

On the Nature of Programmatic Acquisition Strategies: Their Implementation

Entrepreneurs should be ready to make many important decisions on their programmatic acquisition journey

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Programmatic acquisition is a complex topic, so aspiring business leaders look at it from it from various perspectives. It is common to evaluate the general strategy of programmatic acquisition by dissecting specific case studies from a wide range of industries and geographies. Another tactic is to focus on the various financial mechanisms that can create or destroy value in programmatic acquisition. Ultimately, programmatic acquisition provides a unique sphere in which to analyze leadership and management issues, ranging from the creation of high-level strategies to the nuts and bolts of running a business.

We believe there is tremendous value in studying programmatic acquisition through the lenses of case studies and financial mechanisms. However, we also think aspiring business leaders can benefit from the experience of entrepreneurs who have pursued this strategy in the real world. Since we cannot drop MBA students into the C-suites of firms pursuing programmatic acquisition, we developed this note instead.

Based on our experience and research, we present and explore the many important decisions entrepreneurs must make when building a company through programmatic acquisition. Collectively, these choices determine *how* a firm will actually implement a programmatic acquisition strategy (PAS).

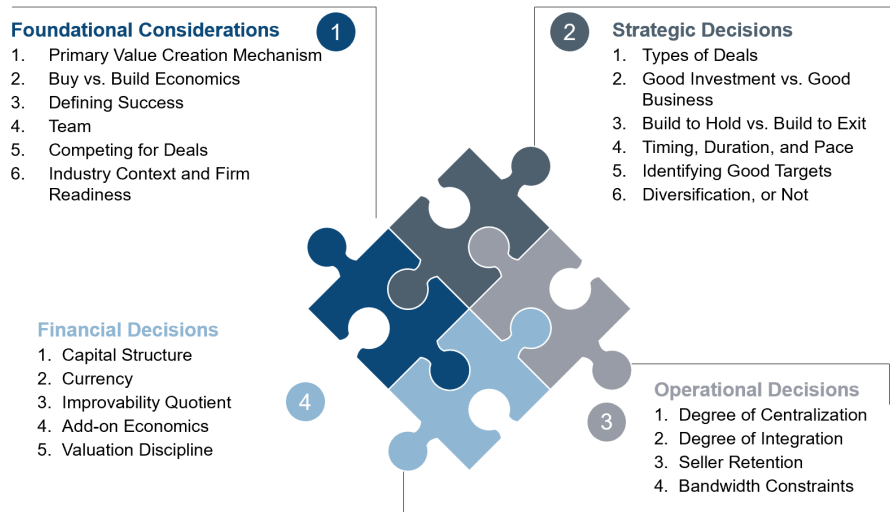
This note is one of a four-part series on PAS. For context and a complete examination of PAS, we recommend reading the following:

- [On the Nature of Programmatic Acquisition Strategies: Why Entrepreneurs Should Consider This Approach](#)
- [On the Nature of Programmatic Acquisition Strategies: How to Source Deals](#)
- On the Nature of Programmatic Acquisition Strategies: How This Strategy Can Go Awry (forthcoming)

This note does not offer a one-size-fits-all model for a PAS; all approaches can result in success or failure, as we point out below. Rather, we provide a framework of key issues that programmatic-acquiring entrepreneurs should consider before embarking on their PAS journey (see **Figure 1** for The Programmatic Acquisition Framework). This analytical tool can help them structure their thinking as they design the best approach to programmatic acquisition for their firm and industry context. In our view, being thoughtful from the start minimizes the risk of needing to make difficult course corrections after the plan has been implemented and increases the chance of successfully implementing the PAS.

Figure 1: The Programmatic Acquisition Framework

The Programmatic Acquisition Framework



When contemplating various ways to implement a PAS, we encourage aspiring entrepreneurs to consider three crucial drivers of success:

- The ability to implement incremental acquisitions without using additional equity
- The ability for shared services to make up an increasingly smaller percentage of revenue as the firm grows
- The ability to achieve multiple arbitrage where the EBITDA* multiple used to value the assembled firm is sustainably higher (at least 2x) than the weighted average EBITDA purchase multiple of the acquired assets

After reading this note, MBA students and aspiring entrepreneurs will be able to identify the major strategic, operational, and financial issues that give every PAS its unique shape and personality. Readers will also better understand how thoughtful business leaders assess the advantages and disadvantages of possible approaches. Finally, readers will learn to appreciate the interconnections among the decisions made regarding programmatic acquisition.

Our Framework for Implementing a PAS

We propose a four-part framework for structuring ideas about implementing a PAS. Based on our experience and research, we believe that entrepreneurs pursuing a PAS must take a position on each of these four issues to maximize their chances of success. We will define the four categories in this section and then explore each one in detail in the remainder of this note.

