Study

April 2019

Buying a Business

A Winning Strategy for Purchasing Another Company in Canada

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Acknowledgements

The author would like to express his appreciation to Alexandra Fioriello, Pierre Cléroux, Jovanka Charbonneau, Patrick Hagarty, Jacques Légaré and Fay Hinkson for their support and contributions toward this study. The author also thanks Sylvie Ratté for her work in scoping and developing the initial proposal for this research project.

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ISNN 978-1-989306-22-2

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Graphic Design: Maître D inc.

Highlights

This study provides insight into why small and medium-sized enterprises (SMEs) buy other businesses, along with advice on how to structure a successful acquisition. The focus is on business acquisitions by third parties, as opposed to management buyouts or family transitions.

To understand common issues, problems and challenges entrepreneurs face when acquiring another business, we surveyed 1,038 entrepreneurs, focusing on those who had attempted or completed an acquisition in the last 10 years.

Here are the highlights of our findings.

→ **Entrepreneurs that acquire other businesses do so to grow.**

Looking at entrepreneurs in our survey who acquired another business:

- **41%** aimed to increase their market share
- **24%** wanted to add a new business line
- **21%** looked to expand geographically

→ **Acquiring another business has a positive impact on revenue growth.**

According to our survey, 46% of SMEs that acquired one or more business over the last 10 years said their revenue growth was outpacing their industry average, compared to 38% of SMEs that did not acquire another business. Our statistical analysis confirms this finding, showing that, compared to their peers, businesses that acquired more than one company in the last 10 years were 66% more likely to have generated revenue growth of 10% or more annually over the last three years.

→ **The key to a successful business acquisition is a well-structured process.**

Companies that followed a structured business acquisition process were 94% more likely to be high-growth firms three years after the acquisition than firms that that did not follow a structured acquisition process.

→ **Many entrepreneurs do not establish a project team or project plan to complete an acquisition.**

- More than half (55%) of SMEs that acquired another business did not appoint an internal or external team to lead the acquisition. This indicates that owners often make most of the decisions by themselves during an acquisition.
- A little over 40% of SMEs did not have a plan defining their objectives for their last business acquisition. Given the link between a structured business acquisition and the success of an acquisition, improving this statistic could greatly benefit Canadian entrepreneurs.

→ **Most entrepreneurs create a post-merger integration plan following an acquisition.**

Having a post-merger integration plan is key to overcoming the challenges that follow an acquisition. These include retaining key staff and clients, integrating information technology (IT) systems and merging cultures. Section 4 of this report provides tips on how to deal with these issues.

→ **Experience with business acquisitions is a key success factor.**

This study found a link between experience with business acquisitions and the probability of success. That said, the learning curve is long. It takes about five acquisitions before a statistically significant link between experience and success emerges.

1 An overview of business acquisitions

Presented below are the survey results regarding entrepreneurs' objectives in acquiring another business, as well as the barriers they face during this process.

Why do SMEs acquire other businesses?

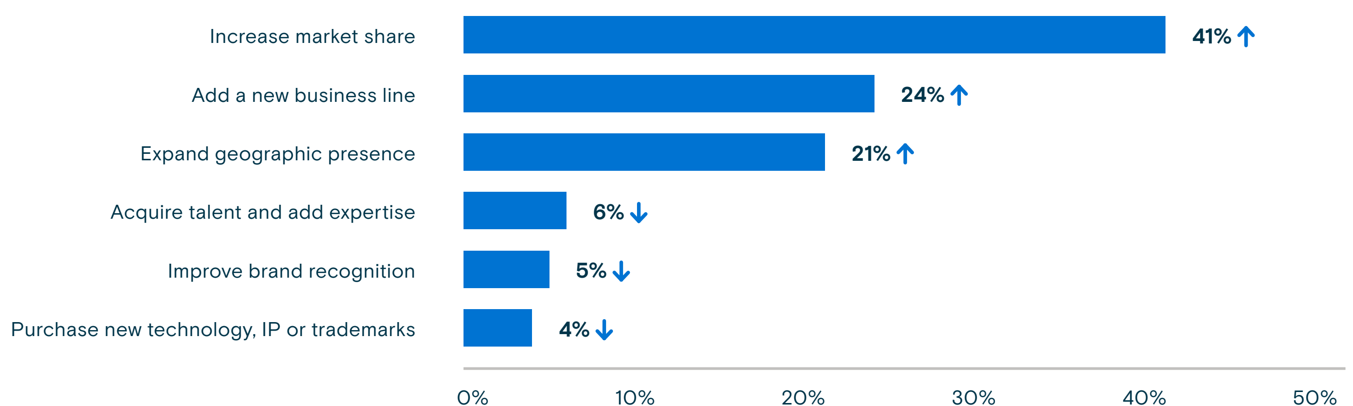
Our survey asked entrepreneurs to describe why they acquired other businesses (i.e., their main objectives). The most frequent responses were that they acquired another firm to:

- increase market share (41%)
- add a new business line (24%)
- expand into a new market (21%)

The common element to these answers is that the entrepreneur wanted to grow the business. In-depth telephone interviews conducted with SMEs seeking to purchase other businesses confirmed this finding. During the 13 interviews BDC conducted, six entrepreneurs noted that: "they are looking to buy other businesses in order to grow faster."

On the other hand, entrepreneurs were least likely to acquire another business to get access to talent and expertise (6%), improve brand recognition (5%), or obtain new technology, intellectual property (IP) or trademarks (4%). Figure 1 provides an overview of these results.

Figure 1 – Reasons for acquiring another business



Source: BDC, Survey on Business Acquisitions, 2018. Sub-sample of companies that completed acquisitions; unweighted; base n = 280. An arrow up (arrow down) indicates a result that is statistically significantly higher (lower) than numbers for other groups, with a confidence level of 95%.

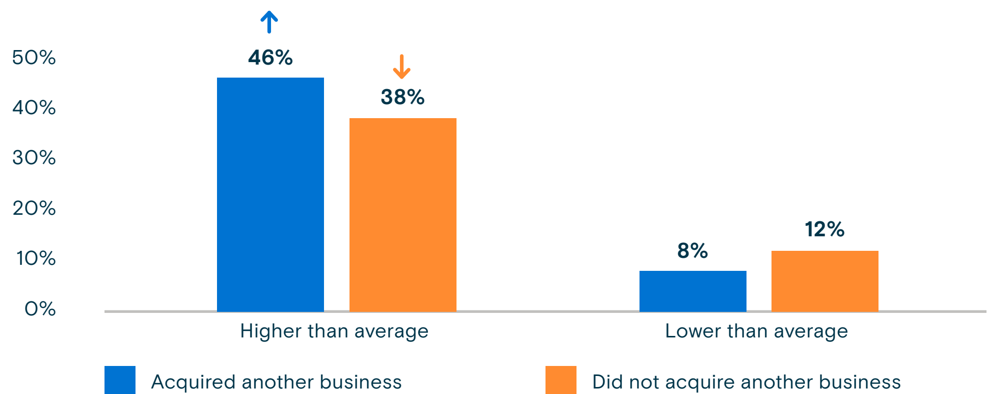
Businesses that acquired more than one business were 66% more likely to be high-growth firms.

