BUY VERSUS BUILD – A PRACTICAL GUIDE TO INORGANIC STRATEGY

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Executive Summary

According to Statistica, the value of global merger and acquisition (M&A) deals amounted to $3.4 trillion in U.S. dollars in 2022, representing nearly 50,000 transactions, and that was a down year. What's driving all that activity, and is it a productive way to grow a business? Why are there so many that seem to either fail or struggle to bring the value that drove the transaction in the first place? What goes wrong? We give you our view of the answers to those questions in this paper.

American business today is based largely on quarterly earnings and a very short time horizon. A year is a long time, two years is an eternity, and anything beyond that is the far distant future and not really considered by many. It's possible for acquisitions to enable a fast and "easy" way to grow; therefore, they're popular. And of course, an exit for the investors in the acquired company is sometimes highly desirable. However, while growing a business by way of acquisition(s) may seem like the most expeditious path forward, it can be fraught with danger, in too many cases leading to selling what was acquired just a few years later, often at a discounted price and only after the culture of the acquired company has been significantly compromised.

Good acquisition strategy should be a part of a broader, longer term growth strategy, meaning after completing a thorough strategic planning process (see The Basics of Strategy – Planning to Succeed), it's been determined that acquisition will lead to a better strategic outcome than moving forward through organic means only. Some of the key reasons companies come to this conclusion include:

- Faster top line revenue growth
- Access to intellectual property
- An established (attractive, strategic) business
- A competitive advantage
- Access to a new customer base
- Growth potential (with investment, structure, etc.)
- Product/service/business model synergies

Note that this white paper is geared toward technology companies, with emphasis on software.

Introduction/Background

Clearly, acquisitions are a viable path in many circumstances, even with some inherent risk.

If done well, acquisitions can provide access to key intellectual property, enable a faster route to market, give the acquirer a competitive advantage, broaden the customer base and, ideally, provide the opportunity for revenue growth that goes beyond what each company could have accomplished on their own.

For private equity firms, where their holdings may or may not be synergistic with each other, acquisitions can provide access to new businesses with growth potential. In these cases, it's typically a matter of investment and process that can take the acquired company to the next level of performance, at which point the option of selling at a significant multiple a few years later can provide an attractive scenario for all parties concerned.

The Problem to Solve

Acquisitions, while offering significant growth opportunities, carry substantial risk if not managed carefully. Common pitfalls include cultural mismatches, disruption in the acquired company's operations and failure to realize the anticipated synergies. These challenges can lead to diminished employee morale, a drop in productivity, or even the loss of key personnel, which ultimately impacts the success of the acquisition. The two most common reasons for potential failure, or at least suboptimization of potential value creation, are poor cultural fit and suboptimal integration execution.

Culture

Cultural fit needs to be carefully analyzed and curated, because without a good cultural fit, nothing else works well. If the culture is lost, the leadership team of the acquired company leaves, the top performers within the company are much more likely to depart, company performance is disrupted, and customers become impacted in a way that prompts them to choose a competitor. All of this erodes the reasons the company was acquired in the first place. This outflow of talent and dismantling of the culture and fundamental reasons for success need to be avoided if the financial benefit is to be realized.

Most acquisitions consist of a larger company buying a smaller company, with the smaller company often being a startup. The acquiring company is typically successful and has been in the market for a while and will have its own culture. Usually, the acquiring company has an experienced senior leadership team, a particular management style, well documented and mature processes and ways of doing business; and the team usually has a fair amount of confidence (perhaps arrogance) in how it functions, often justifiably so, since they are successful and driving the deal.

The company being acquired is often scrappy, with a passionate and motivated team, which succeeded by sheer willpower and an intimate understanding of their customers and business. The type of person who is attracted to working in a startup is not only comfortable with but may prefer a little chaos in their lives; they like to move quickly, make decisions, meet customers' needs, change fast, and innovate. It's exciting and there is a certain amount of adrenaline that goes into the long hours and late-night pizza and beer working sessions; they're just plain fun. "Different personalities" are much more likely to be accommodated and they will thrive in the creative and fast-moving environment. Business processes, documentation, HR process, and tech infrastructure can all be less than optimal, leading to tech debt and a foundation that might not be as solid as one might like.

