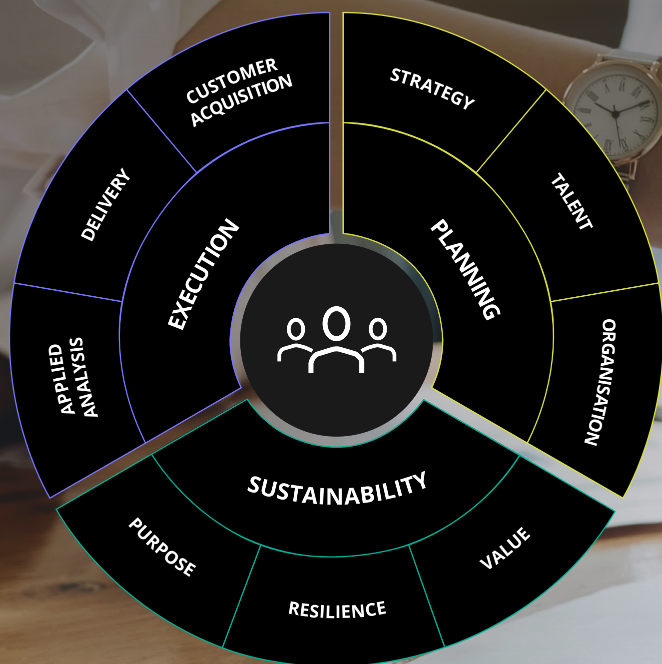
frog capital

Scale-Up Toolkits



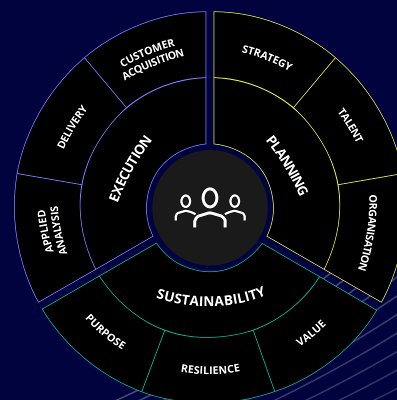
Growth company M&A toolkit

This toolkit includes:

- Criteria that make value creation from acquisition more likely.
- Addressing capacity constraints
- Clarity of vision for combined businesses
- Well-executed acquisition decision tree

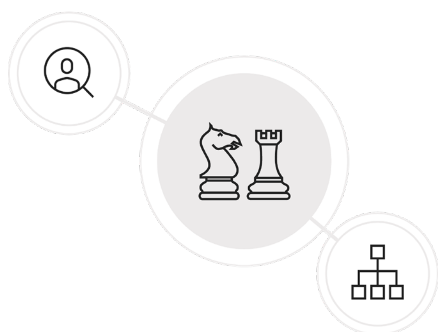
www.frogcapital.com/scale-up-methodology

Introduction



Accelerating your growth story through acquisition, particularly when company valuations have fallen and organic growth is harder in recession, sounds like an irresistible option.

There are many well documented stories of this strategy being successful. One of Frog's portfolio company founders, **Michael Kent** of **Azimo**, has been through exactly this experience. See his comments below. *



In this toolkit we set out the criteria that make value creation from acquisition more likely.

Be aware though that the history of corporate acquisition is generally a sorry tale driven by empire building and personal aggrandisement which has led to disappointment and occasionally huge value loss; various academic studies have suggested up to 70% of corporate acquisitions do not create any value at all, the Harvard Review suggested it could be as high as 90%. If you don't meet most of the criteria below, you should therefore resist the temptation.

Having been both on the acquiror side, with two acquisitive listed companies, and selling two VC backed companies to acquirors as a CFO, I can provide some lessons learnt from both principal perspectives.

About the author

Steven Dunne,
Frog Senior Partner

Steven is a Senior Partner, CFO and Head of Portfolio of Frog Capital, with over 20 years of PE experience gained both within PE firms, and as a senior executive of PE backed companies.

