BUY GROW EXIT

The Ultimate Guide to Using Business as a Wealth-Creation Vehicle

Joanna Oakey

PREFACE

Every business acquisition is the birth of something new – a new lease on life, a new opportunity in new hands. And every exit is the opportunity for business owners to realise their dreams of liquidating the asset they have built for often a very long time, through literal sweat and tears (hopefully, not blood as well . . .). This is why I love working with businesses at acquisition and exit.

In other areas, being a lawyer is often centred around conflict and risk, which – to be perfectly frank – is really not something that ever floated my boat. But working at the point of acquisitions and exits gives me an incredible insight into the point where years of hopes, dreams and toil crystalise into a sale for these hard-working owners, after which they sail off into the sunset, clutching their bag of cash and revelling in their new life. It's also where deals done in a single signature can add years of growth to a business.

IT CAN GO WRONG

I love this area so much I built a podcast around it.[1] But over time I began to realise clearly that this is not the story for every business owner. While I saw the happy stories, I also saw that the point of

1 Check out the *Deal Room Podcast* on your favourite podcast app. There are hundreds of episodes devoted entirely to the world of buying and selling businesses.

exit can be a time of shattered dreams. Very often there is a massive disparity in what a business owner thinks their business is worth versus what they actually achieve.

Or sometimes business owners don't even realise the missed opportunity at the day of exit – the reality they are facing versus what they *could* have achieved had they understood value drivers and exit preparation a little more. The intrinsic value in their business has been depleted both by stepping on landmines along the way and through the failure to have built the business in a way that creates value for a buyer.

Or worse still, in so many cases I've seen people who have not even made it to exit – they have blown up the business before reaching this point.

In all of these instances, these people devoted *so much* time and effort to their businesses. But ultimately, they have missed out on having their business deliver them the value that could have been.

And as the tapestry of experiences in dealing with these businesses started to unfold for me over the years, it became hugely apparent there were a number of key elements that contribute to the ultimate success of our clients: in acquiring businesses, in growing them, and in their ultimate exit.

WHEN IT GOES RIGHT

My clients who found their own nirvana at exit had a number of things in common:

- They **acquired** (either as a beginning, or as a growth tool for their business) with a clear vision of the value they were after, how to maximise that value during the transaction and after, and how to minimise and manage the risks in the transaction and ongoing business.
- They **grew** the business understanding what creates value – future return, not just current-day return. And as they grew, they fiercely protected that value by building the foundations

of their business in a way that allowed them to weather the inevitable storms along the way.

- And finally, as they approached **exit**, they primed their business for market based on their understanding of the value that a buyer would be looking for and the risks that would diminish value in a buyer's eyes. They understood how to play the game of exit, to extract maximum value for themselves, on terms that worked for them.

And so it is that we have our business cycle of buy, grow (and often buying again! Followed by more growth . . .) and exit. Where the understanding of each of these elements, and their interaction with each other, is the secret sauce to **ensuring that the years of effort of growing a business can truly be leveraged**. Where **today's work produces not just today's gains, but also feeds into increasing the underlying value of the asset along the way**, so that at exit there is substantial value that can be extracted. And where **running a business in a sale-ready state ironically provides not just the best business at exit but also the best business to run in the meantime**.

In this book, we examine not just the three phases but the *interaction* of the three phases of business in acquisition, growth and exit. I am always amazed at how many businesses are started (or acquired), grown and sold without ever having properly considered this trilogy in an integrated way. Because understanding the interaction of these three areas is the key to using a business to effectively build wealth, and ultimately, freedom.

TURNING THE DISCUSSION ON ITS HEAD

Buy, Grow, Exit. is about turning the usual business discussion on its head. It is about how to approach these three different phases of business with long-term vision. The underpinning insight requires understanding core value and core risk. It also requires establishing systems and procedures to identify and protect that value and the

The understanding and interaction of the cycle of BUY, GROW and EXIT is the secret sauce to ensuring you are BUILDING A BUSINESS that can truly be leveraged, so at exit there is substantial value that can be extracted.

assets underpinning it, while predicting and preventing problems before they occur. This book takes you through the process of digging into these areas and working out how at each phase you can maximise value and minimise risk.