The founders of startups are usually passionate and charismatic, leading a small team through the unknown, making things work even when not optimal, and generally leading through their personalities. Founders are not usually suited for large companies and the company politics that inevitably come with them; and they sometimes don't fit in well with structure. They often move on post-acquisition, leaving a gap for the team that was energized by their passion.

Suddenly, these two very different cultures are merged through acquisition, and the senior leadership team from the big company is responsible for integrating that "crazy" small company. The first thing to become uniform is HR; benefits, the employee handbook, salaries and titles all have to comply and be equitable. Rarely is this easy, and there are bound to be differences that will cause anxiety. The org chart has to be figured out, and often there are overlapping leaders for the same functional area. The big company will often take the lead, which can cause resentment and disruption as the teams are merged.

Given all these factors, there is only one way to preserve culture, and that is to leave the acquired company alone. If everything remains pretty much the same, and they continue to operate as usual,

then the culture is preserved. But this is not usually practical, for the above reasons, and because there is usually a need to integrate products and customers to get the intended strategic value. So leaving the company completely independent is not really an option in most scenarios.

So if integration is necessary, then how does one go about doing it with as little negative cultural impact as possible? We will talk about the pitfalls of integrating and how easy it is to fail in the next section, but from a cultural point of view, there are a few things that can be done to greatly reduce the risk of destroying that small team culture.

First, don't be arrogant. Accommodate those somewhat different people, let the teams that are in place exist within a broader team setting, don't micromanage, and recognize the value of different opinions. Maybe even take some of the creativity and need for speed and apply it to your own processes; it doesn't hurt to throw a little creativity into those well-established but usually slow-moving existing processes.

Second, let the founders and key leaders have a voice in the overall direction of the new company. This can be difficult, but if they participate in decisions and strategy, understand the tradeoffs that are being made, and communicate these back to their team, the team is much more likely to trust the new leadership and the direction the company is taking. It's the founders' passion after all that they have been following. And, those founders just might have a valuable perspective.

Third, keep it interesting. Allow opportunities for creativity, quick decisions, and impact. People become disenfranchised when they don't feel they are heard, when they are bored, or when they think what they are doing is not bringing value. Job satisfaction comes from the mission, building something unique, having fun, and being challenged. Most people get a lot of satisfaction from being part of a well-run team that works together collaboratively and has an articulated set of common objectives.

Finally, be transparent and honest. These two things are sometimes very much neglected in business today. Treat your employees like adults, give them all the information, good or bad, and enable them to come to their own conclusions on the practicality of the vision and strategy, based on their own critical thought. Far too often, the senior leadership team does not trust the rest of the company to handle the ups and downs that are always present. But in most startups, that is exactly what they have been exposed to, and like to know. Don't underestimate what the truth can do to build trust. If you're honest with your people, and they know exactly why you are doing what you are doing, they will be much more likely to follow you.

Integration

Once the decision to acquire a company has been made, the acquisition team has been assembled, the due diligence work has been completed and the acquisition has taken place, execution of the integration plan can begin. During integration, there are several key success factors to consider. Having addressed culture and people above, we'll address technology, products and market integration here. Integrating a company and its product(s) is deceptively difficult, and rarely done well.

There are many functional areas that require skill and effort to appropriately integrate, and each comes with its particular challenges. This list has some of the major areas to be addressed, but it is certainly not everything to consider.

Strategy and future direction

We will address this topic more fully in the next section of this paper, but at a high level, setting a cohesive and well-articulated strategy that is easily understood by your customers, your employees, and the market in general is critical. It's crucial to ask why the acquisition makes sense from the customer's perspective. If you can clearly answer that question, the rest of the strategy falls in place relatively easily. If not, then it is much more difficult to bring all the pieces together in a productive way. We provide a strategic framework in the next section that helps define how to do this.

Product and product development process

There is usually a need to combine two or more products into a single product, platform, or user interface. If this is the case, then quite a bit of thought and effort will be necessary to plan and build the new offering. How the products function together, what the underlying technology and platform will be, and how the customer experience is expected to be enhanced with the new offering are all key questions.

