John Martinka
Jessica Martinka
PO Box 3085
Kirkland, WA 98083
T 425-576-1814
john@johnmartinka.com
jessica@martinkaconsulting.com
martinkaconsulting.com

Growth by Acquisition Isn't for Everybody

An interesting title of an article about how the author helps his company's clients, isn't it? Immediately telling readers the subject might not be for them. It's because I'm not a salesperson, one size doesn't fit all, etc. In fact, I start out speaking engagements on buying a business by telling the audience (usually management and executive level people0 there's a good chance it's not for them.

But when it is for you, be sure to do it correctly. And that means don't jump in without a plan and when it comes to growth by acquisition that means know why you're doing it.

In my book, Company Growth By Acquisition Makes Dollars & Sense I have a list of 19 reasons to consider growing by acquisition. I'll list them here and go into detail on six of them.

The cake – 16 solid reasons (in alphabetical order)

- Acquire great talent, including the seller
- Assets are cheaper as a package
- Competitive Advantage (fill a weakness)
- Dependencies reduced
- Diamonds in the rough
- Diversify your product offerings
- Easy money
- Integration is easier
- Location, location, location
- Make a competitor go away
- Psychology – Employees like to be part of a winner (growing firm), just like sports bandwagons
- Risk, it's a lot lower
- Overhead the same, volume higher
- Synergy
- Technologies
- Vendor relationship strategies

The icing – the top three

- Customers (efficiency vs. make more calls)
- Yes, we can!
- The bigger you are…the better

ACQUIRE GREAT TALENT

Good employees are hard to find and often are not in the job market. Just talk to any executive recruiter. While all buyers want capable employees, most strategic buyers (that's you) also prefer to see a solid management team in place.

Great employees with industry knowledge and experience are in the job market even less. When you are looking for great salespeople, I believe this is amplified. They won't change if they've got a good thing going. Here are some statistics from an executive recruiter, which explains why it's tough to find good people.

- 82% of people aren't searching for a job.
- Leadership, or the lack thereof, is the top reason management people switch jobs (not money).
- 46% of millennials left their last job because of the lack of career growth.

If you acquire their company and create an atmosphere of growth, those employees will want to stay. While I can't comment on the culture in all companies, I do know that many small family-owned businesses have owners who are coasting. They are doing very well, they aren't working too hard, and they don't want to disrupt the nice moneymaking system they have.

Dependencies reduced

Dependencies are a huge issue in most small businesses. By being larger you can reduce most or all of the following:

1. Customers
2. Employees
3. Management abilities
4. Product
5. Owner

Not too much explanation is needed. More customers over your expanded revenue base, more employees, deeper management, less product concentration, and most importantly, there's more talent to take a load off the owner. And an owner dependency is often the brightest red flag for most profitable small businesses. Of course the owner has to be willing to take advantage of the deeper bench by delegating to them.

Psychology – Be part of a winning team

Employees want to be part of a winning team. They want to feel they're contributing to a winning effort. It's very much like sports, the more the team wins, the greater the number of fans it has.

I'm thinking of a young man in his early 20's whom I know. He took a while to figure out some things in life and is now steadily employed and has been for the last few years (with the same company). He's proud of his job, his contribution, and showed disdain when a new, younger employee (whom he called "the kid") flaunted the rules and wasn't dedicated. (But let's be honest, some employees at this level don't care, but they're not the ones who are important anyway, like "the kid."

Now elevate this to the more experienced people including the management team. In one company there was some doubt about the general manager accepting new ownership. However, this doubt was unfounded as he's leaped at the chance to implement quality controls, better processes, and accountability.

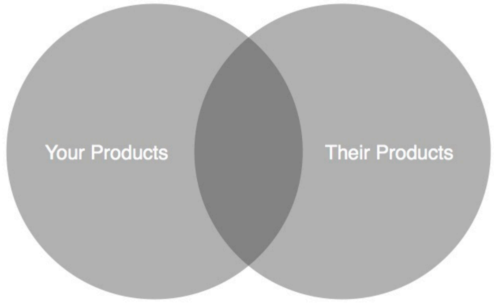
The icing – the big three

Now here are the top three reasons to grow by acquisition.

