Business Sales | Acquisitions | Corporate Finance | Strategy

Guide 4
Acquisitions

AVONDALE

Guide 4
Acquisitions

Avondale is a leading Mergers & Acquisitions strategy consultancy. We have been working with the best entrepreneurs and companies for over 20 years. Operating both locally and globally, the firm has offices in the UK and Central Europe.

We provide a fully integrated service from business sales and acquisitions to business growth, strategy and employee ownership. Solutions-led, we combine our expertise with ambition, resource and vision – partners that drive value and deliver your goals.

In this Guide we examine strategic acquisitions; how they can create competitive advantage, build the purchaser's core competencies, deliver shareholder value; how to buy 'right'.

Please contact av@avondale.co.uk if you have any questions

INTRODUCTION

Acquisitions can propel companies to competitive advantage faster than organic growth can deliver. Carried out well, they can grab headlines and secure 'CEO saviour' or 'leader' reputations. Carried out badly they can also destroy value and create 'CEO scoundrels' as we saw with the UK's Sir Fred Goodwin's ABN AMRO purchase; poorly delivered and overpaid at exactly the wrong time.

Research and experience show that many acquisitions fail to meet expectations or deliver the ideas or concepts behind the original strategy and some even fail altogether as the purchaser does not deliver shareholder value and return on capital lags on forecasts; and thus we buy a 'Trojan Horse.' Legend has it, after a fruitless 10-year siege, the Greek Trojans hid a selected force of men in a huge wooden horse. The Greeks pretended to sail away whilst the Trojans pulled their horse into the city of Troy. Some Greek soldiers were hidden in the horse and at night they crept out of the horse and opened the gates of Troy for the rest of the Greek army and the city fell. The acquisition may appear an attractive 'trophy' but:

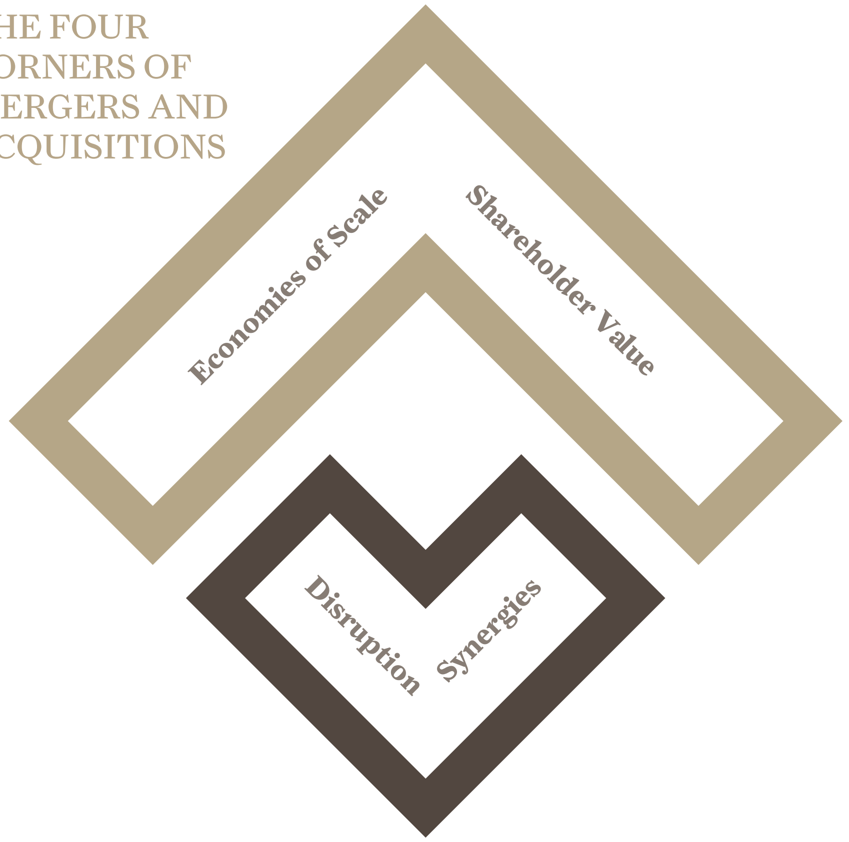
- Does it fit the strategy?
- Will it distract as much as deliver?
- Is it a Trojan Horse; attractive till opened?
- How do we find, or have we found, the right deal?

The 'strategy' combined with value will drive the deal decision, checked by the due diligence. Each of these topics has their own chapter due to their materiality. However, for strategy and finding the right deal, leaders need techniques and knowledge to answer these questions, In this Guide we examine what strategic mergers and acquisitions might mean and some of the best practice around their undertaking, particularly in private companies, to build on the acquirer's core competencies to create advantage; to buy 'right'.

WHAT'S THE STRATEGY?

Strategic acquisitions start with one sole fundament - what is the strategy? What is the plan and vision and therefore does the acquisition fit – or not? This seems obvious: no one would spend millions or sometimes billions without clearly and deeply thinking why they would do it; what the benefits, motivations and outcomes are, would they? Or, would they? Yes, they might, as acquisitions create short term boosts, headlines and immediate return whereas a longer alternative organic growth strategy may be available but less obvious. Also, many leaders simply are not clear what the vision or mission within their sector is and, with abundant capital and not enough opportunity, they can rush into acquisitions. As many see, when acquisitions are driven by negotiation and valuation the discounted acquisition purchase may appear attractive yet there is an adage 'buy cheap, buy twice.'

THE FOUR CORNERS OF MERGERS AND ACQUISITIONS



Clearly, we need to buy at value, but value is defined as far greater than low cost. To value something we perceive its significance even though it may on the surface appear expensive.

Acquisitions are carried out correctly when leader CEO's are clear on:

- The mission and vision for the business against market dynamics and the likely line of probability in those dynamics.
- What business the organisation is in and why – and what they are not in.
- Resources and yield to generate return on capital.
- What the alternative organic growth strategies are.
- The culture, ethos and standards of the business today and tomorrow.
- What customers want today and tomorrow.