Your progression through this book may not be linear.

If you are at (or close to) the point of sale, you may not think you are interested in acquisition.

If you are at the position of newly entering into a business through acquisition, or looking at acquisition as a growth tool, you may not think you are interested in the topic of exit.

And in the midst of growth, you might not be thinking about either acquisition or exit.

But this is precisely the point. While this book is designed so that you can flip to the stage that is relevant to where your business is now, the book as a whole gives the required context to fully understand and make the most of each stage.

When you are exiting, you will benefit from understanding what's in the minds of your buyer.

When you are acquiring, you will benefit from understanding how to protect the assets you have bought, and in truly understanding what will provide value for you once you take this business you are acquiring to exit.

When you are in growth mode, you will benefit from understanding how acquisition can help to achieve growth, and how running in an exit-ready state makes for a better business to run. And most importantly, you will absolutely benefit from understanding what creates value at exit, so that the decisions you are making today take into account (and maximise) the endgame.

And while *Buy, Grow, Exit.* contains lots of long-term strategies, it also contains nuggets of gold that will provide immediate assistance in each phase.

Wherever you are in the process, it's never too late to understand the principles behind driving great deals – and ultimately

in maximising the value and minimising the risk in using business acquisition, growth and sale as your ultimate wealth-creation vehicle.

Ultimately, the point of this book is to dive deeply into why the interaction between buying, growing and selling will help pave the way in driving highly successful deals in acquisitions and exits, and in protecting and enhancing the value of the business between acquisition and exit by building a legal fortress around the core assets.

A DISCLAIMER . . . OF SORTS

Firstly, before we dig into how to use this book, I want to make a disclaimer . . . because I am after all a lawyer (so I just can't help myself).

I want to make it clear that I am writing this book from my perspective as a lawyer.

I'm not a marketing consultant, I'm not a growth specialist, I'm not a business coach. And I've never formally studied any of those areas.

I have however worked with businesses for decades during their periods of buying, growing and exiting, and have seen very clearly what has worked and what hasn't.

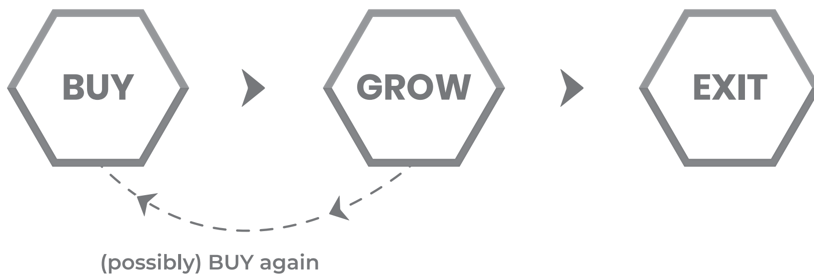
I have interviewed hundreds of professionals on my podcast digging into these issues, and I am constantly involved in discussions about the conundrum of the wave of baby boomer businesses that are now starting to hit the market and are set to create market saturation.

I have spoken ad nauseum to literally thousands of accountants, business brokers and corporate advisers who also – like me – deal with businesses every day at the points of acquisition, growth and exit, so many of whom are dealing with sellers who are disappointed at the true value of their business (or more particularly, the amount they will end up having in their pocket). Or sellers who don't even make it to an exit because the intrinsic value in their business has been depleted as it wasn't built with a mind to what creates value for a buyer.

And so, in this book, I'm not pretending to hold all the answers about how to grow a business and extract the maximum value from it. But I am providing an insight into how to look at that value in a way that you may not have considered before. And into how viewing your current business, or any acquisition targets, through that lens will help you:

- buy the right business in the right way
- grow your business so that you maximise its value and so that value is protected along the way
- exit in a grand fashion, to extract the wealth you deserve.

HOW TO USE THIS BOOK



This book has three parts: Buy, Grow and Exit. And each of these charts a different point in the lifecycle of a business.

