When a Minnow Swallows a Whale: Bigger Can Be Better - And Riskier

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When growing your business by acquisition, it can pay to pick on someone larger - even companies two or three times your size. Buying big can be a quick way to go from being a small player to a market leader. But you don't have to look far to see the risks of this strategy.

Don't Be Dazzled

It's easy to look at a big company and think of its potential as an acquisition: increased revenues, new customers for your existing offerings, new products or services to offer current customers, economies of scale, and higher profits. But don't let the thought of moving up in your industry's food chain allow you to lose track of your priorities.

All too often businesses compromise their strategic goals and acquisition criteria when an attractive target comes on the market. To avoid an acquisition you'll regret, have a strategic plan that outlines where you want your company to be in five years - and stick with it. Review your plan annually and let it drive your internal and external growth, so that you won't be tempted to make an acquisition that doesn't advance your goals.

You also should identify holes in your product or service offering, geographic reach and customer base. Before venturing too far afield - especially if that field is one you don't already know well - work on filling these holes through other means.

Dig Deeper

If you've decided an acquisition - particularly the acquisition of a larger company - fits your company's growth strategy, you should be aware of the risks. All companies sell for a reason, and you need to know what that is for your target. Larger companies, for example, may experience slower growth because they serve mature markets. They may need a new cash infusion to maintain their traditional competitive advantage. Or their product or service offerings may be nearing the end of their lifecycles.

Uncovering these issues requires strenuous due diligence. Make sure you get more than the numbers from this process. Have a thorough understanding of what you'll receive in terms of assets, products and services, operations, and customers. Learn what - if any - business units won't be a good fit with your company's, and if you'll have opportunities to dispose of unwanted units once the sale is completed.

Make a Good Match

Another issue to consider is the possibility of incompatible infrastructures between your smaller company and your larger target. Will the two businesses be able to easily communicate and measure progress? Can their IT systems share data without major technological overhauls? Implementing a new enterprise resource planning system is time-consuming, expensive and initially inefficient, so you'll need to know as early as possible if you'll face this prospect as part of your post acquisition integration.

Another potential challenge of this kind of merger is a culture clash. Does your smaller company have a hard charging entrepreneurial spirit focused on revenue growth? This may not mix well with a larger, established company's maintenance model and slower pace. Entrepreneurial companies are also generally run with less structure, which can seem foreign to employees of large companies that operate from highly structured organization charts and well-defined positions.

If you let one of the merged organizations impose its philosophy on the other, it can result in a permanent and counterproductive "us vs. them" situation. Your best course of action, therefore, is to create a new culture that combines the best aspects of both companies.

Stem the Brain Drain

Before buying a big company, you also should identify key employees and ensure they'll remain after the deal closes. The last thing you need is for a host of talented people to leave the company and spawn new competitors.

To stem that brain drain, you may need to think of incentives beyond the obvious employment contract and bonuses. Learn what key employees would like to do in the newly merged company. They may be keen for leadership opportunities unavailable in their previous, more established, organization. This consideration for their professional goals communicates that yours is a savvy company that wants to reward its people - not a small fish that "got lucky" and devoured a larger one.

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Enlist Financial Partners

Your company probably won't have the internal resources or cash flow to make a large acquisition outright. You may need a combination of a business line of credit, a term loan, a bridge loan, and equity. So, it's smart to start cultivating relationships with lenders and investors long before looking for an acquisition.

Because people do business with people they like and trust, it will be much easier to get a hearing from a commercial banker, investment banker, venture capitalist or private equity investor who already knows your company and track record. These professionals also may be able to advise you on how to conduct due diligence, structure the deal and successfully secure the right kind of financing. Also, they can provide insight on how to manage and reduce your debt once the acquisition is complete.

Know Your Limits

Running a company that's two or three times your current size sounds like an exciting prospect. Before this idea can move from daydream to reality, ask if you have the resources and organizational structure in place to support it. After all, acquisitions are risky even under ordinary circumstances. When you buy bigger, you risk biting off more than you can chew.