AVONDALE

Strategy is deeper than a plan, as it is anticipatory; I liken it to the game of chess in the sense of thinking about moves ahead. The winners in strategy are the ones that can see better where market dynamics are taking them, with the recognition that the customer is the ultimate driver in the marketplace; they see the moves ahead. Which initiatives including acquisitions fit the way your customers are thinking or are likely to think?

Yes, we need scale, we need shareholder value, we want return on capital employed. We want synergy, we want economies of scale, but most of all we want to create organisations that customers champion, businesses they aspire to, and here is where we can get clearer insights into which acquisitions we should buy. In this we see that the CEO must be focused out towards the market as opposed to either following the market, or worse, being pulled into management in operational activities or initiatives. The CEO should be concentrating on questions such as what business are we in and why, and in that context are we ahead or behind the market?

The right strategic acquisitions can help create competitive advantage, increasing business breadth or depth through market share growth, considering new territories, products or skills capability. Whilst we examined this in Guide 1 (Valuations), it is worth relooking at our model of the 'four corners of strategic M&A.' Good acquisitions will ideally encompass all or most corners. The four corners of strategic M&A are:

- Economies of Scale – long term, usually scale led, cost savings.
- Shareholder Value – growth in both buyer and seller companies – value via the combination.
- Synergy – market power by increasing market value and access.
- Positive Disruption – buying valuable skills and capabilities, which means reduced barriers to entry for some markets. This may include buying Intellectual Property or team know-how.

ECONOMIES OF SCALE

There are two main types of economies of scale, internal and external. Internal is where the company and the management itself controls costs and go to market strategy. External is where external factors have a bearing like industry, geographic location or government.

For the most part when making an acquisition many companies focus on internal economies of scale whereby buying a company gives them the opportunity to reduce costs. These may include optimising production in manufacturing or access to more efficient equipment, using technical infrastructure for data mining, reducing distribution costs through larger container or bulk carriers or enhancing buying power. Supermarkets are a case in point; the UK's supermarket giant Tesco's £4 billion takeover of Booker, the country's largest wholesaler, in March 2018 creates a near monopoly of buying power and significantly enlarged market share for Tesco.

Another area that many financial directors don't consider is that scale often gives you cheaper access to money. A larger company has greater options to access money with higher credit ratings and in most part at lower interest rates. This approach may be the leverage needed to accelerate growth through acquisition.

External economies of scale are where geographic locations and cluster offices or production units join together in order to reduce costs and pool resources. Another area that may be a factor is utilising government support such as taxes or grants. For example, Nissan uses funding from the UK government to support manufacturing in the North. Amazon uses Ireland to reduce UK taxes.

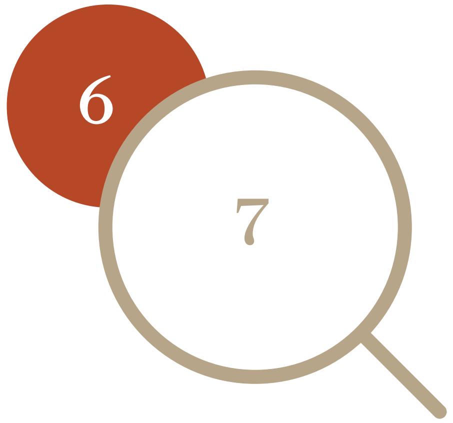
SHAREHOLDER VALUE

Creating shareholder value through multiple acquisitions has been the focus of many studies. It has been well documented that shareholders of the selling company can fare better than the acquirer; share price of almost all targets increases around the announcement of a merger or an acquisition. However, in contrast, the average share price performance of acquirers around the announcement of a merger or an acquisition is slightly negative. Boston Consulting Group carried out a study across 26,000 transactions and showed that the average share price performance over a seven-day window centred on the announcement date was +15.5 percent for the target but -1.0 percent for the acquirer. The main reasons for the lack of increase in shareholder value are:

- Over-estimation of the target's value.
- Misconception of expected synergies.
- Failure in due diligence.
- Failure to successfully integrate the target.

This may make gloomy reading, however, not necessarily long term. Acquisitions can drive competitive advantage which is a key driver to share value. There are also opportunities, particularly in private companies, for multiple arbitrage – buying and consolidating a number of smaller businesses at lower value and, either by proxy of the buyer already being valued higher, creating value in the bolt-on, or by the combined profits increasing size and quality and therefore multiple. Private equity transactions major heavily around multiple arbitrage - the practice of increasing the value of a company without having made any operational improvements to it, either by acquiring a bolt-on or repositioning by scale or sector an asset, see Guide 1 (Valuations).

MULTIPLE ARBITRAGE METHOD TO CREATE SHAREHOLDER VALUE



1. *Existing company A: EBITDA £1.2m trading @ P/E of 6*
2. *Purchase Company B: 6 x EBITDA of £1 million = £6 million*
3. *Bolt companies together at combined EBITDA £2.2m*
4. *Exit: 7 x EBITDA at £2.2 million = £15.4 million. The 7 times is driven by the higher EBITDA pushing multiple up.*
5. *Arbitrage achieved in this example: £2.2 million*

A synergistic acquisition is where the cooperation or merger of the organisations produce a combined market effect greater than the sum of their individual capability.

AVONDALE

SYNERGY

Synergy in corporate finance is usually defined as either ‘Financial Synergy’, arrived at from improved financing activities and in particular a reduction in the cost of capital, or, ‘Operational Synergy’ through the improvement of operating activities, such as reduced costs from economies of scale as defined above. However, in our definition we see these aspects as too close to economies and therefore use synergy to focus beyond cost savings to actual revenue enhancement.

Synergy can and is used to define economies of scale. For example, in the merger between National Bank of Abu Dhabi and First Gulf Bank there are estimated ‘cost synergies’ of around £200 million to be realized over the next three years driven by network and staff reductions, system integration, consolidation of common business functions etc. Of course, this is the aim, and time and hindsight will tell whether the objective is achieved. However, we prefer a more positive context to the word defining a synergistic acquisition as where the cooperation or merger of the organisations produce a combined market effect greater than the sum of their individual capability.

