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INVESTMENT BANKING

To Buy or Not To Buy?

There is a growing trend among the users of staffing services to fill all of their needs, from traditional temporary employees to professional specialists like accountants and information systems consultants, through a single provider. Some industry analysts speculate that the companies that will remain on top of this trend will be those that add to their range of services through acquisitions.

In the last few years, the staffing industry has experienced tremendous consolidation. The trend toward using full-service vendors has been one of the drivers behind this consolidation. Mergers and acquisitions within the industry have occurred at an unprecedented pace and have made some of the biggest headlines in industry publications. As a result of the recent consolidation activities, there seems to be a widening gap between the small companies and the large companies. Faced with the possibility of being among those that are unable to bridge this gap, the owners of independent staffing companies are evaluating their opportunities for growth. Assuming a company has adequate management and financial resources to pursue acquisitions, the logical question on almost any potential acquirer's mind is, "Should I continue to grow internally, or should I grow through acquisitions as well?"

This subject has sparked some lively debates at recent industry gatherings. Not only do people have differing opinions on the best way to achieve growth, but they also appear to have *strong* opinions. Unfortunately, one bad experience can spoil an individual's outlook on acquisitions. But, if successful, a company can achieve significant growth by augmenting internal expansion with acquisitions.

Why do acquisitions fail? The most common reasons include failing to effectively integrate the acquired business and conducting insufficient due diligence. While it is easy to want to hold the seller responsible for an unsuccessful acquisition, the aforementioned obligations reside with the buying company.

In the acquisition arena, integration is key. The same care should be given to an acquired operation as would be given to, say, an adopted child. The newly acquired company cannot be neglected and be expected to continue to perform successfully. The management of the buying company must be committed to supporting and expanding upon the accomplishments of the acquired company.

In a services industry, a business' primary assets are its people. Therefore, it is no surprise that the cultural "fit" between the selling and acquiring companies is important. Integrating the cultures of the two businesses may be the biggest challenge in an acquisition. Culture is one of the few aspects of the acquired company that a buyer cannot easily change. Therefore, it should be examined carefully before moving forward with an acquisition.

Not just culture, but every aspect of a company should be thoroughly investigated before a buyer makes an acquisition. The research conducted by the buyer prior to consummating a transaction is known as due diligence. The due diligence review includes a thorough legal, financial, and operational examination of the target company. Among the items that should be investigated and well-understood prior to making an acquisition are the company's operating trends, competitive position, operational data, management, legal status, and financial stability.

One of the most common questions a buyer considers when contemplating an acquisition is, "Will the business continue to generate the earnings it has generated in the past?" In reality the responsibility for ensuring that the earnings continue ultimately falls to the buyer. The buyer must make a commitment to either independently manage the acquired business or to integrate the business so that it can continue to generate the same level or a greater level of profits. Ideally, the combined company will experience greater operating efficiency. In addition, any new service offerings brought about through the merger can be expanded across the companies' combined customer base and immediately allow for further growth opportunities. Therefore, in theory the answer to this question should always be, "absolutely!"

Regardless of what may be motivating a buyer to make an acquisition, a seller should be rewarded for every bit of value he or she has created up to the point of the acquisition. They should not be penalized because a buyer is uncertain about its own ability to sustain the company's operations following the acquisition. For the buyer, when the transaction closes the work involved in making a successful acquisition has just begun.

Aside from the legal protection provided for in the purchase agreement, it is possible to structure a transaction such a way that minimizes the earnings risk assumed by the buyer. The most common method for addressing earnings risk is to include an earn-out in the purchase price. While a buyer can tie a seller in to the future growth of the company through payments contingent on future growth, the buying company should be proactive in ensuring such growth. In order for an earn-out to be viewed as a real incentive, however, it should provide for significant upside, above and beyond the initial consideration paid for the company. But, it should not be paid *in lieu* of a fair up-front cash purchase price because, again, the seller deserves to be rewarded for their historical success.

It is not practical to believe that the seller should be penalized for or bear the majority of the risk in a transaction. And, unfortunately, the risk associated with making an acquisition cannot be entirely eliminated through restrictive purchase terms. Ultimately, the buying company's management must have confidence in its own ability to continue the success and growth of the acquired company. At the end of the day, this confidence should be the deciding factor in whether or not a company should include acquisitions in its growth strategy.