Purchasing a business is an effective growth strategy

Whatever a company's ultimate objective when acquiring another business, our results indicate that SMEs that completed acquisitions in the last 10 years generated higher revenue growth than their peers. Specifically, our statistical analysis shows that businesses that acquired more than one business were 66% more likely to have generated annual revenue growth of 10% or more over the last three years. (Annex B contains additional details.)

We also asked entrepreneurs to assess their company's revenue growth relative to their industry's average. In the survey, 46% of the entrepreneurs who acquired another business said their revenue growth outpaced their industry's average, compared to only 38% of entrepreneurs who did not acquire another business. This aligns with our previous finding, that a properly planned and executed acquisition is a viable growth strategy. (See Figure 2.)

Figure 2 – How did business growth compare to that of others in the same industry?

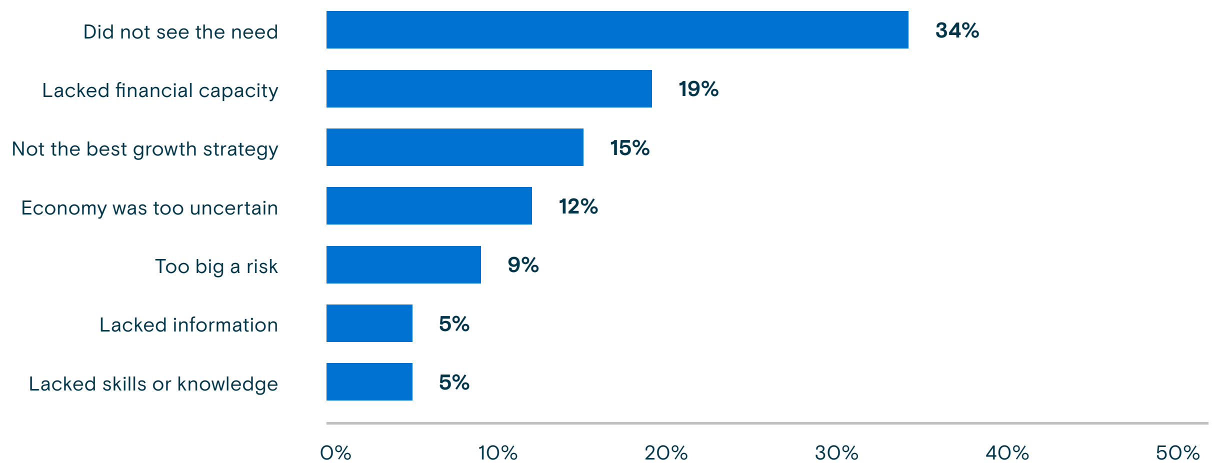


Source: BDC, Survey on Business Acquisitions, 2018. Total sample; unweighted; base n = 893. An arrow up (arrow down) indicates a result that is statistically significantly higher (lower) than numbers for other groups, with a confidence level of 95%.

What stops SMEs from acquiring other businesses?

We asked entrepreneurs who did not acquire another business to explain why they did not. The most common reasons they provided for not acquiring another business were that they felt no need (34%), that they lacked the financial capacity (19%) and that it was not the best growth strategy (15%). (See Figure 3.)

Figure 3 – Reasons for not acquiring a business



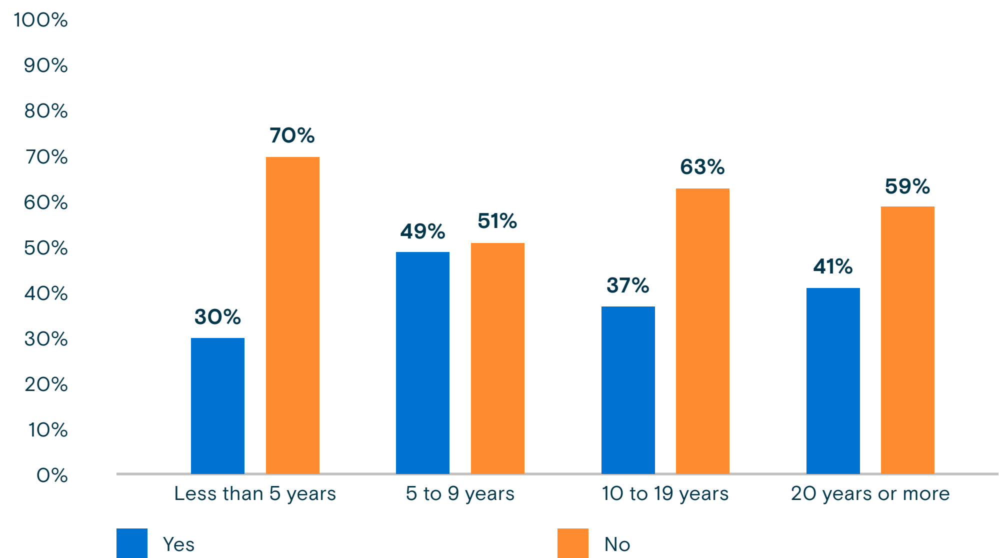
Source: BDC, Survey on Business Acquisitions, 2018. Sub-sample of companies that did not complete a business acquisition; unweighted; base n = 462.

Companies that were less than 10 years old were more likely to have attempted an acquisition.

Do younger firms complete more acquisitions?

In our survey, firms that had been in operation for between five and nine years were the most likely to have completed a business acquisition in the last 10 years. According to our regression results, a company that had been in operation for less than 10 years was 76% more likely to have attempted a business acquisition than a company that had been in business longer. This makes sense, as businesses in that cohort have the ambition that comes with being a "younger" firm and have a critical mass of experience. Both are key drivers of success in a business acquisition.