In our definition, synergy mergers and acquisitions are hallmarked by growth aspects such as better combined know-how or cross selling to enhance revenue. Economies can be seen as cost and efficiency whereas synergy is a trigger or catalyst to growth, and the category can be widely encompassing. To name a few – access to new customers, expertise, ideas, territories, channels or products.

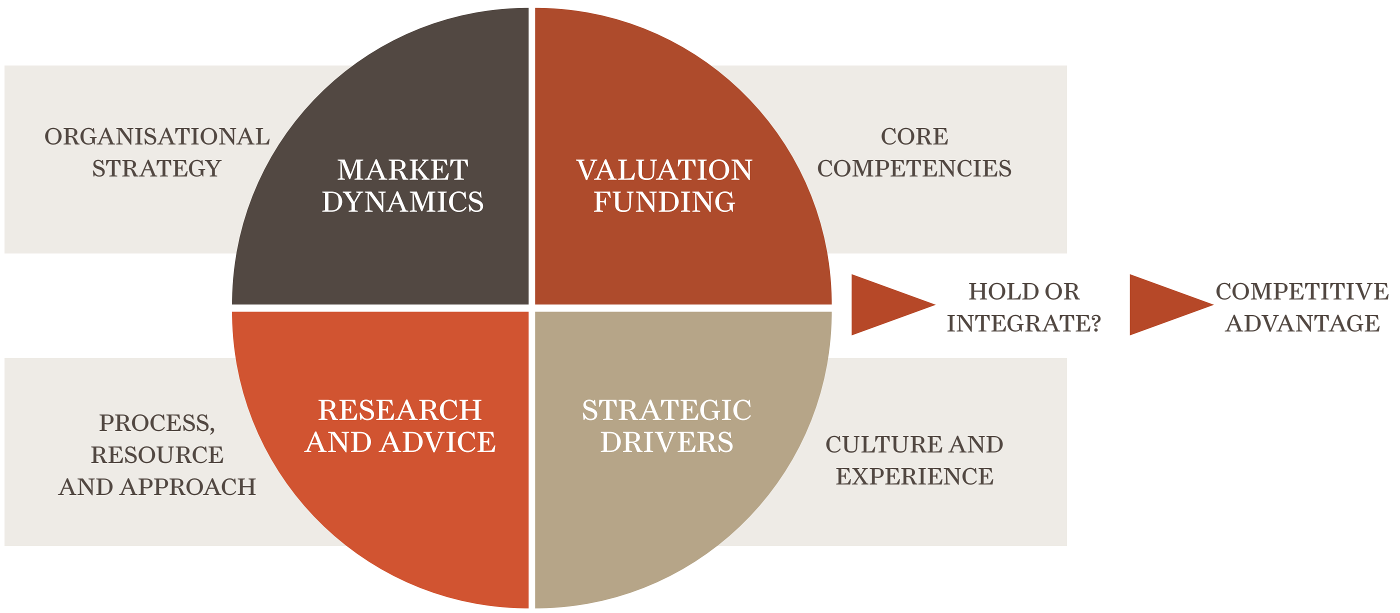
POSITIVE DISRUPTION

This leaves us with positive disruption as the acquisition keystone. To remind you a keystone is the wedge from the summit of an arch where the pressure of all the units are locked together to hold the arch in construction. A Roman speciality, the prolific use of arches were used to create sustainable structures, many that still stand today. In choosing which acquisitions to undertake, the sustainability of the company is the leader’s legacy and responsibility. This is driven outwards and upwards in the market analysis of the sector’s likely direction. When we do this deep analysis, we get clear on who we should buy and why in order to realise the best return on capital. As critically, we get clear where we should not buy, which is why we see positive disruption as the keystone to acquisition.

If a company has the resources and capital, an organic growth strategy probably represents the best alternative to acquisitions. However, if a market is growing rapidly, or the business has been slow to react to the market and is falling behind, speed is of the essence and a well-placed strategic acquisition, placing the customer and market drivers at the centre, may well be the faster route to catch up or even better push ahead. This assumes a trade buyer. If the acquirer is a private equity or individual buyer, the motivations may be different. The alternatives to acquisitions may also be examined, including:

- Joint ventures
- Equity stake investments
- Distribution agreements

Be clear what to buy and what ***not*** *to buy.*



THE ACQUISITION SUM

In strategic acquisitions we see that the decision sum sits around:

- Understanding better the core competencies of both buyer and seller.
- Ensuring the competitive landscape and market dynamics are well researched.
- The customers current and likely future intentions are analysed.
- The four corners of M&A – economies, synergy, shareholder value and positive disruption – are analysed and assessed.

The leadership team therefore are clear on their business strategy and can focus on when to say yes and when to say no to acquisitions. The evaluation as to where and when to buy fits the criteria.

Whilst I consider positive disruption as the driving force for trade companies it is also important to understand that each buyer's motivators are different and so, when we look again at the four corners, the idea of the model is that each acquisition will have all four corners, however, it is perfectly legitimate to buy with none. For example, a private equity or individual buyer may seek entry to an entirely new market. Here the strategy will be about entry to the market; the deal structure and 'value' in the deal will become more salient. Often these buyers will be 'value' invested with the strategy of acquiring a company they believe may be 'undervalued'.

There are also good examples of trade consolidators succeeding by acquiring lots of companies, to bolt together and secure economies of scale to leverage for future sale and value. This strategy requires very careful pricing. The UK's Carillion £4.4 billion was a consolidator and the debt burden recently caused one of the largest insolvencies in the UK. However, alternatively, we have helped several IT companies and healthcare businesses acquire on a modest level at multiples of 4-5 and subsequently sell at

7. This is the multiple arbitrage strategy as set out in Guide 3 (Exit Strategies).

Clear strategic acquisition criteria will include:

Sector	Management team
Location	Product set
Synergy objectives	Sustainable revenue
Client base definition	Cultural fit
Size of venture (turnover, EBITDA)	Risk and value