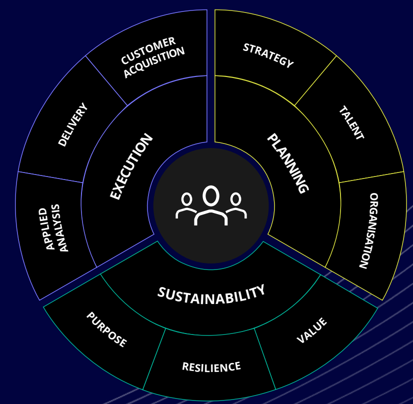
Steven spent eight years as a CFO in two VC/PE backed businesses, both successfully exited. In addition to his operational experience, Steven spent four years as a portfolio director at Livingbridge.

As Head of Portfolio, Steven is responsible for overseeing the portfolio, working with the investment team and leading Frog's Operating Partner programme focused on adding value across the portfolio.

* Michael Kent, Azimo

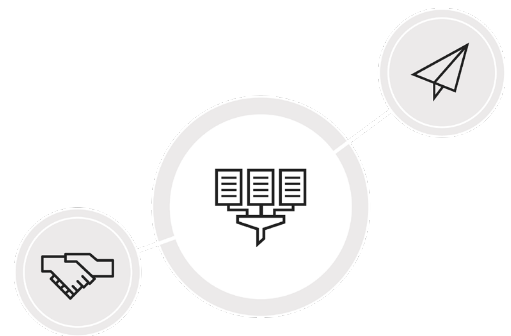
"M&A can be a huge source of value creation especially in volatile market conditions but it's also a high stakes game using a skillset that many entrepreneurs don't have. We found that success depends on a very clear deal rationale, working with great advisors (both formal and informal) and always thinking beyond the completion to how the combined group will come together.
M&A like everything else comes down to planning, people and culture."

Criteria for successful acquisition



1 Value creation driver

The first essential question is why are you pursuing the acquisition? If it is anything other than accelerating long term value creation you should probably stop here. The route to that value creation might be expanding geographically or through adding new products and services or even IP and technical skills but don't confuse the means with the real objective, which is delivered over time not by completing the acquisition.



2 Buy v build analysis

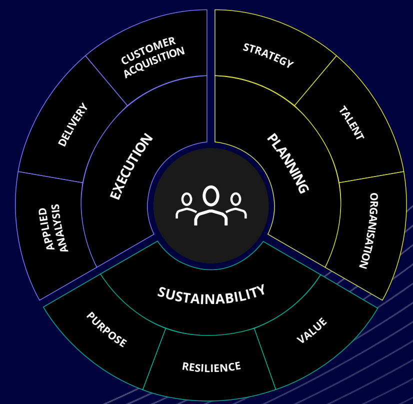
Once you have established the means by which you think the acquisition creates value, the next question is why can't you achieve that yourself? The answer may often be time and resources but then you need to consider the time and resources going into an acquisition and how they could be deployed internally. This analysis will give insight into what makes the acquisition target valuable to you and as a minimum it should put a limit on how much you are prepared to pay for the acquisition before taking the view that deploying the same resources internally could be seen to deliver at least as good a result but with less risk.

3 Purpose, values and cultural fit at all levels

Why is an acquisition riskier than building it yourself? The answer is simple, people. Even if you are buying a company purely for its technology, you will still need to engage with key personnel in the other organisation to make the most of it and you need them to want to engage with you. In any other situation, almost all the value creation depends on a good integration of the two workforces and maintaining the reasons why the acquired company was delivering well in the first place, those things you identified you couldn't build yourself.

Failing to create a clear combined purpose and values or missing cultural mismatches are common reasons for post transaction staff turnover and acquisition failure. This need goes well beyond trite assessments of senior teams getting along in transaction meetings and requires a serious attempt to understand the culture and values of the target organisation at all levels; it also assumes you know your own culture to the same depth.

Addressing capacity constraints



Growth companies are usually struggling to invest fast enough in their organisational infrastructure to cope with the stretching demands of their own growth, but then on top of this, acquisitions require spare capacity to allow business as usual to progress unaffected. If, for example, you don't have the second layer of management in place to allow the CEO and CFO to be focused elsewhere for a few months, then the post transaction phase will be spent getting the original business back on track and all the great opportunities from integration synergies (both revenue and cost) will disappear.