Figure 4 – Firms that completed one or more business acquisitions in the last 10 years, by age of business

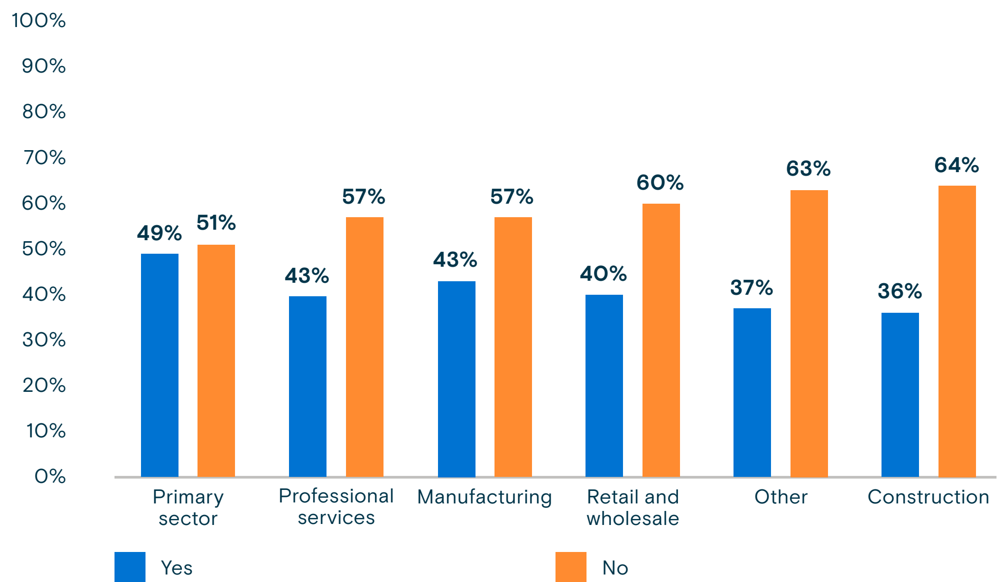


Source: BDC, Survey on Business Acquisitions, 2018. Total sample; unweighted; base n = 1,038.

Business acquisition and the sector of activity

Further, firms in the primary sector (companies operating in the mining, resource and agricultural subsectors) were the most likely to have bought another business in the last 10 years. The professional services and manufacturing sectors followed suit. Firms in the construction sector were the least likely to have acquired a business.

Figure 5 – Firms that completed one or more business acquisition in the last 10 years, by sector



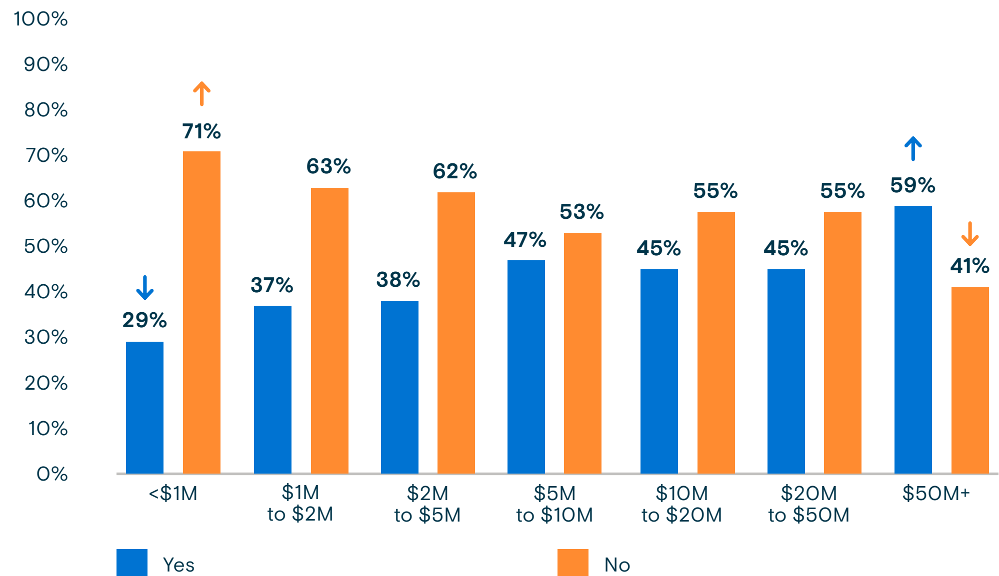
Source: BDC, Survey on Business Acquisitions, 2018. Total sample; unweighted; base n = 1,037.

Business acquisitions and company size

According to our survey, larger firms were more likely to acquire other businesses. This makes sense, as big businesses have the means to purchase other companies. Acquisitions are also a way for more mature firms struggling to maintain high levels of growth to overcome that challenge.

Figure 6 summarizes our survey results on the share of businesses that completed an acquisition. Results are broken down by size of business (as measured by revenue). Of the firms generating more than $50 million in revenues, 59% indicated that they completed one or more acquisition, whereas 41% did not. This is the highest share among businesses in all revenue categories.[1]

Figure 6 – Firms that completed one or more business acquisition in the last 10 years, by size of business



Source: BDC, Survey on Business Acquisitions, 2018. Total sample; unweighted; base n = 1,037. An arrow up (arrow down) indicates a result that is statistically significantly higher (lower) than numbers for other groups, with a confidence level of 95%.

1 The share of firms indicating "yes" (i.e., that they had acquired another business) in Figure 6 is not representative of the overall share of SMEs that purchased other businesses in Canada. The actual share of businesses that acquired other businesses is much lower. The estimates in Figure 6 are higher because our survey specifically targeted firms that had acquired other businesses in the last 10 years.

The key to success is structure

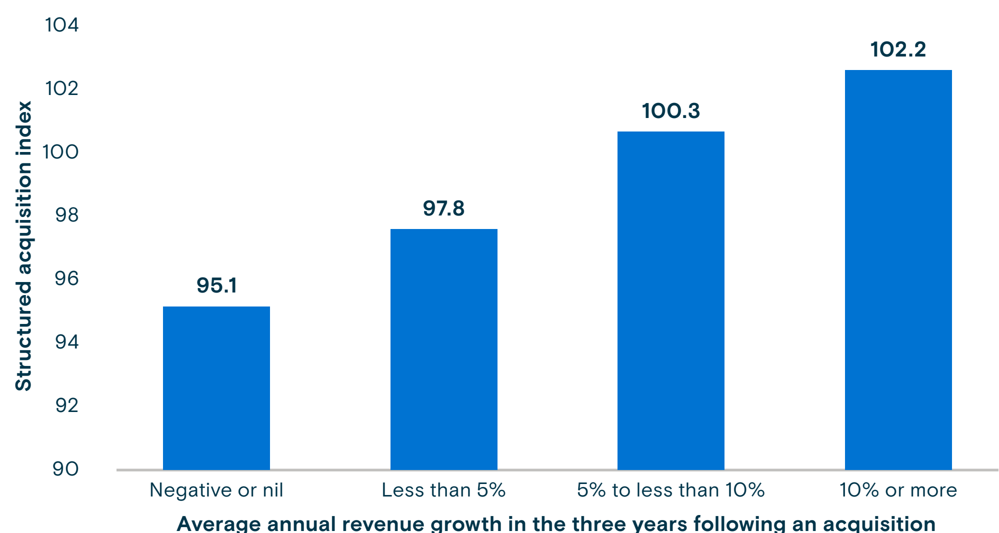
Companies that followed a structured acquisition process were 94% more likely to experience high revenue growth after the aquisition.

We found that an SME that implemented a more structured acquisition was 94% more likely to experience high revenue growth[2] in the three years following the acquisition, compared to firms that did not follow a structured acquisition process. This result is based on an index we developed and statistical analysis. Both methods are described in annexes A and B of this report.

Figure 7 illustrates the relationship between revenue growth and the structured acquisition index. The average index value is equal to 100. Higher index values indicate a more structured acquisition.