TIDY HOUSE

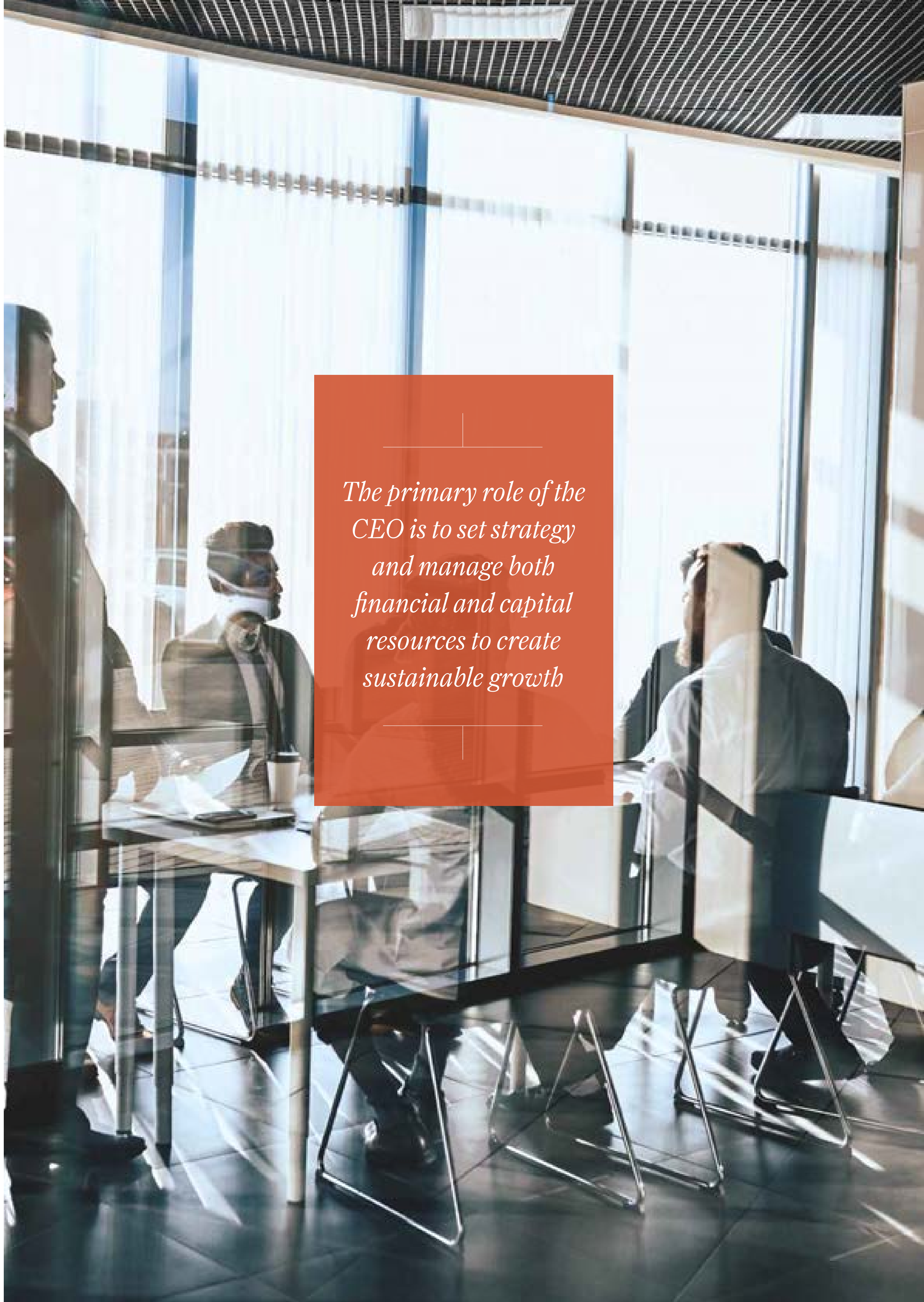
What are your other options? Organic growth, further investment, improved processes, improved marketing? After deciding strategic acquisition is the way forward, you will need to start planning to ensure success. Before you choose to buy 'others', know yourself. The first steps before defining your target criteria is to be sure your company is best equipped to facilitate a successful acquisition, ensuring that your own 'house' is tidy and in order:

1. Make sure your growth strategy is clearly defined so you do not stray from your original objectives and timescales. It is easy to be swayed by the attractions of an acquisition; the same way you might choose chocolate fudge cake off the menu when your goal is to lose weight.
2. Is the organisation (HR, IT, finance, management, systems and processes) adequately structured to facilitate a successful merger with another company? Can you support new staff and systems? Is your existing structure coping with your current set up? Do you need to make changes?
3. Are capital investment requirements and funding facilities realistic? Investigate these before launching into an acquisition project; you don't want to fall at this hurdle later down the line.
4. Ensure internal or external resources are in place to facilitate the acquisition and subsequent integration. One of the fundamental errors made by acquirers is to assume that their own management team is elastic. If you have your core business right, they should always be very busy. Piling on extra duties may well create dangerous fractures.
5. Develop good people for tomorrow's work, which may give you resource to 'parachute' people into acquisitions. This also affords great career opportunities for such future leaders. The talented usually get allocated problems to fix whereas the right acquisitions can represent significant and more exciting opportunity.
6. Do you and your advisors have the skill to target the right company and the technical expertise to structure terms correctly and undertake the process?

The primary role of the CEO is to set strategy and manage both financial and capital resources to create sustainable growth. Acquisitions may sit alongside, or even central to, securing such growth in slow growth economies where organic growth becomes less of a choice. This leaves the leaders managing a careful balancing act:

- Optimising the return from the core business yet investing in uncertain futures.
- The core will always cause 'pressure' as shareholders demand returns now, and customers and managers want results now; few are invested in a company's long-term requirements. "The vested interest of the status quo."

The pressure can result in a lack of resources and focus on critical acquisitions or research and development. The balancing act can only be successfully carried out by leaders aware of the 'vested interest in the status quo' and who are able to communicate charismatically regarding long-term requirements and vision.



BUYING 'RIGHT'

Ultimately the right decision to acquire is ideally based on the overall prospects to create value in the acquired venture and, if a trade buyer, the overall organisation, not on current profits or earnings. This value creation should be in both competitive advantage and return on capital. When, where and how will performance gains be secured versus the acquisition price?