Customers

"This would be a great business if it wasn't for those darn customers" was a semiserious comment someone made to me years ago. Of course it's the annoying (bad) customers he was referring to. It's good customers we all want more of—customers who are loyal, steady, in good financial shape, growing, pay their bills on time, appreciate the value you offer, and consider you part of their team.

An ideal situation is where there are some overlapping products, so there is some continuity and synergy to be achieved. The figure below shows this. Your salespeople now have an easy transition to discussing, and selling, their products, and their salespeople have an easy transition to discussing, and selling, your products.



In simple terms, if your primary motivation is acquiring a customer base, you are acquiring market share. You may have many other reasons (above), but the bottom line is you are buying customers, and that means top-line growth.

YES, WE CAN!

This is not about ego; it is about building an exit strategy in order to get a higher selling price. Buying another company, assimilating it into your operation, and showing that the combined profits are greater than the two individual companies' profits demonstrates to potential buyers that this can be done. It proves you have the team that can integrate one operation into another.

This integration could be their assimilating your firm into theirs or it could be a signal that growing your business (or now a division of theirs) is possible by further acquisitions. A management team that can successfully integrate other firms without major disruption and with immediate efficiencies is a valued team. Too many big mergers and acquisitions fail. Up to 95 percent of public mergers do not live up to expectations. A savvy buyer will appreciate this talent and experience associated with past integrations.

WHY LARGER FIRMS SELL FOR MORE THAN SMALLER ONES (ALL OTHER THINGS BEING EQUAL)

The bigger your business is, the more it will sell for, all other things being equal. A $50 million (revenue) company with 10 percent earnings will sell for a higher multiple (of profit, earnings, free cash flow, or whatever metric you use) than a $25 million company with 10 percent earnings, which will sell for a higher multiple than a $10 million company, and so on.

There are generally accepted ranges for multiples of earnings based on the range of companies' revenue. However, too many small business owners see in the *Wall Street Journal* that a $300 million company in their industry sold for ten times earnings and assume their small business will also sell for ten times. That won't happen; there's more risk in smaller businesses than larger, so the desired return on investment is higher.

The fastest and safest way to grow from $5 to 15 million is by acquisition. Buy another firm in your industry—a supplier, customer, or unrelated company that provides diversification—to have an immediate revenue increase and a larger platform from which to grow organically. See more profit and a higher multiple when you exit.

"It's not bragging if you can do it." (Dizzy Dean, 1934)

A lot of business owners talk about their company's potential or the growth that will occur if the buyer just "does some marketing." Of course, most of this is just talk. Business buyers of all types and sizes are a skeptical lot. When buyers hear too much about potential they think the seller has tried every conceivable way to grow and can't.

So prove you can do it. Grow organically and also go out and buy another company. Show that you can integrate the people, processes, financial systems, customer service, and everything else into your operation. Private equity groups and large corporations make multiple acquisitions. If you can buy another firm and successfully assimilate it, you become more attractive to these buyers. They will assume you can do it again and that your management team is capable. Strategic buyers and equity group buyers highly value management teams—it can even increase the multiple (compared to having the same size company that has not made acquisitions).

We've covered just six of my 19 reasons on why it makes sense to grow by acquisition. I realize most may not apply to your business. It's the few that do apply that are the reasons why this strategy may make sense. Heck, your catalyst may be a reason not mentioned here. The point is this has worked for many companies and you should always have your eyes open looking for opportunities as there are a lot of good reasons to do so.

At the same time I must acknowledge there are pitfalls you need to avoid, but they can be avoided if handled correctly. How you handle the cultural integration makes a huge difference. Letting (most of) the employees, with both companies, know their jobs are safe is important, as with any acquisition. And you will be taking on debt, but this debt comes with good things like customers, good margins, cash flow, etc. If it makes sense to buy another company these pitfalls are easily overcome. As a very wise executive once told me, "Growth hides a lot of operational warts."

This article was written and originally published for IBA, www.ibainc.com.