Growth through Acquisition
Challenges and Insights

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Challenges

Our interview with Jason Milkins, corporate lawyer, partner and co-founder at Roxburgh Milkins, ranged across the major challenges facing any business looking to grow through acquisition, and touched on issues that might be faced by an owner thinking about selling.

At the outset, understanding the reasons why an acquisition might be a good strategy to follow is important. Whether the primary driver is strategic (access to new markets, new products or technology, or a larger customer base, removing a competitor) or financial (economies of scale), an acquisition is a strategic investment and should be planned for accordingly. This should include a detailed analysis of the return expected, how it will be delivered and measured, and when it is expected to have materialised. Investment is likely to be easier to get for assets.

Every year, millions of pounds are lost when acquisition deals don't deliver the returns expected, and often this is down to there being insufficient due-diligence – not just legal and commercial, but including background checks on key personnel; understanding market conditions and how key competitors might see the acquisition; understanding the culture of the company being acquired and what will be required to integrate two workforces together; and understanding the business model and not making assumptions about how it could fit into the way the acquiror works. Shortcuts here lead to a lack of understanding of the business being acquired. A robust legal due diligence will enable the right warranties to be put in place.

It is critical that both sides have good advisors and don't place reliance on those the firm has worked with before simply because the relationship is already there. Acquiring and integrating a business successfully requires specialists with appropriate experience and expertise.

From the seller's perspective, it is tempting to reach for a figure that sounds good, often influenced by unscrupulous 'specialist' business brokers (who will charge a monthly retainer and therefore have little motivation in completing quickly) flattering to win the business. Gaining a clear understanding of what is needed (as opposed to what is wanted) will help immeasurably in setting expectations.

If the business is not in the right place to sell, it is better to step away and take the time to get the business prepared properly. Commissioning a mock due diligence will help to understand how long it will take to satisfy commercial and legal buyer due diligence; and commissioning a valuation will help determine how much time is needed to grow a business to achieve the desired price. 'No deal is better than a bad deal'!

If the seller and the potential buyer are unable to agree on an acquisition price, consider an earn out as a way of bridging this difference of opinion.

Business owners – both buyers and sellers - are often their own worst enemies, mentally having completed the deal, or having their 'million' in the bank already, and not allowing the time to do the job properly. It's important to keep expectations in check – picturing life after a sale can lead to hasty decision making or accepting 'finger in the air' valuations.

Buying and selling a business is risky. For an acquisition to be successful, there needs to be a better than fair market value return. It is important to understand that offer price and valuation, like other terms in M&A deals, are negotiable. However, since a private company's shares are not publicly traded, the benchmarks may not be immediately clear, and the outcome of the negotiation will depend on several key factors.

The ability to demonstrate higher cost savings and, thereby higher margins, can create a material increase in deal value. Competent outsourcing partners may provide an option for risk sharing, limiting the buyer's risk, and minimizing business delivery risk by offloading non-core processes the buyer may be less capable of executing.

Preparation is vital when approaching finance providers, whether debt or equity. This applies both to the business case/rationale for the acquisition and to the due diligence. Neither lenders nor investors will offer if the due diligence is not sufficiently thorough.

Finally, before deciding to sell, consideration should be given to what protection (financial or otherwise) might be appropriate for shareholders and other key individuals. Buyers are should review what is in place to ensure clear understanding of post deal commitments they may be taking on.

World Café Insights

Pre-Deal commentary

1. Rationale

Whether buying or selling, it was recognised that knowing what your personal aims and objectives are before going into the market is important. If you are buying, this means having a clear strategy for acquisition, why you are buying – value growth, customers, assets, people, IP, etc. Trying to understand why a business is being sold is also worthwhile. This requires a clear understanding both of your market, and of the market your targets are operating in.

For sellers, there is a need to make yourself 'redundant', so that the business is be able to operate successfully without you in it on a day to day basis. It is often difficult to go through with what was likened to a 'divorce of ownership and control' – having a clear rationale to start with will help maintain focus.

2. Value

Valuing a privately held business is notoriously difficult, and subjective (if you are selling). How do you know whether the valuation is realistic? Do you know what the owner is willing to sell for (a business, like a house, is worth what somebody else is willing to pay). Post-completion performance earn-outs were recognised as a basis of negotiation around value. For the buyer, a detailed business benefits case is needed to try to get an idea of a price that is realistic.