If an acquirer is uncertain whether an acquisition will generate the required synergies and value then an earn-out can create a hedge, although this will usually slow any proposed integration (see Guide 3 (Exit Strategies)). If they are confident then a 'cash' deal will beat the competition and enable them to drive an integration quickly. Cash will also limit any upside to the existing shareholders and should make acquisition more cost effective.

Deal Fever – happens when you've got so much time, energy and emotion tied up in a deal that your focus shifts from doing the right deal, to simply getting a deal done.

Experienced and successful acquirers will carefully evaluate the risk that anticipated synergies may not be realised. Further they understand the challenges that face effective merger integration, including assessing the true costs of distraction and lost opportunity in the core business that can occur. Usually the failing will sit around culture, but it may also be deal structure. Whilst acquisitions can be a fast track to growth they can also result in problems. A survey by PWC in 2010 showed that only 30% of acquisitions achieved their forecasts in the first year, and 47% of executives left, with productivity nearly always suffering as a result. The same survey suggested that a third increased value, a third were neutral but a third reduced in value. The biggest reasons transactions may fail are:

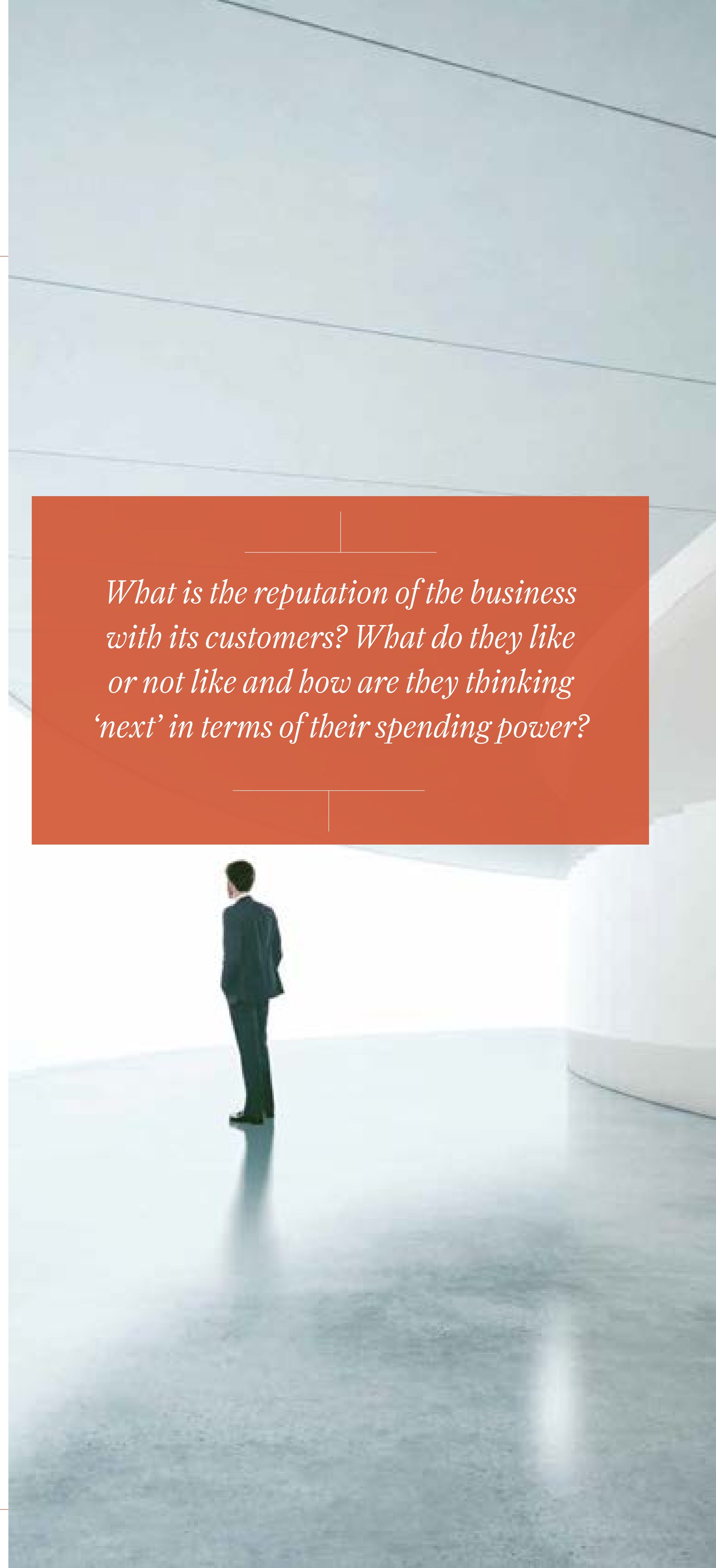
- Distraction to core business – finding and securing the right deal can be incredibly time consuming and can certainly be a full-time job over six months or more for senior executives; and costly. The potential upside of a well-executed acquisition is compelling, so many private companies get caught up in the excitement of the "hunt". Outsourcing to professional advisors wherever possible does reduce the uncertainty, as does awareness of the problem.
- Deal fever - this happens when you've got so much time, energy and emotion tied up in a deal that your focus shifts from doing the right deal, to simply getting a deal done. Even seasoned private equity professionals get deal fever – it's hard not to. The resultant downsides are ignored. Sometimes the best investment decisions are to not make the investment.
- Paying too much – It is only with hindsight we can truly assess this as, if a deal is agreed at the time, the assumption is all the parties have correctly assessed a value they are happy with; however, sometimes competitive bids can drive value to the top of the charts. Add to this a lot of debt to carry out a deal and then follow with a downturn either due to the acquisition or just recession timing and a problem occurs. Get second and third opinions and allow for a downside.
- People management is not elastic. Firstly, M&A activity usually creates a long list of things to do and change. Secondly, and often, this list will combine with a cultural change which then layer-cakes stress on management already running in fast changing competitive, dynamic markets. The three aspects combine to create an overwhelming and sometimes deadly cocktail that results in management failure.

In the end, central to the challenge to 'buy right,' too many leaders lack experience or discipline in their evaluations, and as a result, they make the wrong calls. The research suggests the weakest link is over-optimism on the speed and achievement of change management and integration, particularly around obtaining intended synergies.