This is often answered at a conceptual level, but not in enough granular detail to truly understand the impact, in particular to end users. There is often a long list of needed product enhancements and customer requests from both companies, based on existing functionality. Adding new functionality and combining products can often mean suboptimizing those enhancements due to limited resources, which can mean that a customer is actually getting less than expected, leading to attrition and revenue loss.

Bringing together the product development teams and customer support teams to understand the voice of the customer and create a joint product development plan is crucial. Ideally, the two companies have similar development methods, but if not, those must first be reconciled, with one being chosen. The long-term strategic goals must also be clearly understood, while at the same time considering the short-term product improvement needs and what will add value for customers immediately.

Technical infrastructure

Combining software products can be very challenging if they have been built on different technologies. The technical aspect of product integration is well beyond the scope of this paper; however we address it here because it is critical to both internal efficiency and creating customer value. Sharing data, creating common reporting, training and supporting customers, and troubleshooting technical issues all hinge on a sustainable and supportable common platform.

It is expensive and time consuming to change the underlying technology of any software product. This cost should be taken into consideration in the financial/business case for the acquisition. Often, it is assumed that there will be efficiencies through staff reduction or other redundancy elimination, but the technical requirements are not fully understood and wind up being significantly underrepresented. Then, when it comes time to invest, the budget is not there. Part of the due diligence process needs to include a deep dive into the technical infrastructure to avoid this very common mistake.

Combined value proposition

A good strategic acquisition will strive for the ideal "1+1=3 formula" of providing more value when combined than when products are used separately. A strong value proposition is important for customer retention and maintaining or increasing price. This is also fairly difficult to achieve. Understanding the

business problem being solved and the value to the customer sounds simple, but it is often not fully understood.

The only way to fully understand this is to ask the customer. Direct dialogue and exploration of value with the customer base of each company is vital to truly understanding what will appeal to them, and what they are willing to pay for. A well-articulated return on investment (ROI) that is based on hard data can be one of the strongest tools for the sales team as they cross-sell and attract new prospects. This can be time consuming and it takes a certain skill that is hard to find, but it should not be neglected in the overall process of integration.

Pricing, business model and contracting

Pricing follows closely on the heels of the value proposition. Ideally, the price is supported by an ROI for the customer that is appealing and believable. If this is not the case, it will be difficult to sell at the intended price point. Many products are “nice to have” instead of “need to have”. Solving a critical business problem leads to “need to have” pricing, which provides pricing stability and gives the sales force a quantitative way it can credibly articulate the value of the solution. Note that market research scoped to determine price sensitivity is a valuable way to understand the feasibility of the proposed pricing.

One area that can be overlooked is a common business model, meaning what the pricing metrics are based upon and how they can or can’t be used for the combined product. It’s easy to fall into the trap of one product being based on the number of users for example, while the other was based on the volume of transactions. When combined, it can result in pricing conflict, customer confusion, and difficulty supporting the sales team in selling.

Contracting also often needs to be combined into a single master services agreement (MSA) for all products over time, including legacy customers, which may need to be converted to the new company’s MSA. Support terms and conditions may also need to change. Further, the contract’s duration may be different than the new norm, where for example one MSA is set up for annual renewals, whereas the other is based on a multi-year term. Or it could be that one agreement is more complicated and detailed than the other, in which case the team will need to settle on what’s acceptable for the joint agreement.

Sales process and teams

Combining the sales teams can be a significant challenge. Questions like, “Are both teams selling both products, a combined product, or some mix?” and “How do they get cross-trained and compensated in a fair way?” “Are the customer relationship management (CRM) systems combined, and if so, how do the prospects and sales milestones get converted?” Most CRMs have a fair amount of “dirty data” in them, so cleaning up a large database and combining it can be a huge challenge. This is often overlooked or underestimated during the financial due diligence process, and it’s typically under-resourced.