Note that businesses with higher revenue growth have index scores above the average of 100, whereas firms with low revenue growth have index scores below the average. This reinforces the conclusion of other parts of this report: A structured acquisition process increases the chances of an acquisition's success.

Figure 7 – Structured acquisitions index and revenue growth



Source: BDC, Survey on Business Acquisitions, 2018. Sub-sample of companies that completed acquisitions; unweighted; base n = 284.

2 A high-growth company is a company with average annual revenue growth greater than 10%.

> “You’ve got to put that team together and make sure it’s super high-functioning with a clear vision and objectives.”

Case study

Fuller Industrial

Structured approach to acquisition pays off for this manufacturer

It was a chance meeting that led Jeff Fuller to make an acquisition that doubled the size of his company and opened the door to exciting new growth opportunities.

His company, Fuller Industrial, had experienced rapid growth selling rubber-lined pipe systems, liners and coatings to mining companies around the world during the resource boom of the 2000s and early 2010s.

But when world prices for commodities fell sharply in 2014, mining companies scaled back and sales at Fuller in Sudbury, Ontario softened. CEO Jeff Fuller began to search in earnest for an acquisition that would diversify sales and rekindle growth.

It wasn’t until he bumped into a sales rep for ACR Group that the pieces fell into place. ACR produced rubber lining, and rubber and urethane parts, for heavy industry at plants in Edmonton, Alberta and Richmond, British Columbia—a good fit for Fuller’s business.

A structured approach: The key to a successful acquisition

Once Fuller had made the deal to buy ACR, he put together an acquisition plan that included objectives for sales and productivity improvements as well as a communications strategy to support the integration of the two companies. He also assigned a team of executives to oversee integration.

“You’ve got to put that team together and make sure it’s super high-functioning with a clear vision and objectives,” says Fuller, whose combined company has about 160 employees.

Fuller’s purchase of ACR, which was partially financed by BDC’s Growth & Transition Capital team, has diversified the company and provided new opportunities for sales growth.

Integration produces culture clash

Despite all the preparation, the acquisition has been far from smooth sailing. When Fuller introduced lean manufacturing techniques to ACR, it produced a culture clash that made it hard to achieve forecasted productivity gains. Fuller ended up replacing ACR’s top management as well as some production workers.

He admits he didn’t focus enough on the human resources dimension during due diligence and then waited too long to make the necessary changes. “My recommendation would be spend a lot of time on the human resources part,” he says.

Despite the challenges, Fuller says the acquisition has positioned his company for major growth in the years to come. Today, about 50% of revenue comes from outside Canada. He is now looking for other acquisition targets and will benefit from the lessons he’s learned during the ACR purchase.

3 Common gaps and challenges

We asked entrepreneurs a series of questions regarding the key steps they implemented during the acquisition and integration processes. The intent was to identify gaps in the process at both stages (i.e., gaps) to help guide future improvements.

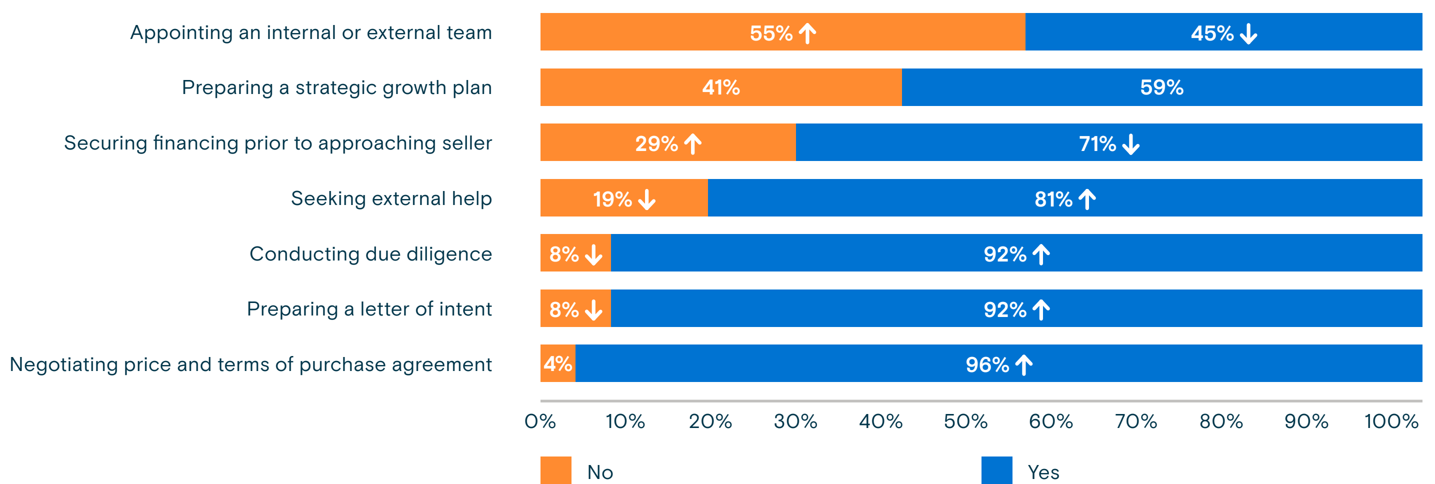
Table 1 – Good and bad practices entrepreneurs followed during the acquisition process

The good	The bad
↑ **Firms that acquired other businesses were generally willing to seek external help, including consultations with a financial advisor.** Of the firms that acquired another business in our survey, 81% said they sought outside help from accountants, lawyers or other acquisition specialists.	↓ **55% of survey respondents had not appointed a dedicated team to head their business acquisition.** This indicates that in most acquisitions the owner makes key decisions—probably alone. Concentrating decision-making in one person is risky, given the broad knowledge base (spanning accounting, operational, legal and financial knowledge) required for a business acquisition to succeed.
↑ **Most entrepreneurs (92%) prepared a letter of intent (LOI) as part of their last business acquisition.** This is an encouraging result. Skipping an LOI and rushing into drafting a sales contract is risky and can lead to an abandoned or failed deal. Note that an experienced mergers and acquisitions (M&A) lawyer can draft an LOI relatively quickly and efficiently. The advantages of an LOI are that it: • tests the parties' seriousness and commitment to the transaction • defines certain key areas of the agreement • highlights remaining open issues	↓ **41% of entrepreneurs did not prepare a plan defining the purpose and objectives of the acquisition.** Given the link between planning and the success of an acquisition, this is an obvious area for improvement.
↑ **Almost all the entrepreneurs (92%) we surveyed said they completed a due diligence assessment of the business they purchased.** The high percentage is not surprising, given the importance of fully understanding the financial situation and liabilities of a business one is buying. However, a significant portion of respondents found the due diligence process difficult and challenging (see next section).	↓ **29% of entreprenerurs didn't seek financing prior to approaching a seller.** The mix of financing can dramatically alter the return on the acquisition and the buyer's risk. Getting financial partners involved at the beginning gives you time to negotiate an optimal financing package and helps ensure you're ready to go as soon as you find a good acquisition target.