Part I, Buy, is most relevant if you are . . . buying – *go figure!*

You might be starting out in business and are at the point of that initial acquisition, or perhaps you are in growth mode and are using acquisitions as a growth tool. This is where you need to understand the strategy of acquisition. What you need to look out for. How to maximise the value you can extract, and minimise the risk. And how to ensure the processes along the way support, rather than undermine, this approach.

Part II, Grow, describes the necessary phases of growth and consolidation. This is an extremely important phase to come back to after every acquisition, during any period of fast growth, and before exit.

Part II, Grow, describes the necessary phases of growth and consolidation. This is an EXTREMELY IMPORTANT phase to come back to after every acquisition, during any period of fast growth, and before exit.

It's the phase that protects the assets you have bought and built, and locks in that value. It's also the phase where you get to set the business up in a way that will maximise its value, and the value you will be able to extract.

The decisions made in this phase impact your tax outcomes, and therefore the ultimate cash you will see out of a sale. But they also impact whether you will even make it to a sale. Because this is the critical phase for a business, of testing the strength of the fortress that has been built around the business.

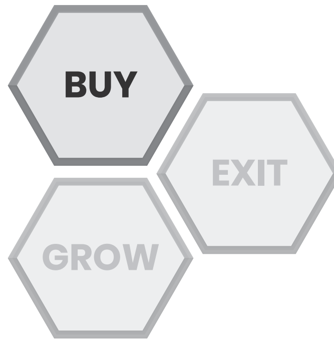
During the growth and consolidation phase, every business faces repeated and often unexpected landmines along the way. Those landmines will threaten not just to erode the value in a business, but sometimes threaten its very existence. So in this phase, we lay the right foundations for maximising value, and we build the fortress around the business to fiercely protect that value.

And in part III, Exit, you are in the final phase of value extraction. This is the pointy end, where it's imperative to understand the methodology of the sale process, and to understand the potential bumps along the way so they don't throw you off course. It's also where it's important to understand the levers you can pull, and ultimately how to control the deal and the risks, so you can maximise the pot of gold at the end of that business rainbow.

So your progress through this book will most likely not be linear. You may be at a specific point in the business where one of these phases is most relevant.

Where are you in this cycle?

And so without further ado, I bring you part I, Buy.



Part I

BUY

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Before you delve into this part, I recommend that you start by measuring your acquisition readiness by taking our very short scorecard. Find the scorecard at our resources hub at www.buygrowexit.com.au.

Chapter 1

HOW AND WHY BUSINESSES ARE BOUGHT

Acquisitions, done right, provide the ultimate opportunity to build extraordinary wealth.

The reasons for buying a business (or into a business) vary. You might be acquiring to start out in business, or replacing a job with a business, sometimes referred to as 'acquisition entrepreneurship'. Or you might be acquiring a business for the growth of your existing business. You might be setting out on a directed path of consolidating businesses, perhaps to eventually sell them in a trade sale or through an initial public offering (IPO). Or you might be acquiring a parcel of shares in a company as an investor, or in a business you are already working for.

Whatever your reason for the acquisition, and whatever the size of your acquisition 'target' (the business you are buying, or buying into), the fundamentals of acquisition remain the same. In this part, we investigate what those fundamentals are to help you drive acquisition success.

Let's look at some of the different ways business are acquired.

ACQUISITION ENTREPRENEURSHIP

'Acquisition entrepreneurship' is a term that describes starting an entrepreneurial journey by acquiring and building up an existing business (or series of businesses) rather than by starting a new business from the ground up.

By acquiring a business that's already generating revenue, you can avoid the pain and hard work of startup, and also a lot of the associated risk (given the high rate of failure for startups).

Buying a business gives you access to established systems and customer and supplier bases which have already stood the test of time. You get to confirm in advance that there is a market for the product or service (by the proven revenue base). And it gives you an ability to evaluate the business and its current processes, and to work out how you might inject new ideas to optimise it.