In 2016 the UK DIY chain Homebase was sold to Wesfarmer, an Australian cooperative, for £340 million. They introduced the Bunnings brand to the stores. After just two years, in 2018, the Australian conglomerate sold Bunnings and Homebase in the UK and Ireland to turn-around specialist Hilco Capital, reportedly for just £1. The acquisition has been described as one of the great M&A failures, however, in reality it was the business plan after the deal that created the disaster.

Wesfarmers assumed what worked in the Australian market would work in the UK. They underestimated the costs of converting shops, fired 160 experienced managers without replacing their knowledge of the UK market, and delisted top-selling lines. They did this in a highly competitive market, and thus an unforgiving one, at a time when retail is suffering heavily in the UK due to both Brexit and online competition.

It's a remarkable point that nearly all the investment is in due diligence. That is checking the target company is 'as represented' creating a snapshot of the target. Yet with a little more investment, this due diligence picture can be used to develop better business plans and strategy on how to gain value after the deal. Leaders will, on agreeing a deal, have a strategy, and that's fine, but how often does this get updated against advice from due diligence as to whether that strategy is right or realistic? If we imagine the due diligence process (see Guide 6 (Integration)) as part of the business planning and future strategy we can materially add to our chances of buying, right. The process should not be just about a 'survey,' but also the development plan. This should include a detailed look at the people in the business as well as its customers. In strategic acquisitions, understanding your overall market drivers, both opportunity and threat, is critical. This thinking should ultimately be led by customers. What is the reputation of the business with its customers? What do they like or not like and how are they thinking 'next' in terms of their spending power?



CASE STUDY

STRATEGIC ACQUISITION CASE STUDY- SHARP GROUP PLC & COMPLETE I.T.

Sharp Business Systems Plc, a global organisation, had previously defined a progressive corporate level strategy to augment their existing traditional Managed Print and Document Management business streams with an IT Managed Service Provider (MSP).

In August 2017, Sharp started upon this journey with the acquisition of Midshires Business Systems, a predominately Managed Print VAR with a modest IT Managed Services offering covering the North West and Midlands.

For their second acquisition in this marketplace, Sharp decided to engage Avondale as their strategic corporate advisor, and the decision was made to complement the initial acquisition with a pureplay SME/mid-market UK MSP with broader/complimentary geographical coverage.

Avondale thus drew upon their extensive tech market expertise to research suitable potential acquisition targets and Complete I.T. was identified as the right acquisition. The company had a strong sales force and marketing led approach across multiple offices as well as a good technical background and recurring revenue. There were other target sellers but the Sharp management team, as a result of theirs and Avondale's strategic preparation work, were clear that buying a managed service provider was easy but acquiring one with the right sales-led approach was critical. Whilst Sharp have a strong sales force they are not IT experts and this was the critical play. Being clear on the Sharp Group's strengths and weaknesses, as well as objectives, made identifying and agreeing the deal with the right select company a very straightforward choice.

PEOPLE AND CHANGE MANAGEMENT

When agreeing and then checking a deal, virtually all the acquisition advisor fees are spent on legal and financial assessments, yet the studies show that cultural mis-alignment is the number one reason that deals fail to realise their intended return. In most situations, beyond checking legal employment compliance, how much time is spent looking at the people? Very little! Many firms struggle with diversity in their executive teams. Further they will have their own recruitment approach and history which creates their own culture; we could define this as values, beliefs and mindsets. No two firms have the same establishment and therefore invariably cultures will be different.

In change management, systems, products and even branding are hard (or tangible) elements that can be changed quickly. Values, beliefs and mindsets form a code of conduct which ultimately translate to how an organisation gets things done. As these are soft and intangible, they are the hardest elements of any acquisition to both get a handle on and to change. See also Guide 6 (Integration).

If I think about my history, I went to a solid well reputed private secondary school. Not being the best student, I was not destined for university. That was only destined, back in my day, for very bright people. Consequently, I went to a local college for my A levels. The college believed students were adults and should be 'self' disciplined yet in the private school they believed in 'set' discipline, so this was a seismic cultural shock for me. The result: way too much freedom and off the rails I went. Fun as this was, if we compare this to companies, 'off the rail' employees are expensive. Culture can be set by a myriad of elements.

- How tight or trusting are the controls?
- What is the reporting or the speed of decision like?
- How flexible is the organisation, is it rigid or free flowing, is it open or closed?

Most employees tend to be reliable; this means they like the same result tomorrow that they have today, perhaps even routines and approaches. If work is seen simply as work, they just want the least stressful route. Changing mindsets and beliefs is high stress for many and in some cases an impossible hassle. Executives and leaders may tend to be more flexible but in most profitable organisations the executive team is not the bulk of people. Therefore the "soft stuff" around culture really matters and this requires a dedicated, experienced, empathetic team with time. The team should aim at delivering the synergies and then harmonizing these cultures against clear goals. There should never be an assumption that one culture is better than another simply a recognition that, like people, no two companies' culture is the same. People are the heart of most companies and people need respect and self-actualization. Big or small acquisitions create change and uncertainty. It is disruptive for the people involved – both buyer and seller. Buying 'right' requires empathy to this disruption followed by simplicity – yet in a jargon-filled corporate world this is often forgotten. Simplicity includes:

- Regular jargon-free communication.
- Clear guidance and action. Address any concerns immediately.
- Simple presentation of opportunities and threats and the consequent strategy.
- Repeating the strategy regularly in different formats and methods.
- Deep systematic rapport-building beyond the 'day one' presentation.
- Comparing and harmonizing contrasting values, beliefs and attitudes.
- Genuine lasting rapport, empathy and care with people.
- Track communication simply; Excel and Word suffice. Complex IT creates barriers.
- Focus on the key and important areas of change required, not the micro detail.
- Preserving wherever possible the operational model particularly in the early days.
- Making tough decisions quickly. Some of the people that you've acquired, as well as some of your own people, will struggle with the larger entity.
- Tell people where they stand quickly, even if they won't like the answer.
- Challenge people, reward and say thank-you.

