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Grow by Acquisition

and become more dominant in the marketplace

Matthew Oliver, a director of M3 Corporate Finance in Bristol, says acquiring another company can be a cost-effective shortcut to growth for smaller businesses.

Matthew Oliver, a director of M3 Corporate Finance

An acquisition can increase the size and profitability of a business overnight but few smaller firms consider it as a viable option. This is surprising given that buying an established firm is faster, less risky and usually cheaper than building a business from scratch. It's almost always easier to finance than organic growth because funding organisations can see exactly what they are spending their money on.

Acquiring another business allows you to move into new markets, acquire new customers or new products. If you are a manufacturing company, for example, you may want to acquire a supplier in order to lower your supply costs and have greater control over the supply chain – this is what the textbooks call vertical integration. Alternatively, you may go for horizontal integration and take over a competitor/complementary company so that you can acquire additional products or know-how and expand opportunities in your customer base.

Acquiring another company and increasing your size also gives you a more dominant position in the marketplace. For instance, you may want to sell to a large corporation but fail because your business is too small to be taken seriously by the major players. However, if you significantly increase in size by acquiring a larger firm then you are more likely to register on their radar.

Another reason for buying a business might be to acquire skills or expertise to strengthen your own business. For example, you may run a small consultancy firm and know of another company that has a great team of consultants with an impressive track record. Rather than recruit people yourself with its potential pitfalls and undoubted delays, why not buy the consultancy instead?

The first thing to establish is why you want to buy another business – is it to diversify, acquire new customers, boost revenues, or provide a more comprehensive customer service? It's worth pointing out that you don't only have to consider firms that are for sale. If you are a business owner you will know the market and potential opportunities and therefore be aware of suppliers, competitors or other businesses in your sector worth further investigation.

Clearly the price needs to be right for all parties involved, but given the right rationale for the acquisition and structure of the deal, a win-win situation may well be achievable.

Once a target company has been identified, you need to start your due diligence process which should involve a detailed review of the target company's operations. This list is not exhaustive, but you should consider:

- Evaluation of the financial performance of the businesses relative to other companies within the sector.
- Find out what customers/suppliers think of the business.
- Will there be any additional constraints on your plans from having a combined entity?
- Benchmark the target's performance against your own and your expectations.
- If you are buying new products and technology, check that they are secure (patents where applicable).
- Find out how the target is financed and think about any additional liabilities that may arise down the road (warranties for example).

It is worth thinking about what can go wrong – and tailor your approach accordingly. One of the biggest reasons why acquisitions fail is a clash of management cultures. It's vital to ensure that the companies fit together and that the staff can work effectively as part of a larger team.

Another reason for failure is flawed business logic or poor understanding of the business you are buying. For example, a business could be up for sale because a competitor is bringing out a vastly superior product in the next 12 months. The important thing is to make sure that all the reasons for buying a business add up and that you are not missing anything.

You should also be aware of the full range of funding options that are available to finance the transaction. One size/type/structure does not fit all transactions. But funding acquisitions is easier than the alternative of funding organic growth.

Of course, every deal is different which is why it's crucial that you obtain professional advice before going down the acquisition route.