By buying a business you also avoid the often long lead time involved with starting from scratch, and can simply focus on implementing improvements, scaling the business, or any other growth strategy.

ACQUISITION AS A SUPERCHARGED PATH TO GROWTH

Acquisition can also be an extremely powerful move even if you already have an existing business – as a supercharged path to growth.

This is one of my absolute favourite topics. I am an entrepreneur at heart, and the opportunities for SMEs to grow exponentially through acquisition excite me. But this is so often overlooked by businesses that spend years and decades in the grind of slow organic growth, completely overlooking the power of this alternative pathway.

The power of acquisitions to add years of growth in a single signature is widely understood by large corporations, who consistently use M&A[2] and bolt-on acquisitions to grow.

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2 Mergers and acquisitions. Check out chapter 23 for more jargon busting!

Statista reports that in 2019, the global value of M&A deals amounted to US$3.4 trillion. What's more astounding is that in 2020, despite the COVID-19 pandemic ravaging countries all over the world, global M&A deals still totalled a whopping US$2.8 trillion. And in a recent report, McKinsey & Company reveal research that confirms companies that regularly and systematically pursue moderately sized M&A deliver better shareholder returns than companies that don't.

But it is a little-known secret that this strategy can work just as well for SMEs to grow. And indeed, the size of a business can be critical not just to growth, but also to survival. Recent statistics in Australia, compiled by the Australian Bureau of Statistics and the Australian Small Business and Family Enterprise Ombudsman, have painted a very clear picture that when looking at the survival of businesses over a four-year period, the greater the size of a business, the higher its rate of survival.

Thus, ultimately for many small businesses, acquisitions can play a crucial role in determining their commercial success and, ultimately, survival.

So let's investigate why acquisition is such a killer growth strategy.

ORGANIC GROWTH VS ACQUISITION GROWTH

In the main, SMEs focus on organic approaches to growth. But the one overarching issue with organic growth is that it's slow! On the other hand, strategic acquisitions can (if done right) achieve growth rapidly. So, while organic growth offers control, the reality is that years of organic growth can be achieved in a single deal through a strategic acquisition.

I have had some fabulous discussions with clients who have looked over their years (often decades) of business building and finally come to this realisation after their first or second acquisition. One client in particular comes to mind: Jerry. Jerry recently recounted the story to me of the history of his consulting business,

which had seen him spend a decade in long, hard growth. On the outside his business looked like a success, but the grind of their focus on organic growth had worn him and his business partners down. On the advice of an adviser, they decided to look at alternative strategies for growth and started pursuing acquisitions. Jerry recounted to me that he had a pivotal moment on the day he signed the contract for his first acquisition – when it suddenly struck him that he was now doubling his revenue in a single signature. His first millions took him a decade. But through acquisition, his next millions happened in just a few months. Of course, it came with a price, but the leverage it brought him and his partners allowed them to scale in a way they couldn't possibly have achieved organically in even a fraction of the time, and ultimately the business quickly went from strength to strength off the back of that acquisition, and he went on to do many more in the future.

This lightbulb moment is just not seen very often in the SME business world.

Some of the most successful business owners I know work religiously with this acquisition approach, and continue to build empires around them – empires that run with much less effort and grind than the rest of my clients that I see who are stuck in organic growth mode.

So many businesses continue the daily struggle to clamber their way to growth to try to make it to a size that will sustain them. You will soon read the stories of some of the minority that have discovered the power of acquisition for growth and that are now revelling in the spoils that it can bring.

While I won't pretend that acquisitions are just as simple as turning up and signing a document, the reality is that an acquisition done well will immediately increase revenue, but the biggest win is the impact on the value of the business. So, while an acquisition of a similar-sized business might double the revenue, the goal is to triple

So many businesses continue the

DAILY STRUGGLE

to clamber their way to growth to try to make it to a size that will sustain them.

or quadruple the ultimate value – to achieve an uplift in the value of the business you have just acquired simply from the benefits you can now access from the increased size.

Let's take a closer look at what these benefits are.