Do entrepreneurs follow all the steps in the acquisition process?

The lynchpin of a successful acquisition is a well-structured process, and planning is vital. The more rigorous the acquisition process, the more likely it is to succeed. See section 2 of this report for more information on the impact of a more structured process. Figure 8 shows the share of respondents who did or did not complete key steps during the acquisition process.

Figure 8 – Completion of key steps during the acquisition process



Source: BDC, Survey on Business Acquisitions, 2018. Sub-sample of companies that completed acquisitions; base n = from 327 to 335. An arrow up (arrow down) indicates a result that is statistically significantly higher (lower) than numbers for other groups, with a confidence level of 95%.

How to improve your chances of success during the acquisition process

Here are a few ways to avoid some of the common gaps we identified and to improve the chances that your business acquisition will succeed.

1 Build a team of internal and external experts

Internal experts include representatives from your finance, sales and marketing, and operations teams. External representatives could include lawyers, accountants and bankers, as well as valuation, due diligence and human resources (HR) experts. A member of your senior management team—likely the CEO—should lead the team.

2 Identify clear objectives for your acquisition

These objectives could include adding new products, expanding into new markets, improving margins, growing market share, improving brand equity, or acquiring new machinery, technology or human talent.

When establishing the objectives, try to answer the following questions.

- Why are we making this acquisition?
- Does an acquisition make more sense than internal expansion, licensing, franchising or a joint venture?
- Will it improve our ability to grow or increase our pace of growth?
- Will it enable us to access new markets (expand geographically)?
- Will the acquisition improve our competitive position?
- Will it enhance shareholder value?

3 Draft an acquisition plan

An acquisition plan provides a roadmap that senior management can follow. It will help you focus on your objectives, and filter out bad or inappropriate deals. You can use the plan to communicate the purpose of the acquisition to your staff, bankers, shareholders and other stakeholders. A well-developed acquisition plan will also reduce advisory fees by providing clear marching orders to your financial advisors and other consultants.

Your acquisition plan should set out:

- a target budget and timeline for the acquisition
- sources of financing
- the method for finding acquisition candidates (e.g., internal search, networking, industry contacts, an investment banker, an M&A advisory firm)
- the characteristics of an ideal takeover candidate
- the roles and responsibilities of each member of the acquisition team
- a risk inventory, including mitigation strategies and an assessment of whether these risks threaten your value-creation strategy
- your openness to partnering with others, including partial ownership of the business you want to acquire

4 Conduct a market review to find your needle in the haystack

In our interviews, many entrepreneurs noted that finding the right acquisition target was a long and difficult process, with the potential for much wasted time and effort. Here are some screening criteria to help you find the right company. Remember, a financial advisor can help you answer many of these questions.

- Does the company have a proven operating concept or history of success? Firms that have demonstrated stable financial and sales performance during the ups—and downs—of the business cycle are better acquisitions.
- Will the acquisition result in more diversified and/or stable cash flows for your combined company? Favour acquisitions that make your business more resilient through diversification.
- Can the skills and competencies of one firm help improve the competitive position of the other? For example, will the acquisition complete your product offering or offset weaknesses in organizational capacity?
- Will the acquisition unlock cost and revenue synergies, or create value for customers in other ways?
- Does the company have room to grow in its market? Does it have excess capacity that you can use?
- Does the company produce goods and/or deliver services that are subject to technological change? If yes, what is the potential impact of those changes on the company? Avoid businesses at risk of technological obsolescence.
- Does the company have a strong management team that is willing to stay in place after the acquisition to deal with integration and other issues?
- Does the company have a recognized brand that you can use? Is it a leader in a market niche? Does it have access to different suppliers or access to more favourable terms from its suppliers than you do?

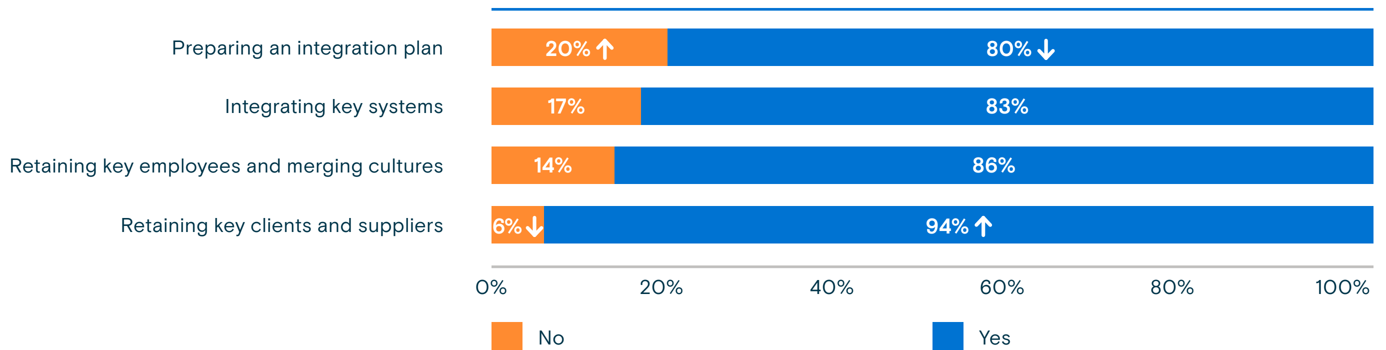
Approximately 20% of SMEs did not prepare a plan to identify and realize their integration objectives once their acquisition was completed.

Do entrepreneurs follow all the steps in the integration process?

We asked entrepreneurs how they integrated the target business following the acquisition. Most entrepreneurs completed the integration steps that we asked about. However, approximately 20% of SMEs did not prepare a plan to identify and realize their integration objectives once their acquisition was completed. This is important, because our literature review and interviews indicated that many entrepreneurs fail to realize their integration objectives—particularly synergies. A formal integration plan can go a long way toward mitigating this risk.

Further, 86% of business owners said they tried to retain the seller's key employees. This is good, given the importance of key personnel in ensuring the seller's business continues to operate effectively and remains viable. Unfortunately, retaining key staff also ranked as one of the most difficult steps during an acquisition. See section 5 of this report for information on how to tackle common integration issues.

Figure 9 – Completion of key steps during the integration process



Source: BDC, Survey on Business Acquisitions, 2018. Sub-sample of companies that completed acquisitions; base n = from 293 to 335. An arrow up (arrow down) indicates a result that is statistically significantly higher (lower) than numbers for other groups, with a confidence level of 95%.

What are the greatest challenges in completing an acquisition?

Entrepreneurs identified retaining key employees, conducting due diligence, and negotiating price and commercial terms as the most challenging aspects of an acquisition.

