In the Market to Buy a Company?

Know Why You're Buying and What You're Getting

By Christopher Helmrath

In previous columns about the M&A marketplace for family businesses, I have focused on the sell side. In this piece, let's concentrate on the buy side: Here is what companies need to know, consider, and attend to when shopping for an acquisition.

First things first: potential acquirers need to be able to answer two critical questions. Why am I looking to buy a company, and, once a target is identified, what am I really buying? We'll get to the how-of-it and other important considerations when this essential foundation has been laid.

The why. Is the sole motivation to bring in additional cash flow? Looking for a strategic combination that enhances current products or services? Is the drive to block out a competitor or capture the sellers' customers?

There are a lot of good reasons to buy another quality business. The emphasis here is on "quality," on knowing what exactly is for sale before spending money and significant time.

If you're reading this column, then you know all about cash flow — the amount of money (or equivalents) available for incremental spending. Capturing additional cash flow can make perfect strategic sense.

The same goes for a complimentary combination, where two companies function better together than apart. Perhaps the target business produces a product or service that feeds the acquirer.

That's the offensive strategy. There's also the defensive play that can pay rewards. Consumer-facing businesses come to mind first. Some companies look to acquire local competitors to capture their customers and become strong enough to deter new entrants from entering markets, particularly in industries with a low barrier to entry.

The question here is what is blocking out a competitor worth to you as a risk methodology? You might have to overpay, but is the strategic value higher? There are probably multiple businesses chasing the same customers as you are.

The bottom line on strategy is to have a thoughtful rationale. A lot of acquirers buy companies on a hope and dream. We want to be successful or more successful. That's a great motivation, but ambition should not be mistaken for reasoning. The deal needs to make sense. It still may come up short or even fail, but formulate an objective plan.

A next step for companies shopping for an acquisition is what should be bought?. Many know. They already work with the firm or compete against it. If not, hire a firm that can help to find a suitable target. Either way, the key here is due diligence. Thoroughly review the financial statements and evaluate all aspects of the operations. Determine how the business would operate and cash flow under your ownership. Combining the knowledge garnered in due diligence with your projections will determine the sales price.

Speaking of price, let's talk money. Access to financing is relatively easy right now. There's a lot of cheap money out there. The more challenging elements are the terms and conditions of that cash. In general, family-owned business people have grown accustomed to autonomy; now they're in a different world. The question is can you get the money and also have the terms and conditions you wish to have?

Owners who don't care about terms and control can execute acquisitions all day long. Those who do care have a lot to consider. Those who go outside the family to raise capital or borrow frequently have to relinquish some power. Of course, debt is just about making payments. Easy. Equity investors can be different. They often want a say regarding operations and key decisions.

Then there's the leadership of the purchased company. What do you want from them, if anything? Perhaps the CEO is an asset you want to retain. Be sure to negotiate that into the deal.

How about staff? Do you want all of them? Some of them? Again, something to negotiate. This isn't just about money. And if you're bringing people on, integration and communication are big issues. Don't let these employees hang in limbo, communicate your plan and execute upon it if you want to keep them. They'll flounder or leave, otherwise.

In closing, I'm going to proffer some thoughts and research from Harvard Business School professors Richard S. Ruback and Royce Yudkoff.

"The most successful entrepreneurs through acquisition we've seen," they wrote in the Harvard Business Review, "look for businesses we call enduringly profitable, business that are more likely to have a stable income over time."

We help companies strategize for M&A deals and execute on them on both sides of the transaction, buy and sell side. I encourage business owners to hire experts, whether it is us or someone else.

Family business owners are good at running their successful companies, but they almost certainly have limited experience at transacting an acquisition or sale.