THE BENEFITS OF ACQUISITION FOR GROWTH

The top three benefits of acquisition for growth that we see being utilised most fully by our SME clients are:

- the ability to add clients and revenue while being able to strip costs out of the acquired business
- the ability to add to their current service or product set (to enable cross-selling and upselling, the provision of a fuller solution to both client bases, and to make clients more 'sticky')
- the ability to access business value arbitrage.

Let's examine these three.

A CHEAPER WAY TO ADD CLIENTS AND ACCESS ECONOMIES OF SCALE

Many of our clients who are pursuing an acquisition strategy have as their main driver the ability to add to their client base immediately, thus increasing their total revenue, while being able to strip out costs that are sitting in the target business (such as reception, administration, accounting, marketing and other services that can be often partly or fully absorbed into the existing business's overheads).

Often where the price for the target business is based on the current profit in that business, the **profit** in that business will jump immediately after many of the costs are ripped out on the basis that the acquiring business can take them over with their current overheads. Therefore, the **value** of the acquired business also immediately increases providing a fabulous, almost immediate, uplift in the value of the asset you have just purchased.

For example, we work with many accounting practices who adopt an acquisition strategy for growth. Generally when they acquire an additional accounting practice, they are able to strip out a lot of the costs of the acquired accounting practice by moving them into their current infrastructure. This allows a massive acceleration in the profit from the acquired entity, and greater return overall.

Obviously some costs can't be entirely absorbed by the current business, but many of those types of costs can be paired with the spending of the current business and together – due to greater buying power – this can achieve better pricing through economies of scale.

A LEVERAGED WAY TO PROVIDE MORE SERVICES OR PRODUCTS

Acquisitions can give you the platform to offer a better solution to your clients through giving them access to more holistic services, where your acquisition serves to add new services or products to your current offerings.

The addition of extra services or products also provides a highly leveraged opportunity to upsell and cross-sell to the customer base of both businesses. You will have a new set of products and services to offer your current clients from the offerings provided by the acquired business. And you will also then have an opportunity to upsell and cross-sell to the customers of the acquired business with the services or products of your current business.

This ultimately results in not only a massive opportunity to increase the leads and revenue for each business separately, but it also produces a better, more complete, customer solution for both sets of client bases. The other benefit of adding more products and services is that it makes your clients more 'sticky'.

Examples of how to apply this strategy well include seeking a target that has services to complement your existing products, or vice versa. Or simply to add on to your existing service or product offering.

If we use the example again of accounting practices, typical acquisitions in this industry revolve around adding financial

planning, mortgage and insurance businesses, which not only enable an accounting practice to extend the services they can offer their current clients but also provide them with the client bases of each of these additional businesses to sell their accounting services to.

This shows how acquisitions can provide incredible leverage. And of course if you are acquiring multiple businesses, this ability to cross-sell can provide exponential increases in value for each additional type of service or product business you add.

A WAY TO CREATE BUSINESS VALUE ARBITRAGE

Most businesses simply think about profit in considering the value of their business, but another essential consideration is the **multiplier** that will be applied to the profit to arrive at a sale value.[3] There is a general rule of thumb that SMEs are valued at around about 3× profit. But in reality, the multipliers used for each individual business can vary hugely. Generally speaking, our SME clients can sell or buy somewhere in the range of a multiplier between as low as 1, all the way up to about 10.[4]

There are lots of considerations behind what multiplier will apply to a particular business, and one of those considerations is size. Often the greater the size, the higher the multiple that will apply. In very simple terms, this means that you might be able to acquire a business for 2× profit but once you merge it into your existing larger business, the value of that business jumps to 3× profit. So if the business you

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3 When I say 'profit' or 'earnings' in this book, I mean operating profit (revenue minus the operating expenses) which is essentially for our purposes the same as the term EBITDA – a term that is used in the world of business acquisitions. See chapter 23 – the jargon buster – for the definitions of EBIT and EBITDA. You will need to get used to these terms if you venture into buying or selling a business, as they are standard terms industry wide, but for simplicity in this book I'll use the everyday terms of 'earnings' and 'profit'.