3. Due Diligence

The key message here is take your time. Gut feel can be useful, but there is significant benefit in ensuring answers are provided to questions such as:

- Are customers tied in any way to the owner?
- Are there any required contractual provisions that might interfere with contract novation?
- How is the business operating?
- Are order books healthy?
- Where are the potential roadblocks to a sale?
- What potential is there to grow the business and/or improve profitability?
- What are the market demographics – is it an ageing population or a shrinking market?
- What is the risk around the customer base? The broader the base, the lower the risk.

Planning is key for all areas of due diligence, ensuring that time is made for the auditing and probing necessary to identify 'unknown unknowns'.

4. Shareholders, Directors and Management

What is the demographic of the existing management team - are they nearing retiring? What level of involvement does the incumbent owner envisage for themselves? Do any of the management team or employees have a shareholder's interest (actual or potential) in the outcome?

Buying out of family ownership can be complicated by a sense of family entitlement in the business.

5. People and Culture

Culture fit was recognised as critical if there are plans to integrate workforces. Migrating values is tricky, but not understanding the mind-set of both businesses involved can lead to disillusioned staff.

Staffing and HR due diligence should include behaviours, values, existing and potential talent, as well as management structure and incentives.

6. Operations and Risk

Detailed due diligence to gain an understanding of what will be required to run the business post-deal:

- Is the business relationship based? Are there key people required to maintain/build relationships post deal? Relationship based businesses are harder to manage.
- Are there any risks arising from potential changes planned post-deal?
- Are there any complexities around contract novation?

The time taken to contingency plan during the due diligence phase is time well spent.

Post-Deal commentary

1. People & Culture

TUPE (Transfer or Undertakings (Protection of Employment) Regulations) is a process that must be followed irrespective of your plans for employees in the acquired business. The regulations cover redundancy and relocation, and specialist advice is recommended to reduce risk of recourse to employment and loss of staff.

Notwithstanding the law, failing to act on people overlaps and role duplication, leaving people nearing retirement even when their roles have changed or disappeared, and generally not facing up to staff difficulties can only lead to staff loss after the acquisition.

Differing experiences of pre-deal messages were relayed. Not doing what you say you are going to do when you first speak to transferring employees – and that includes whether you plan to integrate or leave then to operate independently - will only lead to distrust, the rapid loss of hearts and minds, and reduce the chance of realising the benefit to the business of the acquisition.

A communications plan focussed on a positive message about mutual benefit, value and interest to both sets of people, early induction into new management practices, proactively assessing development needs and career aspirations (especially of key people), and clearly defined values and expectations set up front, will all greatly assist in aligning the culture and the 'personalities' of the two businesses.

The forming-storming-norming-performing phases are all necessary and inevitable for a new team to grow, face up to challenges, tackle problems, find solutions, plan work, and deliver results. Changes need to be carefully managed.

Sellers can negotiate conditions of sale that include their staff, but these cannot force people to choose to work for a new employer if they do not wish to, even if ‘golden handcuffs’ are in place. Analysis of the risk, potential and consequences if they leave is still necessary.

Aligning people processes, leadership development, training in new skills, cross training, career development – all need to be planned and introduced quickly after the deal is finalised.

2. Skills, Roles, Retention

Understanding and then looking after key people, especially management (if the manager is good, then the care him is good), will significantly improve retention. Redefining job roles if required, changing or re-balancing skill sets, identifying new roles, dealing with job overlaps, standardising and aligning roles and responsibilities will all help to minimise loss of staff, as will aligning pay and benefits quickly.

Nor should the importance of the office environment be overlooked. It will be tempting to locate teams together, but this can create cultural silos.

3. RoI & Earn-outs

An acquisition is a strategic investment, so there should be a business plan with goals and key performance indicators (KPIs) identified pre-deal. These must now be monitored.

Ideally, integration goals will also be in place, assigning RoI to alignment of values with KPIs and success criteria.

There may be processes for maximising potential in both sets of clients, and there should be a plan to fast track the value of the acquisition.

Similarly, if there are cost savings from combined resources, including any premises economies of scale, then these must be monitored to ensure they are delivered.

Equally, monitoring and measuring customer and supplier retention will be necessary.

Where earn-outs have been negotiated, mechanisms to retain key staff during the earn-out phase, and ensuring earn-out targets are properly managed and measured, will help maintain focus and ensure both sides benefit.

