



## **GROWTH THROUGH ACQUISITIONS**

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Where do you want your company to be in five years? You can be there in one year with an acquisition. Growth through making acquisitions is an external growth strategy, one that is pursued by many and executed by few. An acquisition is a great leap, a great risk, a great reward, a throw of the dice.....choose what you want to call it, but its attractiveness as a growth strategy is unparalleled.

All growth strategies have the common goal of gaining more customers. However, the external or acquisition growth strategy is completely different than the internal growth strategy. The internal growth strategy focuses on retaining customers and aggressive selling. This strategy is geared to incremental growth, often in single digits, over a period of many years. The external strategy focuses on large amounts of growth (50% or 100%) right now. The growth through acquisition buyer sees the addition of a target company to its existing company as important for the future success, growth, and profitability of its existing business.

For the business owner, an acquisition in the same line of business or a complementary line of business makes the most sense. There are two important strategic objectives in an acquisition. The first is diversification of the business owner's investment and the second is diversification within the investment. By owning another complementary company or operations in another geographic location, the owner has diversified (lessened risk) his holdings. Also by acquiring another company the owner has diversified his investment through additional customers, markets, distribution channels and products or services. The second is the creation of shareholder value through the diversification, growth in size and increased profitability.

So, what is to be gained in the tactical sense? The rewards of an acquisition are potentially many, but here are five that most acquisitions should achieve.

- ✓ Increase revenue and customer base
- ✓ Increase product mix
- ✓ Increase revenues through cross-selling
- ✓ Gain new distribution channels
- ✓ Reduce operating (infrastructure) costs

Almost by definition, any acquisition will achieve these five rewards quickly. Assuming that you have bought a profitable company, you now have a much larger platform with more customers and a different product/service mix. Now for the hard part – capturing the synergies between the two companies. The economic benefits in an acquisition are achieved by synergies (1+1=3) and economies of scale. Synergies are found by matching a strength in one to a weakness in the other, such as a strong marketing department versus a weak one. When one boosts the other, additional revenues and profits are found. The acquisition may have increased market share (elimination of competitor) allowing the combined entity to raise prices or resist price decreases. The most common and profitable synergy is in the cross selling of product/service lines. You will have two different product lines, and you will have new customers to introduce new and complementary products and services. This is the true nature of synergy in a growth acquisition.

Economies of scale often refer to cost reduction or increased purchasing power. In cost reduction, management finds ways to reduce cost and increase efficiency, such as the elimination of overhead expenses. Increased purchasing power is achieved by ordering full truckloads, or spreading costs over more people. In the manufacturing world, plant efficiency may increase from 70% to 85+%. It is the synergies and economies of scale to be found in a strategic acquisition that allow the acquiring company to justify the purchase in the first place and to pay for the acquisition.

Just like the commercial that says “don’t try this at home”, growth through acquisitions requires some special attributes of the acquiring company. For one, you will need the management capacity to take on the additional load, although the target company may have excellent managers. Next, financial capacity in the form of excess cash flow is essential to make any acquisition happen. Financial condition should be the same or even stronger after the acquisition. Today’s financing markets are highly favorable to acquisition transactions. Between the commercial banks and the abundance of mezzanine lenders, almost any acquisition can be financed. Finally, not just any acquisition will do. The target must be a strategic fit to the existing company, meaning that the two companies together will have some significant advantages over its competition.

Surprisingly, an acquisition (or two) can be considerably cheaper than an internal go-it-alone growth strategy. Consider how much time, effort and money will be spent over the next five years by trying to beat the competition into submission. Growth through acquisitions is faster and less costly than one might think. In one transaction, a company might leap over its competition, penetrate new markets, introduce new products and eliminate a competitor. Obviously, these benefits would be quite a coup. Your average run of the mill, get bigger acquisition will not deliver spectacular results, but should achieve a substantial measure of the five rewards.

Arguments for and against growth acquisitions can be endless. Should we acquire underperforming companies for bulk? Why not acquire best in class market dominators? Is there anything to consider in between? Acquisitive management teams will focus on

strategic fit first, followed by the economics. Nevertheless, owners need to be aware of the M&A markets to capture a synergistic or even serendipitous opportunity. Management that is actively hunting should not be surprised by a competitor's move and will have had the opportunity to acquire or pass.

External growth strategies are fundamental to large publicly traded companies seeking to achieve strategic advantage and increase shareholder value. For smaller, middle market companies these strategies are more difficult to execute, but should be an integral part of management planning. With the promise of five years growth in one year, acquisitions can be life changing events, a huge management challenge, a corporate rejuvenation, and an opportunity to move to another level.



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