4 As an aside, there are certain types of businesses where there may not be any profit yet, or where value sits in something other than revenue or profit, so value will be calculated in other ways.

are acquiring has a profit of $500k, and you are buying it at a multiple of 2 – you will purchase it for $1m.

If by adding it to your existing business, you are then able to increase the multiple from 2 to 3 because of the increase in size, the value of that business suddenly becomes $1.5m (3 × profit of $500k = $1.5m). As opposed to the old valuation based on the smaller size of 2× profit. So there is an almost immediate increase in value of $500k, just by the multiplier moving.

But wait, there's more! Your **existing** business may also increase its multiple. If your business prior to acquisition also has $500k in profit with a 2× multiple then prior to the acquisition it also had a value of $1m. And if its multiple increases to 3× because of the uplift in size, then its value will also increase to $1.5m.

So when you add the two uplifts together you can see that you may have **paid $1m for an acquisition**, but have suddenly **added $2m to the business** (when you add together the value of the initial $1m + another $500k uplift from each entity due to the increased multiple).

Now if you can achieve that sort of increase in price (business value arbitrage), I think anyone would agree that is good buying!

		BEFORE ACQUISITION		AFTER ACQUISITION	
	PROFIT	MULTIPLE	VALUE (PROFIT × MULTIPLE)	HIGHER MULTIPLE DUE TO COMBINED SIZE	VALUE (PROFIT × MULTIPLE)
Existing Business	$500,000	2	$1,000,000	3	$1,500,000
Acquisition Target	$500,000	2	$1,000,000	3	$1,500,000
		Total value of the individual businesses	$2,000,000	Total value of the combined business after acquisition	$3,000,000
				Cost of acquisition	$1,000,000
				Increased value from acquisition	$2,000,000

Of course, I have oversimplified this for the purposes of explanation of the concept, and you will have to do work to dig into what the drivers are of the valuation multipliers in your industry and how size is likely to impact those drivers. But these figures illustrate the concept that so many businesses miss entirely.

We have many clients who have clicked onto the power of this approach, across many industries. For example, one of our clients is a dental aggregator. There is often very little sale value in each individual practice that they acquire. But when aggregated, each of these small practices add up to a whole that will ultimately provide a rich opportunity for IPO, or just a much higher multiple for a trade sale due to the ultimate size achieved with the practices aggregated together. This particular aggregator uses a model which often encourages the sellers to maintain some equity in the business, so that they too get to participate in the uplift of the value that is brought by the increased size of the whole business together. Genius.

Here are a bunch of other benefits that an acquisition for growth can bring:

- **Access to new markets (or quicker access to new markets) and expansion of geographical reach.** Acquisition of a business that's based in another location instantly allows the acquiring company to gain a foothold in that area for distributing its original products or services. In addition to this, combining the assets of both businesses often enables the resulting business to expand into new locations that were previously not served by either entity.
- **Cost reduction by targeting upstream or downstream of the supply chain (vertical integration**). Acquiring a business that's part of your supply chain (for example, a furniture retailer buying a business that manufactures furniture) can lead to huge savings in overhead expenses and costs. Aside from simple costs

savings, acquisitions within your supply chain can also help to reduce supply chain risk, and increase operational efficiency.

- **Access to more advanced technology.** Acquisition gives businesses the opportunity to upgrade their technology or access new technology that would otherwise require a long process to create organically.
- **Increased workforce.** Acquisitions typically increase personnel size. Each team member comes with their own unique set of industry knowledge, skills and experience – all of which are valuable in propelling the business to greater success. These employees are also very likely to have an already existing network of industry contacts, which further widens the business's potential reach and impact. This value in talent acquisition has recently become more important as we have moved into a tight labour market, a trend which is likely to increase into the future.
- **Access new expertise.** Acquisitions are a great way to add new expertise to your business. Many of our clients' acquisitions of very small businesses are driven simply by wanting to scoop up talented staff – sometimes referred to as 'aqui-hire' (hiring through acquisition).
- **Greater market share.** When you acquire a business that is related to or complements your own products and services, you will also increase your share of the market by taking out competitors. Ultimately larger market share is generally tied to improved value through increased efficiency, and easier brand recognition in the market.