STRATEGIC ACQUISITION COMMUNICATIONS

ACQUISITION ORIGINATION RESEARCH

If a business is on the market there will be both motivation and probably competition for a purchase. However, some sale advisors over-inflate value to win engagement fees which can distort the market and result in wasted time. Also, competition can lead to a higher price than necessary, albeit the price is the value as the market decides.

Researching for 'hidden' sellers or 'off-market' opportunities and potential sellers and then targeting them can be very fruitful, however, it requires significant time investment and resource and should not be undertaken lightly. This research and approach can be carried out in a variety of ways either internally or by outsourcing to M&A advisors or corporate finance professionals. Success can also be gained by building a network amongst seller advisory firms and looking at both financial and trade press.

Deal origination should not be underestimated. It is a full-time job and requires careful research, combined with determined yet discrete reach-outs. This requires a tricky blend of analyses, sales skills and tact. It can take years to build up a network amongst the seller advisory community and the data resources to manage acquisition projects in house are expensive assets for a 'one off' deal. Therefore expert help may prove more effective than internal origination, with fees offset by both knowledge of the market, tacit knowledge of sellers, data resource and skill in the execution. One common mistake made by buyers is not being clear on who they should buy and then trying to create interest in too wide a pool. Focus is essential.

The origination methodology should include:

- Database analytics to target and short-list.
- Lateral thinking to enhance.
- Clear strategic targeting.
- Determined resourceful approaches.
- On-going approaches to ensure both awareness and build relationships.
- Iterative research whereby the origination process refines as knowledge is secured.
- National and international capability.
- Discretion, sales skills and tact.
- Crafted and persuasive presentation of the buyer value proposition.
- Intuitive and analytical assessment of the best prospects.
- Non-disclosure agreements at every step.
- Strong track-record and networking.

Targeting and research are important but so is the actual method of approach. First impressions count and unless you are a public company you will need to sell your position and tread very discreetly. The subject of an overall sale is seen as highly confidential and sellers of quality assets are rightly very mindful of the right time, approach and buyer. The best approaches usually include:

- Careful research to identify the right person. This is not always the CEO or chairman but could be the major shareholder or, if a venture capitalist is in the business, the manager who looks after the company in question. This ensures the key influencer is approached and therefore the offer is more likely to be considered.
- A letter, email and/or LinkedIn approach, or a combination, followed by a call expressing strategic interest in working together and exploring options which may be investment, a sale or merger, or simply sharing ideas. A wide discussion which both parties can learn from, without commitment or pressure, encourages the prospect of a dialogue.
- Via an intermediary who specialises in acquisition work. This investment will be perceived more seriously as it is less casual, but also their 'middle-man' position will secure an earlier understanding of motivations and be able to sell your buyer proposition with more independence. Outsourcing the acquisition work will save time and increase opportunities by increasing dialogue and resource.
- Patience and 'Guanxi'. (In China a person who has a lot of 'guanxi' will be in a better position to generate business than someone who lacks it because he is better at building personal relationships). Confucianism places significant value on interpersonal relationships which effectively creates obligation. Trust is built not because you signed a binding contract, but because 'guanxi' obligates. So it is with acquisitions. Sellers will often choose buyers even where the deal value is less because time has been invested in personal relationships and a key to this is also understanding the motivations of the potential sellers; a savvy acquirer and advisory team can cultivate 'guanxi'.
- Rapport, discretion and understanding needs to be built. An immediate "we are busy so let's get down to business" will result in seller caution.
- Proof of credentials, particularly in the case of a management buy-in or private company target. Being able to demonstrate acquisition track record and funding is important.
- Careful positioning of the buyer's value proposition and the benefits it offers shareholders, the business and the team both in deal value, future value and ongoing strategy.
- Cultivation. A 'no' now can turn to a 'yes' as circumstances change. It is essential to 'sweetheart' sellers over time. Stay in touch, track, regular interest and ensure regular conversations and better meetings. If you have a relationship you will be the port of call when circumstances change and, invariably, they will.
- Strategic targeting. Time invested upfront on who to buy and why, to match your business plan creates a narrow focus of desired targets. This then enables resource to focus on where the acquisition breakthrough will occur on a few selected quality sellers. Cultivation and 'Guanxi' can be invested in but over a narrow front. Too broad and the acquisition work becomes volume driven which leaves too much to chance, and acquiring assets simply because they have said yes, or the price is 'right' but not the 'value', is inadvisable.
- Face to Face. Leaders are busy but availability and willingness to be flexible on when and where to meet sellers can build both trust and relationships early on. With the ability to remote work, serious acquirers should be prepared to do the running. This is not a sign of weakness or overt keenness, it is respect to the seller's position, as for them it's probably their biggest deal, for the acquirer hopefully one of many.
- Carry out your desktop research. Meetings should not be fact finding meetings but relationship building meetings and actually form the early precursor to due diligence.

Bear in mind that the seller will have as many questions about your organisation as you do about theirs. Avoid over-selling the opportunity, take a consultative approach and leave the seller wanting to know more. The meeting should be concise; prepare and present the top five realistic opportunities and the reasons behind them.

CASE STUDY

STRATEGIC ACQUISITION CASE STUDY – PROCTER AND GAMBLE AND GILLETTE MERGER

In 2005 Procter and Gamble (P&G), an American multi-national consumer goods corporation, acquired Gillette, a brand of men and woman's razors and shaving supplies for an approximate $57bn.

The move made sense for both companies for a number of different reasons. One of these being that they both had existing presences in different emerging markets, namely the Brazilian, Russian, Indian and Chinese (BRIC) economies, which allowed the two firms to combine their market positions in these regions. More specifically, Gillette had a strong presence in Brazil and India while P&G had already broken into the Russian and Chinese markets.

The BRIC economies are important markets for MNC's to target because they can be difficult markets to enter but can present companies with a competitive edge over rivals when tapped into effectively and this can be a key factor in attaining dominance in a globalised marketplace.