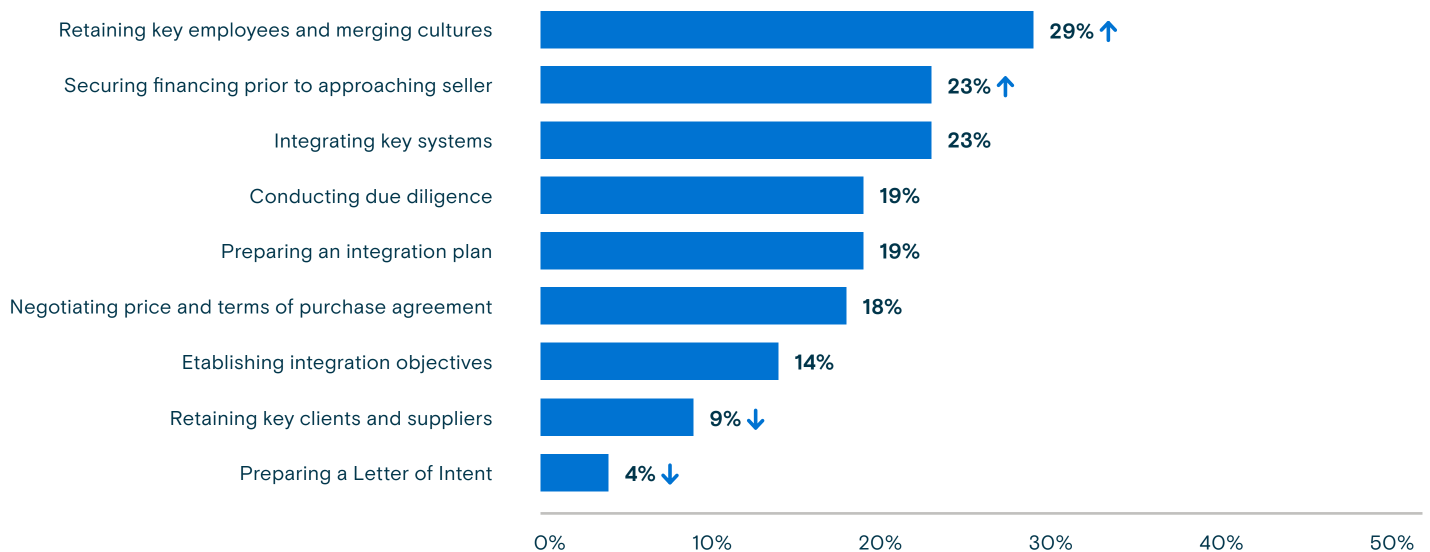
→ **29%** of entrepreneurs found retaining key employees challenging, which, interestingly, is higher than the 18% that identified negotiating the purchase price as difficult.

→ **23%** of respondents said securing financing was challenging. From other surveys[3], we know that a large share of SMEs rely on personal financing or funds from relatives to purchase another business; even if credit conditions for businesses were generally considered favourable while we were conducting the interviews.

→ **23%** of entrepreneurs found integrating key systems challenging.

→ **19%** of respondents found conducting due diligence, and preparing an integration plan, difficult—not surprisingly, given the complex skill sets these tasks require.

Figure 10 – Most challenging steps in completing an acquisition



Source: BDC, Survey on Business Acquisitions, 2018. Sub-sample of companies that completed acquisitions; unweighted; base n = from 238 to 321. An arrow up (arrow down) indicates a result that is statistically significantly higher (lower) than numbers for other groups, with a confidence level of 95%.

3 These include Statistics Canada, *Survey on Financing and Growth of Small and Medium Enterprises, 2017* (Ottawa: Statistics Canada, 2017). https://www.ic.gc.ca/eic/site/061.nsf/eng/03086.html; and Pierre-Olivier Bédard-Maltais, *Investment Intentions of Canadian Entrepreneurs: An Outlook for 2019* (Montreal: Business Development Bank of Canada, 2019) https://www.bdc.ca/en/about/sme_research/pages/investment-intentions-canadian-entrepreneurs-outlook-2019.aspx.

4 How to deal with common issues in integrating two businesses

Integration issues primarily stem from the challenges of merging two companies' HR, business cultures, IT systems, management and operational processes. The following sections provide advice on how to resolve common problems.[4]

Retaining key workers

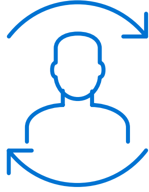
The fear of job losses and insecurities regarding other changes will affect staff morale. Unless you address these fears, key personnel will leave or performance will suffer. If staff layoffs are planned, be objective when identifying redundancies and the most-qualified candidates. You may want to set up a formal review committee to go over performance evaluations and personnel files. Representation from the seller's side would improve the committee's decision-making ability, as the seller is more familiar with his or her staff. Remember to be transparent, and to communicate early and frequently.

Merging employee benefit and retirement plans will likely be another challenge. Changes to benefit plans could include terminating, freezing or merging existing plans, or transitioning to a completely new plan. These plans are important components of compensation, and changes or insecurity about potential modifications can have a material impact on morale. Again, good communication is key to addressing these issues.

Customer retention

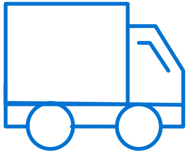
Take steps to retain the seller's customer base. This could include meeting with key clients personally or engaging with them through other channels. At the very least, you should send out letters thanking customers for their business, introducing the new management team and explaining your plans for the new entity. Take time to explain your post-acquisition value proposition. For example, let your customers know that the acquisition will result in lower costs or better-quality products.

4 The approach to integration issues described in this section is based on the approach described in Andrew Sherman, *Mergers and Acquisitions: From A to Z*, fourth edition (New York: American Management Society, 2011).



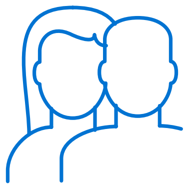
Facilities and relocation

Rent and lease payments are large expenses and, therefore, prime targets for efficiencies. Nevertheless, when making decisions about workspace, try to keep the human component in mind. For example, if you are considering relocating employees, think about the impact on their commute and on staff interaction, as well as the facilities needed to serve clients well. Relocation can affect overall integration and can lead to significant turnover, if not adequately managed.



Supplier risk

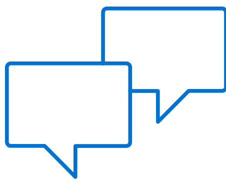
Ideally, you should have identified any risks or issues related to the seller's suppliers during due diligence. That said, you may face integration issues if the seller depends on a limited number of suppliers, or if a supplier is an integral part of a just-in-time inventory system. Terminating a supplier contract under these circumstances could cause significant disruption. Be sure to think about short- and long-term impacts before terminating any vendor relationships.



Corporate culture

Companies with different cultures find it difficult, if not often impossible, to make decisions quickly or to operate effectively together.[5] Here are tips for resolving cultural differences in the context of a business acquisition.