4. Integration

People integration is not the only challenge. There should also be clear plans for systems and process integration, and regular risk analysis will be required to help keep the integration on track.

Pre-Deal Notes

Why	Culture and values
Culture - mind set	Staff talent
Behaviours	Consolidation
Disillusioned staff	Motivation
Personal aims	Values
Integration	Family business entitlement!
Gut feel!	Purchase of Family Business
Best fit?	Contract restriction and value
Commercial	Post-performance earn-outs
	Unknown / known unknown
Ageing Population – is your market growing?	Groundwork
Calculating net benefit	Demographics
Migrating values is tricky	Customers
	Deadlock
Staffing and HR due diligence	Culture fit
"Divorce of ownership of control"	Contracts – novation
Management of incentives	
Demographic of management team - are they nearing retiring?	Planning key all areas of D/D
Management team	Management A/C
Structure and capabilities	Growth from the acquisition
Shareholders interest of employees	Profitability
Level of involvement of owner / manager	Standard D/D
Are customers tied to owner?	Commercial / Tailored
Relationship based difficult to manage	Value – what is the correct value?
Making yourself redundant	
Structural planning	Focussed
Directors	Contingency planning
	Financials
Be clear on why you are buying: value, customers, assets, people?	HR
Realistic valuations - how?	Rationale for sale
Why are they selling? Their Incentives	Transparency
Emotive. What are they willing to sell for	Integration
	Time
	Values
Financials due diligence	Unknown unknowns
What gets reviewed?	Real life vs reality
Auditing (probing)	Do behaviours match the value statements?
Valuations?	Take time
Transition of contracts post sale	Dirty hands due diligence - get stuck in
Order books?	Culture part of planning
Contractual set up of customers -> migration	Unrecognised talent in acquisition
Roadblocks to sale – What other roadblocks?	
Required contractual provisions	Why W.S.M. half of catchment area is water
	Take time
	Protect staff? Jobs?
Management a/c	
How you going to make this business successful	How is the business operating?
What potential liabilities lie in the business, including profitability	Culture
Building relationships and sales	Skill set
Action plans to bring changes to and risks to make the business successful	Clear strategy and focus on acquisition at the start
Planning	Lower risk to buy a broad customer base vs a narrow one

Post-Deal Notes

Fairness	Post deal
Honesty	Duplicated staff
Looking after key people	Transfer personnel and employment
Customers and suppliers	25 miles area to relocate staff
Understanding who they are	Risk analysis
Business plan and goals pre-deal / monitored KPIs post-deal	Measures during deal to maintain staff
Focus on management	Valuation
If manager is good then care home is good	
Integration vs independence	Value prop similar?
Ignoring people overlaps	Base minerals
Redundancy	
Staff nearing retirement	Recruitment considerations
Distrust	Redefining job roles if required
Comms pre-deal: +ve message about value and interest to both sets of people	New roles required?
	Cost savings from combined resources
Base minerals	Locations of acquired business (premises etc.) considerations
Honest, trustworthy, decent	Training coaching to ensure aligned
Induction into management practices	Lose staff when takeover
Face up to staff difficulties and deal (with) Do not put on a shelf	Conditions of sale
	Key persons
Change needs to (be) stepped slowly / managed	ROI = values and morals
How to change or re-balance the skill sets	Systems integration
Clearly defined values and expectations upfront	
What to do if not working?	Team integration
Alignment and pre-defined KPIS	Staff areas of responsibility
Job roles?! And responsibilities	Training / leadership
Clear internal comms plan	Change management / handover issues
Processes for maximising potential in both sets of clients	
How (to) align real 'values' and integrate	Cultural
	Forming-storming-norming-performing
Key people	Career path mapping
who are they?	Design of job descriptions
risk analysis - what if they leave	Roles and responsibilities
Do what you say you are going to do	A clear plan for integration
Honesty	Business plan for each new business
	Knowing my staff have a job on sale
Sanity during earn out	impact
Training and development	Due diligence effects what to pay
Hearts and minds - communication	
Culture assimilating personalities	Job overlaps
Values alignment - people & tasks	Merging cultures
People and processes	Proper handover
On boarding induction	Re-structure
Maximising value fast by planning it	Managing
Measuring integration and success criteria	Keeping customers
Office environments - team is a hot desk and impact on culture	Understanding training and knowledge
Earn out targets to hit	Cross training
Staff loss after acquisition	Keeping staff