The sales teams will typically be geographically distributed and will likely have overlap when combined. Reassigning territories and establishing a team that can sell all the products is not a trivial undertaking. There can be considerable disruption to the sales process when a territory is changed, and a new person is now responsible for prospects that were being managed by another salesperson. Compensation can get complicated for legacy deals that get partially attributed to more than one person. And finally, changing salespeople can be disruptive to customers, especially when long-term relationships are in place and the deal close cycle can be many months.

Customer support

In most cases, the main purpose of an acquisition is to increase revenue growth, so preventing customer churn, to the fullest extent possible, needs to be a focus point. If the above functions are not well integrated, the likelihood of losing customers is much higher. A well-thought-out strategy for customer communication is therefore critical. Customers need to know that they will continue to be supported, and that the people they have interacted with will remain engaged.

If a product is to be sunsetted, careful communication with customers and a viable, better alternative must be provided. It is often presumed that the customer will understand what is going on and why, but that is not the case in many scenarios.

If service terms are impacted, that too must be communicated to the customer and changed with care. A strong customer support team will make a big difference in the success of retaining the existing customer base. How the two teams get combined and who they serve is a critical part of the integration and can either lead to happy customers who feel they are getting more than they did prior to the acquisition, or customers being upset that changes are impacting their daily lives in a negative way.

Marketing and go-to-market (GTM) strategy

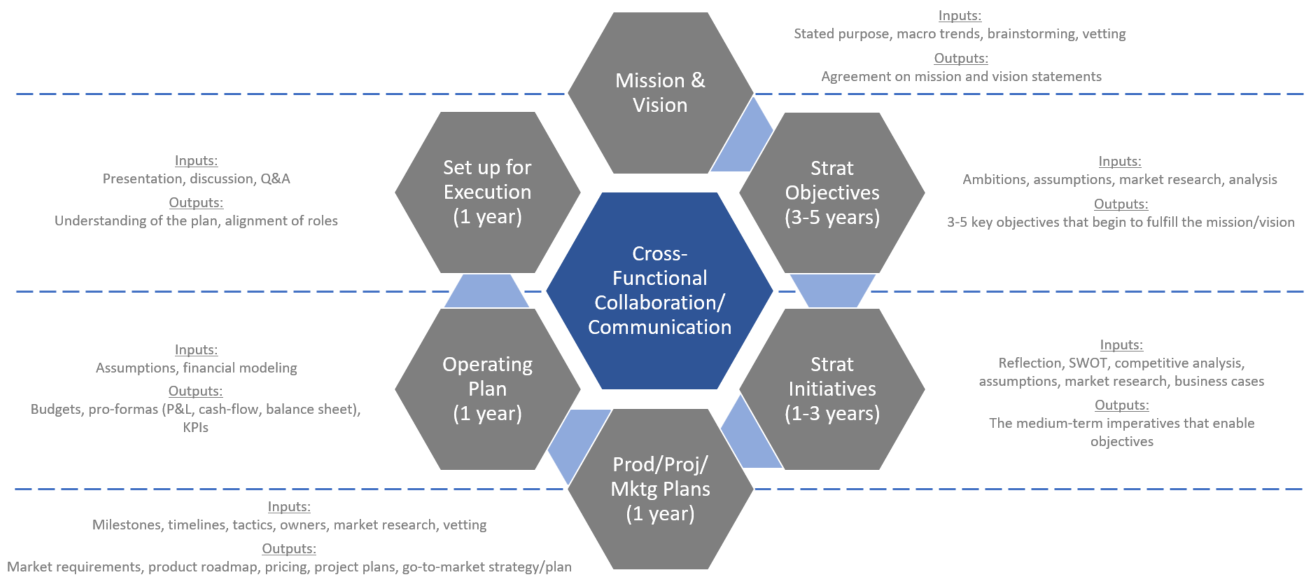
How the value proposition and combined products are communicated in the market post-acquisition is an important element of the overall strategy. To achieve competitive advantage, the market has to understand and value the new combined entity. This is another opportunity to validate assumptions with market research.