In particular, P&G were making substantial headway in China where they were already conducting market research with a view to tailoring their products to the specific differences in that market. P&G tend to produce the products they sell in the markets in which they sell them, as opposed to shipping them around the world, because they view the customer as king and value the market research they conduct into the countries they target. P&G also had established a strong presence in the Philippines and Eastern European markets such as Russia and Poland which allowed them to introduce Gillette into these markets as well.

Moreover, P&G had a history of successful mergers – they did not change too much but made small improvements to the acquired company, namely in efforts to improve their global footprint and helping to integrate their own advanced business systems.

As part of this, P&G began to combine its advanced technologies with Gillette products. Furthermore, the Gillette acquisition presented P&G with the opportunity to introduce male based products to its primarily female based range at that time, allowing P&G to reach new sectors of the market and cement its market superiority. The merger also presented Gillette with the opportunity to accelerate its growth by use of P&G's distribution network. Perhaps most importantly, it helped to propel P&G into a position of market dominance, pushing its main rival Unilever into second place.

NEGOTIATION

A successful acquisition requires careful planning, good timing and effective negotiation. We have dedicated an entire Guide to negotiations. However, strategic acquisitions will employ negotiation strategy in understanding how you can match the seller's goals to yours. Understanding each party's unique deal motivation gives you a distinct advantage. What do you want to win and what can you afford to lose? By understanding the other party's motivation, you can create a strategy, anticipate any moves during the negotiation and react accordingly. It also enables you to be proactive and lead the negotiation to achieve your goals. Think like a good chess player – several negotiation moves ahead of your opponents, and listen. What is driving them? What do they respond better to? Do they need facts? Do they need an intuitive feeling of reassurance? Walk in their shoes – think like them. Ultimately loosing on smaller points and focusing on your big wins gives the other party a feeling that they have won in some form. Fighting for every point will end in a stalemate at best.

THE SEVEN DEADLY SINS OF ACQUIRERS

- Lack of 'Guanxi' - trust is built not because you signed a binding contract, but because 'guanxi' obligates.
- Cultural misalignment – 70% of acquisitions fail to meet CEO expectations due to failure to change manage the people. Culture is deep values, beliefs and how things get done, not both sides being casually dressed! In misalignment we may also make the mistake of assuming a merger is a take-over rather than, perhaps with hindsight, a partnership!
- Poor integration support – due diligence is seen only as checking rather than creating the strategy. The strategy suffers as deal fatigue kicks in and is not reset within the first few months. Look at the Homebase transaction on 2016 for £340 million, then in 2018 for £1.
- Paying too much (or not enough?). Establishing value is notoriously difficult. If the accountants lead, you will lose the deal and, if the visionary CEO controls, enthusiasm may lead to bust.
- Failing to look ahead – what is the reputation of the business with its customers? What do they like or not like and how are they thinking 'next' in terms of their spending power?
- Deal fever – When you've got so much time, energy and emotion tied up in a deal that your focus shifts from doing the right deal, to simply getting a deal done. Remember Sir Fred the Shreds ABN Amro and RBS deal, carried out despite his board's cautionary warnings.
- Deal fatigue – letting the complexities overrun the commercialities, creating drag to the point where everyone forgets why the deal was agreed in the first place.

SUMMARY

Acquisitions can sit at the heart of effective business growth and shareholder value strategy. They are however technical and require a robust expert approach and good advisors to ensure success. Done well, they offer new territories, products, expertise and scale that can accelerate both profits and value. Alongside, acquirers can gain strong brands, innovation and intellectual property. In the current slow growth economic climate (western economies) acquisitions offer a viable alternative to organic growth because they are fast, and further, competing may simply not be an option where the seller has effectively built a brand and secured market loyalty that creates a barrier to market share growth.

We can't guide on acquisitions without also looking briefly at financing albeit Guide 1 (Valuations) is dedicated entirely to that subject. Clearly for acquisitions to work the valuation versus debt or capital and equity structure needs to be right otherwise the cost will outweigh the return. There is an art to financing acquisitions, including questions like: do we use our reserves or borrow; how do we structure deals to secure vendor financing and reduce risk.
See Finance, Due Diligence and Deal Structure Guides.

There have been numerous highly rewarding, successful acquisitions, for example, Disney's purchase of Pixar completely updated their technology approach and radically reinvigorated the business. The overall global acquisition market in 2018 was £3 trillion, so buying right is big business. A good acquisition strategy is a result of clear objectives and understanding of your market drivers; carried out well they are highly rewarding.

Business Sales | Acquisitions | Corporate Finance | Strategy

WHY AVONDALE ARE DIFFERENT

- **Our expertise:**
  We are a team of creative, seasoned and candid experts that challenge, create impact and provide you best advice
- **Our authenticity:**
  We have a strong relationship-led ethos
- **We are agile:**
  Our flexibility enables a bespoke approach to match our clients' needs
- **Teamwork:**
  Championing clients' needs with intelligence and resource
- **Our technology:**
  A highly developed system enabling better research, blended with virtual data rooms to enable global interaction
- **Our strategic thinking:**
  We anticipate and challenge ahead to create fresh perspectives

AUTHOR

Kevin Uphill
Chairman
kevinuphill@avondale.co.uk

CONTRIBUTOR

Simon Baldwin
Principal Consultant

See also:
Guide 1: Valuation Methods and Multiple Arbitrage
Guide 2: Employee Ownership Trusts
Guide 3: Exit Strategies by Design

Avondale is a leading Mergers & Acquisitions strategy consultancy. We have been working with the best entrepreneurs and companies operating both locally and globally for over 20 years.

Our firm provides a fully integrated service from business sales and acquisitions to business growth and strategy to corporate funding opportunities.

Our expertise, combined with ambition, insight and vision, creates value and delivers excellence.

If you think an acqusition may be right for you, please call us on 01737 240888 or email: av@avondale.co.uk

CONTACTS

HQ: REIGATE, UK
Chapter House, 33 London Road,
Reigate, RH2 9HZ
Phone: +44 (0)1737 240 888
Email: av@avondale.co.uk

LONDON, UK
8 St James's Square,
London, SW1Y 4JU
Email: av@avondale.co.uk

Visit www.avondale.co.uk for other Guides in the series

AVONDALE