- Recognize cultural fit as an important issue that needs to be addressed.
- Give preference to targets that have a similar culture to your company.
- Identify senior managers responsible for integrating business cultures. You may also want to bring in outside assistance to identify and resolve cultural differences—people within a business often find their culture challenging to recognize.
- Set tangible and measurable goals for cultural integration. For example, you can measure how well you have integrated two sales forces by measuring how often they are selling the other company's products.
- Consider the strengths and weaknesses of each culture. Try to retain the best of both existing cultures.
- Build a brand that is attractive to both sets of employees in terms of career opportunities, rewards and a sense of identity.



Communication is critical

Communicate early and often. You may also want to set up a post-merger taskforce to help disseminate information and manage integration issues. The taskforce's mandate would include uncovering, evaluating and resolving post-merger problems. It would also act as a conduit from labour to management to communicate and resolve issues proactively.

5 "Cultural Issues in Mergers and Acquisitions," Deloitte, accessed February 2, 2019, https://www2.deloitte.com/content/dam/Deloitte/us/Documents/mergers-acqisitions/us-ma-consulting-cultural-issues-in-ma-010710.pdf.

Patrick Hagarty

Team Lead, Solutions Development, High Impact Firms at BDC

Post-merger integration: A key tool to integrate two businesses

Most businesses do not have a formal process to integrate both companies following an acquisition, according to Patrick Hagarty, Team Lead, Solutions Development, High Impact Firms at BDC. “They’ll do the acquisition, they’re hoping for the best, but there’s no formal process to integrate both companies.”

A formal post-merger integration (PMI) process can help you obtain the full benefits of a deal. It will allow you to establish the objectives for the acquisition and then put a project management structure in place to ensure the two businesses are properly integrated.

“It’s basically figuring out, ‘What am I going to do? Which parts of the business am I integrating? What is critical? What is the timeline and proper sequencing?’—and then acting on that,” Hagarty says. “It’s a full-time job.”

Three elements are key to a successful PMI process

1 Establish a PMI team

One of the first steps, maybe even before you close the deal, is to identify a core team of people from both companies to lead the integration process.

“Very rapidly you want to figure out who you keep on board, who are your champions and make sure you settle them down so they can be part of the process,” Hagarty says.

The team should build and execute an integration blueprint to achieve your operational objectives.

2 Develop a target operating model

Next, you should assess what needs to be integrated and how, function by function. Hagarty says this will help you focus on the most critical elements of the process for the first 100 days.

When two companies are looking to integrate their accounting systems, for instance, one company might be using a basic accounting module, while the other uses a fully developed enterprise resource planning (ERP) system. Management has to decide what system to use and who gets to lead the integration. The team also needs to understand the impact of those decisions on other departments in the business.

“All of that happens under a clear understanding of what’s the operating model that we are trying to envision,” Hagarty says. “What’s the end state? How’s it going to look?”

3 Communicate the plan to key stakeholders

Any acquisition will create disruptions in the target company and in your business, but you can take steps to ease the transition and decrease uncertainty.

“Designing the organizational structure and communicating that plan quickly to your champion people will help you retain key team members,” Hagarty says. “Change management and communicating to people about what’s going on is one of the things that needs to be well done.”

5 Business acquisitions: It takes a while to get good

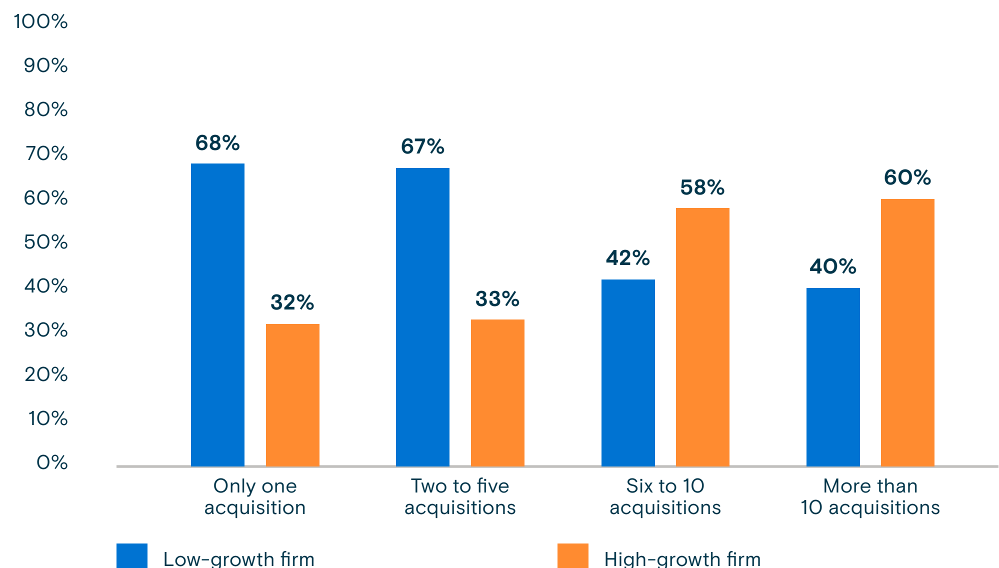
Companies that have completed more than five acquisitions were more likely to be high-growth firms.

We looked into whether the buyer's level of experience with business acquisitions is a key success factor. Specifically, we analyzed the relationship between the number of business acquisitions a company had completed during the last 10 years and that company's revenue growth three years after its most recent acquisition.

As expected, there is a link between a firm's level of experience with business acquisitions and the probability of success. However, experience only matters after a critical mass of acquisitions. As shown in Figure 11, a firm is only more likely to be a higher growth company after it has completed more than five business acquisitions.

This indicates that firms face a long learning curve before getting acquisitions right. That said, other results presented in this report show that a more comprehensive and structured approach to acquisitions can help reduce that learning curve.

Figure 11 – Number of business acquisitions completed and revenue growth



Source: BDC, Survey on Business Acquisitions, 2018. Sub-sample of companies that completed acquisitions; unweighted; base n = 304.

> "Now, we would know how to do the due diligence, but the first time around, we should have sought some professional help"

Case study

Paradise Island Foods

Cheese entrepreneurs reap tasty growth from well-planned acquisition

After some initial bumps, Len and Kevin Thomson's business purchase is paying big dividends

Len and Kevin Thomson thought they'd made the perfect acquisition when they bought Bothwell Cheese.

The brothers already owned Paradise Island Foods, a thriving business on Vancouver Island that packages and wholesales cheese for sale in B.C. grocery stores, restaurants and other commercial establishments.

In Bothwell, they were buying a cheesemaker with a national brand and reputation for quality. What's more, the company had capacity in its New Bothwell, Manitoba, factory to meet all of its own and Paradise Island Foods' needs, with lots of room for future growth.

"The plan was all based on scaling up Bothwell's production, developing the Bothwell brand and supplying Paradise Island Foods," Len, 50, says.

They secured financing from BDC and another lender, beat out two competing bidders, and closed the deal in 2010. It wasn't until they started to gear up production at Bothwell that the surprises began.