GIVE ME SOME EXAMPLES!

I have so many examples of businesses where acquisition for growth has achieved incredible outcomes.

We've already examined our clients in the accounting industry, who have achieved amazing results from using acquisitions to quickly

expand their client base and their service offering. This not only nets them an uplift in revenue, but given they are able to rip out significant costs in the acquired entities due to duplication, they also get an uplift in the value of the acquired entity after those costs have been stripped out – providing an immediate return on their acquisition spend. And when the acquired entities provide new service offerings, they have also been able to get a further uplift from the upsell and cross-sell opportunities.

We have also seen great returns with clients who run gyms and health centres. This is another industry where multiple sites can be a licence to print money. And while it can always be an option to open a brand-new site[5], acquiring an existing business with an existing client base is generally the much faster route to adding locations. And this is particularly attractive when the cost of the acquisition can be quickly offset with the gains that can be made through being able to run the acquired business cheaper through economies of scale and the absorption of many running costs like being able to share management (and take on higher quality management personnel as a shared resource) and overheads (like accounting, bookkeeping, CFO, administration and marketing).

We have clients who run business coaching, who have added on acquisitions of complementary businesses such as marketing and recruitment. These additional business units have given them the power to offer their clients incredible holistic growth services (rather than just business coaching) while also using the client bases of each individual business to upsell and cross-sell to the other merged businesses – contributing to a massive and fast increase in the size and reach of each of those merged businesses.

Our clients have also reported great uplifts in the performance of both the acquired and the acquiring businesses through greater business insights – for example:

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5 Often referred to as a 'greenfield' site or business.

- marketing that has worked well for one business
- management techniques that lead to strong team performance
- approaches used by one team that could be replicated across the other in dealing with customers.

Essentially our clients have reported that acquisitions have enabled them to pull the best out of each business and replicate it across the others.

We have clients in the dental industry who are successfully using this growth through acquisition approach. There are aggregators who do this on a large scale, but also the smaller practices who have clicked on to the benefits of bolting a few practices together to get the benefits of greater scale. They often:

- share specialists between practices (increasing the service offering of each practice to enable upsells)
- achieve greater buying power and use shared resources to reduce costs
- share insights from one practice to the other (for example, successful marketing techniques).

We also have clients in recruitment, marketing, technology, software as a service (SAAS), retail, manufacturing, home services, professional services and many other industries who have achieved so many of these benefits.

The opportunities are real, but they are missed by so many businesses who just haven't even considered the possibilities.

Are you one of them . . . ?

ACQUISITIONS TO INCREASE YOUR MULTIPLE FOR EXIT

Contrarian advice: before you exit it might be a good idea to look at acquisitions as a way to increase your size, or fill out your service or product offering.

In an earlier section on business value arbitrage we considered the concept of how value at sale is often based on the multiplier that

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is applied to the earnings, and how that multiplier can often increase as the size of the business increases. For example, micro businesses can sell as low as 1× earnings. But larger SMEs can attract multiples of at least 3× or 4× earnings, and often much more depending on the industry.

Very simply, this means that sometimes if you are gearing up to exit, you can use acquisitions to add value quickly to your business prior to exit. Those acquisitions can potentially provide three benefits on the sale value, by:

- increasing the profit that a multiplier will be applied to
- increasing the multiple that will apply to the earnings in your current business
- increasing the multiplier to be applied to the part of the business that you have just acquired.

So you might find that you can spend a bit of money prior to exit acquiring businesses to increase your size (and multiple), and achieve an exponential uplift in total value.

