also called internal growth, requires an abundance of financial and human capital as well as time. Organic growth refers to internal activities pursued by companies to increase their scale. Organic growth can include: expanding product/services and geographic footprint, increasing sales and marketing activities and any other internal investments used to increase the overall sales of the business. These are great traditional approaches to increasing revenue; however, the amount of capital required to achieve success can be extensive, if not overwhelming. Organic growth demands a considerable amount of time and patience and still may not generate the desired results. Further, for many business owners considering retirement, they simply do not have the time, or the patience, to consider growth from within.

Growth through acquisition, on the other hand, can be a much faster and often more cost effective means of expanding a business. Acquisitions can often serve to access new markets and new sources of revenues and earnings. Other benefits of acquisitions include: increased employee capabilities and resources, reduced competition, increased market share, increased geographic reach, increased strategic alliances, greater economies of scale and new products or services.

Despite the many benefits of acquisitions, no acquisition is without risk. One should approach growth through acquisition with their eyes wide open, as there are numerous risks for potential pitfalls. Probably the most common concern centers around customer and employee attrition. The other major area of concern is post-merger integration, which happens to be the number one reason why acquisitions fail and can often result in substantial unanticipated costs if not addressed properly during due diligence. Nevertheless, problem areas are typically very predictable, especially for a synergistic acquisition in which the buyer is familiar with the industry and possibly the target company. Thorough due diligence involving an investment bank, legal and accounting firms will facilitate identifying potential problem areas. Few problems arise without a solution and the vast majority can be mitigated through negotiation and advice from an experienced investment bank.

As with any business transaction, there are numerous risks associated with inorganic growth that should be analyzed and reviewed. However, an argument can be made that the risks are not only smaller but are also much easier to anticipate and quantify than the more traditional risks associated with organic growth. The specific expenses of an acquisition can be predicted with reasonable accuracy, though post-merger

integration costs are harder to quantify. When measured against a clearly defined objective, the time and expenses associated with organic growth can be much less predictable.

When acquiring another business, the purchasing company buys more than just tangible assets. They also obtain the company's personality and culture. This could be a potential problem if the business being acquired has a poor reputation in the market. A similar problem arises with "turnaround" companies, businesses in financial or operational distress that can be acquired for a reduced sale price. Whether the problems are financial or operational, avoid these turnaround companies. There are professionals who solely focus on rebuilding distressed companies and reselling them, and these transactions should be left for those with sufficient time and capital to invest in a "turnaround" project. It is often impossible to identify the full extent of a distressed company's problems.

Assume that a business has \$12 million annual sales and wants to grow by 50 percent. Suppose there is a company with \$6 million in annual sales and 10% EBITDA selling for \$3.0 million. It is assumed that beyond revenues and EBITDA, the target company also brings value-added components, new product lines, cross-selling opportunities, and potential cost savings from operating synergies. Through such an acquisition the acquiring company can achieve its goal of 50 percent growth for a reasonable \$3.0 million. Additionally, by working with its investment bank and legal team, the acquiring company may be able to avoid paying the entire \$3.0 million up-front and instead defer the payments over a 3-5 year time frame.

Once a determination has been made that growth through acquisition is the appropriate course for a company, it should next focus on finding the "right" target. Now the focus should turn to finding a highly complementary business with strong history of financial performance. While this can be incredibly time consuming, the process can be aided substantially by an investment bank which can perform the majority of the work. Perform sufficient due diligence and negotiate appropriate purchase price and terms. When the transaction is properly analyzed in coordination with an experienced investment bank, the value of the business can quickly increase. The old adage is true: it's typically cheaper to buy a business than build one from scratch.

Please contact Aaron, Bell to review your unique circumstances.