The capacity requirement is not a short-term issue but covers multiple phases:

1. **to cope with senior resource deal distraction for due diligence and negotiations and relationship building with the target team**
2. **to integrate the immediate increased requirements of people, systems, funding e.g. working capital.**
3. **Spending quality time to create an agreed integration plan that both sides engage with.**

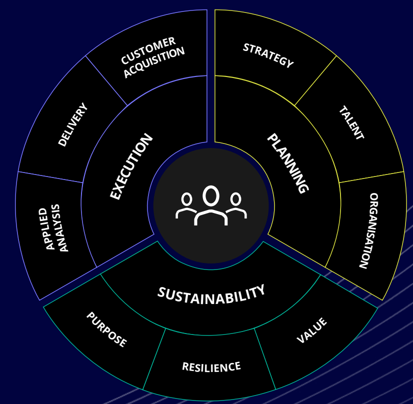
Its erroneous to think a few people can work ridiculous hours for a few weeks to get through the transaction bottleneck and then everything will be OK. Completing the transaction is not the objective, creating sustainable long-term value is. That takes an investment of time and energy over a longer period of time but also requires good relationships to be effective.

If you rush to complete a transaction without building relationships and alignment that will support the combined management team deliver the long-term objectives, then the chances of success are much slimmer.

The bottom line here is that you cannot buy in transaction consultancy skills to fix this capacity constraint as they will only be there for the short-term, and it is not just a short-term problem. If you have no spare management capacity in your existing business the chances of extracting value creation from an M&A strategy are minimal. You therefore need to define internally:

1. **The time & resources needed to source and execute such an acquisition**
2. **Who will lead which workstream?**
3. **What external advice will you require?**
4. **What are you expecting to learn and what are you planning to do if you find something unexpected?**
5. **What red flags would lead to walking away from the deal: Important to define these upfront to avoid deal fever influencing downplaying the importance of negative findings**
6. **Where are the go/no go gateway meetings and who attends?**
7. **What resources are required for successful integration and who will be leading these plans (ideally a group comprising people from both sides)?**

Clarity of vision



Clarity of vision for combined business including organisation structure and management roles

A clear external vision for the combined company in the marketplace is important but the combined business needs to go beyond that and also have an internal narrative of how that will be delivered. This requires clarity on organisational structure across the combined business and most importantly, clarity of roles. Often this is fudged to provide as much management continuity as possible on both sides but in my experience that is a mistake. People on both sides of the acquisition realise things will eventually need to change and if you compromise you stretch out the transition phase and make it less effective by creating muddled reporting lines and uncertainty on outcome.

Generally, I think it is better to avoid compromises and agree the hard decisions on people upfront. Providing a transition phase in a controlled manner is more effective when everyone is certain about what the end picture looks like and committed to getting there.

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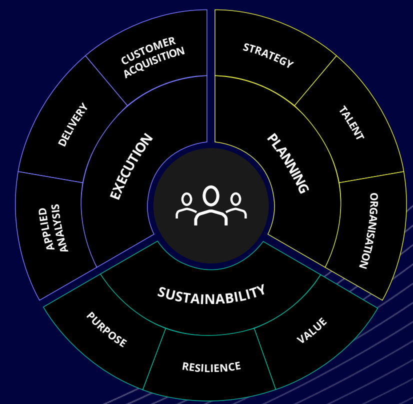
05 Summary



Well executed acquisitions can significantly improve the value creation of your company.
To give yourself the best chance of succeeding you should follow the decision tree:

Can you simply articulate how the acquisition will drive value creation?

Decision — NO → Rethink the decision to acquire

YES ↓

Is the objective more effectively achieved through acquisition rather than organically?

Decision — NO → Rethink the decision to acquire

YES ↓

Is there business alignment in:
a) Purpose; b) Values and c) Cultural fit at all levels

Decision — NO → Rethink the decision to acquire

YES ↓

Do you have the capacity to undertake this transaction and integration without impacting on the core business?

Decision — NO → Rethink the decision to acquire

YES ↓

Is there clarity of vision for the combined business including organisation structure and management roles?

Decision — NO → Rethink the decision to acquire

YES ↓

Complete a detailed implementation and integration plan incl. integration team defined responsibilities and work streams and capacity to execute

↓

PROCEED

Rethink the decision to acquire

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See more at www.frogcapital.com/scale-up-methodology

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