As I write, our team is working with two clients who are doing exactly this. One of those clients is in engineering, and spent 14 years slowly growing his business. He came to us as he started to consider selling the business, having been approached by buyers at around about a multiple of 4× profit. But in the process of sale he came to the realisation that there were a bunch of businesses on the market in his industry that were smaller and were selling at less than half his multiple. Being good with numbers, he realised very quickly that he could buy one of these smaller entities and immediately double its value (given he would buy it at a multiple of less than 2, but then roll it into his current entity that was being valued by prospective buyers at a multiple of more than 4). So he cleverly decided to acquire one of those smaller players and double the acquisition price overnight, in addition to adding a lot of extra general value in the business through extra technology and personnel from the acquisition.

It's so exciting to see businesses come across opportunities like this that can greatly increase their value at sale, but just sad that often the idea hadn't come far earlier in the lifecycle of the business to enable them to use the strategy multiple times over to maximise the impact.

ACQUISITIONS FOR ROLL UPS

Another approach to acquisitions is a directed path of consolidating fragmented industries through a 'roll up'. A roll up is when an investor buys up multiple small companies in the same market and combines them into a larger entity. This provides economies of scale, expanded geographic coverage, great brand recognition (if the acquired entities are re-branded), and can also sometimes be used to merge companies with complementary capabilities that will enable them to together provide more products or services than they could as smaller, independent businesses.

It can lead to significant cost reductions in the long run as well as a greater share of the market.

Consolidated businesses can also get cheaper financing if the new entity is more stable, more profitable, or has more assets that can serve as collateral. (But, sometimes financing can be more difficult in a roll up than in an acquisition of a single business, as it can involve more complex financing considerations.) Being larger, the new company can likewise negotiate better terms with suppliers and offer a wider range of products or services.

Given that larger businesses are generally valued at a higher multiple of earnings than smaller businesses, this consolidation of smaller businesses can provide an immediate uplift in the value of the acquired entities (simply because as part of a bigger business, their earnings are now valued at this higher multiple – on the basis of the business value arbitrage approach we discussed earlier).

Roll ups are a favourite tool of private equity firms, which have earned billions using it. And we have clients using this approach to varying degrees. Some are only aiming for a handful of acquisitions

to roll up over a number of years, whereas others have their sights on a more aggressive acquisition path, working through hundreds and hundreds of targets, aiming towards tens of acquisitions (or in some cases 50 or more) over a short time span.

Ultimately the end game for roll ups is generally a timed exit (often over a short-term period of five to seven years) via a trade sale or through an IPO.

ACQUISITIONS FOR INVESTMENT

Acquiring shares in an SME can also be a great form of investment without needing to necessarily be part of the management or operation of the business.

Most SMEs will aim for a profit level of between 10% and 25%, and of course many SMEs will achieve far higher (but also possibly lower!) than this. By choosing a solid business to hold equity in, you have the opportunity for not just distributions out of the profit each year, but also (and often most lucratively) a stake in the pie of the future sale value of the business.

This is a favoured form of investment by investors who have a willingness to contribute capital to help fund expansion of a business, or who have business experience that they are willing to offer in the form of mentorship for the management of the business – with the aim of the capital and (or) the mentorship intended to help fuel expansion of the size and value of the business.

We work with many buyers who are investors in businesses, and many businesses who sell part of their equity to investors, to achieve fast and strong growth – and have seen this enrich both the founders and the investors.

MANAGEMENT BUYOUTS

Acquisitions will often also be made by employees.

The term 'management buyout' (MBO) is often used for this sort of transaction – where the management team purchases the business.

But for many SMEs this is not necessarily limited to the management team (given many SMEs often don't have a structured management team) – so often in SME world this terminology is more broadly used to refer to an acquisition by an employee or group of employees.

A sale to employees makes a lot of sense for both the founder and the employees buying in. The business is known to the buyers, and therefore the level of due diligence required and operational handover post sale is far reduced. This approach also provides the employee buyers the potential for far greater control and rewards financially than they had as employees. This can be a great succession strategy for a business owner, and also a fabulous retention strategy to keep on board the best players by offering them ownership over time.

This type of acquisition will in some cases be funded by the seller through payments agreed to be made over time. Sometimes this might even be negotiated by the employee buyers to be paid slowly enough to enable it to be funded to a large degree by dividends (coming from the profits of the business).