Major investments were required

"We found we'd bought an old car," Kevin, 49, says with a laugh.

"Tired iron," Len adds. "We scaled up very quickly, and we very quickly learned the equipment in place was not going to keep up to the volume we wanted to produce."

The brothers had to make major investments to refurbish and upgrade the plant and its equipment. The previous ownership group's focus had been on generating profits rather than on upgrading the plant.

The Thomsons don't fault the decisions of the former owners. Instead, they blame themselves for not doing enough due diligence on the factory. "Now, we would know how to do the due diligence, but the first time around, we should have sought some professional help," Kevin says.

Brothers followed a structured approach

Despite the due diligence misstep, the Thomson brothers avoided many common pitfalls.

They were well prepared financially. They'd diligently paid off the debt from buying Paradise Island Foods from their father and were ready to face the unforeseen investments that cropped up after they bought Bothwell.

They made another good move when they kept Bothwell's CEO on board during a four-year transition period to help them learn the business. Kevin is now Bothwell's President, while Len is President of Paradise Island Foods in Nanaimo.

After the purchase, they focused on gaining the support of Bothwell's employees for their growth plans and creating a family atmosphere in the business like the one they had in Nanaimo.

The acquisition turned out to be an outstanding success. Growth at the companies—which together have about 215 employees—has been over 20% a year since the acquisition.

Conclusion

The key to a successful business acquisition is a well-structured process.

Acquisitions are a key driver of growth

Our study found that most SMEs acquire other businesses to grow. Using our survey data and statistical analysis, we were able to demonstrate that it is, in fact, a viable growth strategy. Specifically, our survey data show that the revenue growth of firms that acquired other businesses outpaced that of firms that did not.

The key to a successful business acquisition is a well-structured process. Using our survey data and statistical analysis, we were able to show that a business with a well-structured acquisition process was 94% more likely to be a high-growth firm three years after the acquisition than firms that did not follow a structured process.

We identified a number of common gaps in the planning process for a business acquisition. For example, less than half of SMEs that acquired another business set up an internal or external team to carry out the purchase. Further, 41% did not have a plan defining objectives for their acquisition.

Finally, we found that, although experience with acquisitions matters, the learning curve is long. Entrepreneurs seeking to buy another business can reduce that learning curve by ensuring the acquisition process is well structured.

Annex A: Methodology

The BDC Research and Economic Analysis team developed an online and telephone survey to gather primary data on the issues affecting SME business acquisitions in Canada. The survey, conducted by BPI Research, gathered information on 1,038 firms, including some that had completed a business acquisition or that had tried to do so in the last 10 years. The survey was carried out between October 22 and November 9, 2018. We also conducted in-depth telephone interviews with entrepreneurs to gather more qualitative information, and reviewed previous studies and reports on business acquisitions in Canada.

This study uses a series of multinomial logistic regressions to analyze the impact of a business acquisition on a company's revenue growth. Each regression is described in the sub-sections below.

Revenue growth and business acquisitions

The goal of this regression is to test the hypothesis that a business that has acquired another business in the last 10 years is more likely to be a higher revenue growth company. The regression results isolate the impact of having completed an acquisition, controlling for other factors, including the company's past revenue performance, size (measured by revenue and employee count), the industry or region in which it operates, and the number of years it has been in business. The regression equations show that the variable of interest—completion of at least one business acquisition—is a statistically significant predictor of revenue growth in the three years following the acquisition, with a p-value equal to 4%.

Revenue growth and a business acquisition's structure

The goal of this regression is to test the hypothesis that a more structured acquisition results in higher revenue growth. To test this hypothesis, we developed an index to measure the extent to which a business acquisition was structured. The index uses information from our survey on whether entrepreneurs implemented specific steps before, during and after their business acquisition. Firms were awarded one point for each step they implemented. The index score for a firm corresponds to the number of steps it implemented. Table 2 summarizes each step included in our index.

Table 2 – Steps in a structured acquisition process

Pre-acquisition phase	Acquisition phase	Integration phase
Preparing a strategic growth plan and defining the objectives of the acquisition	Securing financing before approaching the seller	Establishing the integration objectives and synergies before preparing an integration plan
Conducting a market review to gather information on potential companies to buy	Preparing a letter of intent and confidentiality agreement	Preparing and implementing an integration plan
Seeking external help (from accountants, lawyers or other experts)	Conducting in-depth due diligence on the acquisition candidate	Integrating key systems and processes, such as those for IT, payroll or accounting
Appointing an internal and external team to help with the acquisition	Negotiating the price and terms of the agreement	Trying to retain key employees and merging business cultures
		Trying to retain key clients and suppliers

The regression results isolate the impact of a structured business acquisition, controlling for other factors, including the company's past revenue performance, size (measured by revenue and employee count), the industry or region in which it operates, and the number of years it has been in business. The regression equations show that the variable of interest—a structured acquisition process—is a statistically significant predictor of revenue growth in the three years following the acquisition, with a p-value equal to 3%.

Annex B: Econometric results

Table 3 – Business acquisition structure and revenue growth

Variable of interest[1]	Multivariate odds ratio (95% CIs)[2]	p-value[3]
Structured process[4]		
Non-structured process (reference)	–	–
Structured process	1.94 (1.05-3.58)	0.0337

Notes

1 The logit regression model uses data from the 315 firms in the sample that had completed a merger or acquisition in the last 10 years. High growth was defined as average annual revenue growth of 10% or more in the three years following the most recent merger or acquisition.
2 An odds ratio greater than 1 indicates that the odds of experiencing high revenue growth (> 10%) in the three years following a merger or acquisition increase when a firm implements a structured process. 95% confidence intervals (CI) were estimated using robust standard errors.
3 P-values were estimated using robust standard errors.
4 "Structured process" was defined as a score on the structured process index greater than or equal to the median structured process index score. The structured process index ranges between 0 and 13. A score of 0 indicates that the firm did not report implementing any of the 13 acquisition steps presented in Table 2, and a score of 13 indicates that the firm reported implementing all 13 acquisition steps.

Table 4 – Business acquisitions and revenue growth

Variable of interest[1]	Multivariate odds ratio (95% CIs)[2]	p-value[3]
Merger and acquisition experience[4]		
Involved in one or no business acquisitions during the last 10 years (reference)	–	–
Involved in more than one business acquisition during the past 10 years	1.66 (1.02-2.68)	0.0399

Notes

1 The logit regression model uses data from the 315 firms in the sample that had completed a merger or acquisition in the last 10 years. High growth was defined as average annual revenue growth of 10% or more in the three years following the most recent merger or acquisition.
2 An odds ratio greater than 1 indicates that the odds of having revenue growth of at least 5% were higher than those for the reference group. 95% CIs were estimated using robust standard errors.
3 P-values were estimated using robust standard errors.
4 Experience includes both successful and failed merger and acquisition attempts during the last 10 years.

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