Types of Aquiring Firms

PRIVATE companies are typically acquired to improve existing operations, expand opportunities for management, broaden a customer or supplier base, or improve the company's profits in order to resell the company for a profit. The motivation behind completing the transaction is often different depending on the acquirer, as is the management style after the transaction is completed. Companies are generally acquired by one of four different groups: a public U.S. company, a private U.S. company, a foreign company, or an investment group (which can be further refined into Private Equity firms or Venture Capital firms). This article serves to provide a general discussion into each group's motivation for seeking an acquisition and the management style used by each in order to achieve their goals. While the amount of consideration paid in a sale is important, entrepreneurs interested in selling their company should be aware of the differences in post-acquisition management style in order to select an offer that best fits their expectations for the firm going forward.

A Public U.S. Acquirer

A public company typically looks for companies that fit into its overall corporate strategy and will allow it to improve or expand its operations. Desirable companies will provide needed inputs into their operations, have access to previously ignored or inaccessible customers, or have access to technology that may be patented or licensed. Further, an acquisition provides an additional source of management candidates that may be valuable to the firm, or the acquired company may provide an opportunity to allow the acquirer's management an opportunity to gain additional experience. Public acquirers will also be very sensitive to environmental regulations or other possible legal issues because of the liability it may present to the firm and potential damage to the acquirer's image.

A public company is likely to have easy access to cash and equity needed to complete a transaction, and the consideration paid in a deal may contain either. The acquirer may retain management after the transaction to ensure continuity after the deal, but also may replace existing management with management of the acquirer. Additionally, it is possible that the acquirer may move the operations to a more suitable location. Once the company is folded into the acquirer, the acquired firm will likely be subject to the established reporting and management practices used by the parent firm. This may include audits, meetings, the use of additional forms, or other tools used to track operations. This change can be difficult for entrepreneurs, who are used to operating independently and may not be used to increased oversight or bureaucracy.

The acquisition will ideally lead to an increase in the company's net income and earnings per share. The company will be managed with this focus. While increasing the sales of the company will be a goal, the most important measure will be the after-tax profits of the organization. In order to achieve this, the public company may update operating machinery or outdated computer systems and streamline operations. Further cost-savings may be achieved by consolidating purchasing and distribution with the parent company. It is possible that the acquirer will reduce personnel or eliminate unprofitable lines of business to improve the earnings of the acquired firm.

A Private U.S. Acquirer

Private acquirers may not be the first in mind when it comes to the various types of buyers, but they represent a significant share of the annual merger and acquisition activity. There are a number of reasons why private companies may be interested in an acquisition. For example, there may be synergies between the two companies that are only achievable by a merger. In some industries characterized by high volume products or services, or where there are duplications in business functions such as legal, accounting, and marketing, economies of scale may play an important motivating role behind an acquisition. Similarly, by acquiring a company that has a prominent role in a particular area will allow the acquiring firm to expand geographically, by product offering, or by services rendered. Frequently, a company is acquired for its proprietary technology. It is at times less costly to acquire a firm that has deployed a specific technology and has trained, in-house expertise that is knowledgeable than to independently develop the technology and train your own staff. An often overlooked reason behind an acquisition is the financial and reporting systems that are essential to the operation of the business. An acquiring firm can adapt to and deploy these new systems faster and cheaper by acquiring a company that already has these skills and wherewithal. Lastly, although it's true that a reason for acquisitions by private buyers in the same industry is to eliminate competition, selling a company to a competitor rarely produces the highest sales price. Similarly, this can also be said for acquisitions that are initiated for the sole purpose of obtaining customer lists.

A Non-U.S. Acquirer

Foreign acquirers are often interested in U.S. firms in order to gain entrance into U.S. markets. The acquirer may only be interested in using the firm as a basis to sell their products or services to U.S. consumers and may not be interested in the continued operation of the firm. A foreign acquirer may be interested in purchasing the company in its entirety through cash and/or equity, but may also be interested in creating a joint venture with the firm. The U.S. provides these non-U.S. acquirers with a safe harbor. There is little fear of nationalization, threat of devaluation of the dollar, and often the tax consequences of an accquisition are more favorable for this type of buyer.

Foreign firms will also have relatively easy access to the capital needed to complete the transaction and are often willing to pay a significant premium over book value in order to acquire a U.S. company. The acquiring firm will likely seek to retain some or all of management and may offer equity to encourage retention. Management continuity may be important to ensure a smooth transition to the foreign acquirer's management style and lessen possible culture or language differences. The acquiring firm will likely place management to track the progress of the firm and integrate the operations with the parent.

The primary focus of many foreign firms is to gain as much market share as possible. As a consequence, the acquiring firm will strive for top-line growth. Increasing sales numbers, gaining customers in new markets, and expanding sales in existing markets may be the focus of the parent firm. Once the sales expectations have been met, the focus of operations may shift to streamlining operations and improving profitability.

An Investment Group

The past thirty years has seen enormous growth in the number of investment groups and the capital available for investment. These groups look for companies that have significant growth opportunities available to them, as well as opportunities to improve profitability. These groups seek to acquire firms and grow the firm over a five to seven year horizon, leading to an initial public offering or another sale.

The consideration paid in a transaction with an investment group is typically a mix of cash and equity in the company, but may also include an earn-out or company debt. The cash in the transaction is often financed by the cash flows of the company. Consequently, investment groups seek firms that are able to generate sufficient cash to repay the debt used in the transaction. EBITDA (earnings before interest, tax, depreciation, and amortization) is the holy grail for these groups as they combine their equity with other layers of financing, including bank debt. The profitability and cash flow of the firm will be closely monitored by the investment group. These groups may not become immediately involved in the day-to-day operations of the firm, but should the company fail to meet financial projections, it is likely that the group will become increasingly involved. Management may be replaced if the company does not perform to the investment group's expectations.

The investment group is likely to have other portfolio companies in the same industry. As a result, these groups may have access to potential customers, management expertise, technology, or other benefits to offer the acquired firm. The investment group may also add additional management to improve various operations of the firm.

IN summary, the motivation for acquisition and the management style after a transaction varies depending on the acquirer. It is important to consider these factors to attract potential acquirers and to evaluate possible offers. When considering a sale of a company it is important to consult with qualified attorneys, accountants, and investment bankers to ensure that any decision is appropriate for you and your firm.

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