Acquisition: Major Tool for Increasing Company Value

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A major strategy of global companies is to build company and shareholder value through acquisition.

In fact, according to consulting firm Bain, 90 percent sustained value creators (SVCs) – companies that grow at least 5.5 percent annually while earning cost of capital – use mergers and acquisition as a primary tool to drive increased revenues and stock values.

Defining appropriate targets depends on your company growth strategy and goals. What is your long-term desired market position? Are you seeking to grow in products or services offered or enter new geographic locations or industries?

A realistic assessment of present strengths, competitive advantages and weaknesses will point to possible avenues to explore. An acquisition can either build on existing assets or fill gaps and shore up shortfalls. New technologies are often a driving force behind purchase transactions.

Strategies can be defined as scope or scale. Scope means adding to what your company offers through purchasing of related businesses. Examples include a retailer adding a complementary service business or a computer manufacturer purchasing a software company. The aim is to capture more customer dollars along the value chain. Manufacturers often purchase suppliers to ensure an ongoing source of critical materials or components.

In a scale transaction, similar businesses are purchased, for example, additional restaurants, hotels, or stores. Why compete – just buy the other company. This strategy can lead to market domination in an area (buying competitors) or expanded locations (new cities or states).

The purchased businesses either retain their identity or are rebranded as company stores. Another strategy is to buy companies producing products at different price points, thereby increasing the customer base. A parent company might hold luxury, middle-of-the-road and economy brands. If handled well, the luxury brand can add luster to the less prestigious products.

Integration of scope and scale deals is different. In scale transactions, company integration can result in cost and operating efficiencies because of similarities. Merging back office staff and transactions is a benefit. Purchasing can also be centralized. Marketing is leveraged by extended reach.

In contrast, a scope transaction can be more complex. Since the business sector, customer base and operating systems are usually different, it's critical to retain experienced personnel to shorten the parent company learning curve. There may be very little overlap in operations and management.

Each opportunity must be examined closely to determine if it is indeed a good deal for your company. Preparing a deal thesis is the first step. This study documents how the transaction will add value to both companies. It spells out what is being purchased – physical assets, capabilities, access to markets, technologies – and the expected financial and operational results of the purchase.

Once the deal thesis is complete, thorough due diligence is performed to test assumptions, especially concerning benefits to the parent company. A rigorous examination of the target company's finances, operations, hidden liabilities, market position and image must be implemented.

Based on due diligence, the optimal purchase price can be determined. Some companies actually begin the due diligence process in advance of a company coming on the market. They proactively determine whether or not a business is an attractive target.

After the deal is made, the integration process must be planned out thoroughly. This is a critical stage and if it doesn't go well, key personnel might leave and company morale and profitability can plummet. The difficulty of integrating operations, procedures and policies is often understated, especially in companies with complex back-end systems and differing management styles.

Another important area is change management, which helps employees cope with the merger process. There is often a great deal of fear and uncertainty. Minimizing this will help the process go smoothly. Engaging existing employees and asking them for input can help create a culture of commitment so that they work with the parent company instead of against it.

If implemented correctly, acquisition of other companies can create something truly greater than the sum of the parts. With interest rates still low and abundant capital available in the present economic environment, the time might be right to explore acquisition possibilities for your company.