A well planned go-to-market (GTM) strategy is necessary and needs to be executed on multiple fronts, including branding and product naming (e.g., does the acquired brand continue to exist?), advertising, digital and social media, web sites, and many other areas. All of this should look seamless to the external market and customers, even though it is usually a complex process behind the scenes.

Additional Considerations

Mapping acquisitions to strategy

As alluded to, the strategy of the business must be determined ahead of any acquisitions. Without that, acquisitions occur haphazardly and often fail. Specifically, there needs to be a strategic reason, or ideally multiple reasons, the acquisition is the right path. This discussion should be thoroughly vetted as the organization is working through its 3 to 5-year strategic objectives and the initiatives that enable those objectives. It's here that the assessment of what the organization is currently capable of should take place, in addition to a look at competitors, market conditions, unmet needs and ultimately, the assembly of a business case that may or may not include the necessity of an acquisition to accomplish the initiative. From a strategic perspective, there are several reasons an acquisition may make sense, which are discussed further in this section.



Intellectual property

Acquiring a company to access its intellectual property (IP) can fast-track innovation, however it's crucial to assess how well the IP integrates with your existing assets and whether it supports your long-term strategic goals. Normally, the decision to pursue an acquisition for the sake of IP comes after an analysis of the options of "buy" or "build." Sometimes, the build option is nearly impossible, for example when the acquisition target has been incrementally building the product or suite of products for years, or even decades. In other cases, the product could feasibly be built, but the IP owned by the company being considered for acquisition has patents that would make it difficult to build an effective, comparably priced substitute.

By way of an example, an organization providing doctors with clinical decision support tools meant to put a framework around organizing their patient orders might consider the acquisition of a company that provides key inputs into those orders, such as a database of trials done throughout the world and the evidence created as a result of those studies. In this case, it may be that the database in question has decades of evidence within it, so much so that it would be extremely difficult to reproduce it.

Faster route-to-market

Acquisitions can dramatically shorten the time it takes to bring products or services to market. Identifying companies with established distribution channels, hard to duplicate products, outstanding brand presence, or complementary customer bases can leverage this advantage.

The example above represents faster route-to-market as well. In this case, if a replicated solution would even be possible, the ability to accelerate the timetable would be a clear advantage, in this case by several years.

Competitive advantage

Acquiring a competitor can remove barriers to market entry or expand market share. It's essential to conduct a thorough competitive analysis to ensure the acquisition will truly enhance your position.

In the case of the example above, it may be that the company being considered for acquisition has a longstanding brand and reputation for the very best evidence in the world, in which case acquiring the company and integrating the order sets framework with the best evidence available would provide an enormous competitive advantage, since in this instance the order sets business is new and relatively unknown, but with co-branding, it would have immediate appeal to customers.

Customer base

As discussed, expanding into new customer segments through acquisitions can fuel growth. Sometimes, the acquired company gains access to channels or new customers via the new parent company, or in other cases the parent company is able to enable expansion of the acquired company from a geographic perspective.

In sticking with the same example, it may be that the company providing its database of evidence has completely penetrated the U.S. hospital market, whereas the acquiring company is just getting started with its order sets product. If products could in some way be combined, made better together, and priced attractively, the entire base of hospitals could be leveraged to sell the joint offering, thus quickly growing revenue overall.

Conclusion

Clearly, there are many reasons to acquire another company, whether faster access to revenue growth, the need for intellectual property, a competitive advantage, access to a new customer base, or product and business model synergies. However, acquisitions, if done right, are not easy and not for the faint of heart. Success, while critical, must take into careful consideration, the following:

- How the acquisition fits into the overall strategy of the business
- The impact the acquisition will have on the culture and people
- What thoughtful integration will truly consist of and what it will cost

There are no easy answers as to how best to execute the perfect acquisition strategy. The key is to go into the process with eyes wide open, including an understanding of the potential pitfalls and a willingness to adapt and invest as needed once things are in process. As a last word of advice, be sure the acquisition and integration teams are experienced, having been through similar processes on multiple occasions. If the teams are relatively inexperienced, consider bringing in consulting partners who can assist with the process and have the knowledge to avoid as many costly mistakes as possible.

If you would like to explore this topic further, please contact the authors:

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