The first part of our framework is the **Foundational Considerations**. Before starting their PAS journey, entrepreneurs should map, in broad strokes, its implementation. This means identifying the primary mechanism or mechanisms for value creation, defining tangible measures of success, choosing an

* Earnings before interest, taxes, depreciation, and amortization

industry, setting an appropriate geographical scope, and understanding the financial capital, operational infrastructure, and human resources that will be required, among other things.

The second category encompasses **Strategic Decisions**. These decisions guide entrepreneurs' choices in finding assets to acquire with which to build a business inorganically. In our view, a PAS's chances of success are much greater if an entrepreneur determines, ideally before the first transaction, the rough profile of assets worth pursuing in terms of size, quality, and fit, as well as the scale and pace of the plan for accumulating a collection of these assets.

The third portion of our framework involves **Operational Decisions**, which are choices related to the tactical implementation of a PAS during both the deal-making and post-merger integration phases. A thoughtful entrepreneur will determine the level of resources that their firm will need to source and close good deals. They will also develop a strong plan to realize the full value of acquired assets in a manner consistent with their strategic and financial objectives.

The fourth category addresses **Financial Decisions**. These choices will have a significant impact on the financial return of the PAS. Besides weighing the advantages and disadvantages of various approaches to funding deals, the entrepreneur should identify and quantify sources of expected profit margin expansion. They should also establish reasonable valuation ranges to pay for assets and think about how to ensure price discipline is maintained during competitive bidding processes.



Richard Challis (London Business School 2015) is the co-founder of [Arven Capital Partners](#), a London-based programmatic acquirer of financial planners. Arven seeks to acquire majority stakes in market-leading financial planners with excellent reputations and strong client-focused cultures. Challis considers his company a strategic holding company of growth-oriented financial planners who value their clients, employees, independence, and legacy. The financial planning industry is characterized by recurring revenues with low customer churn and high EBITDA margins, which translate to free cash flows at high conversion rates. The growing industry is extremely fragmented, with numerous small, independent service providers. Challis says this was an attractive context in which to implement a PAS with his partner Daniel Potgieter (London Business School 2015).

We have been working with the programmatic acquisition framework since before the company began. It has been invaluable to think about the foundational, strategic, operational, and financial levers we can pull and how each choice will shape our strategy, business, and journey. When we first sat down to contemplate our strategy, we were staring at a blank piece of paper. The framework helped us formulate a clear plan for investors and potential acquisition candidates. Articulating a crisp story to potential sellers is essential, and the framework helped us refine our message and strategy. There are many choices to make, and we try to be thorough and intentional to fully understand the implications of our decisions. This helps us build a superior business and become a buyer of choice in our industry.

Generally, we think the financial planning industry is a compelling pond in which to play. The industry meets a lot of desirable selection criteria, as it is home to many small players with plenty of owners at retirement age and seeking liquidity. We aim to acquire three to five businesses each year. That seems like the right pace to give us scale and allow us to stay in control, run the companies well, and provide outstanding client service. Our integration strategy is to embrace decentralization, which appeals to sellers and clients. We will leave legacy names and brands in place—perhaps we will rebrand when we hit

full scale. We will centralize capital allocation decisions, however, which we think is a huge driver for equity returns.

Our plan is focused on purchasing good businesses that are solid assets—this was especially important for the first few transactions. In the future, there might be more leeway for businesses that need improvement. Our orientation is to ensure all our targets meet our financial criteria; we do not think of ourselves as strategic buyers who will pay more than a business is worth. Geographically, we are pursuing deals throughout the UK.

Financially, we hope to get to a point where all consideration for acquired assets is financed from debt and internally generated cash, although we want to provide sellers with the opportunity to keep 20% of their equity in the game to create more wealth for sellers and align interests; we believe that is key to making this strategy work. We anticipate meaningful multiple expansion for our larger, more professionalized, and more institutionalized business.

The programmatic acquisition framework is a wonderful tool for mapping out a programmatic acquirer's approach to the process. It forced us to think about what works for us and why. Of course, there are no absolute answers, but we feel more confident going into the game having embraced the framework and forced ourselves to make conscious decisions.

Foundational Considerations

Primary Value-Creation Mechanism

Arguably, the most important decision that an entrepreneur will make regarding programmatic acquisition is to pursue the strategy at all. There are other methods by which an entrepreneur could grow a firm to create economic value for multiple stakeholders. For example, an entrepreneur might choose to focus on organic growth opportunities or to complete one large acquisition or a handful of them on an episodic basis. Programmatic acquisition requires the systematic purchase and integration of a series of assets into the base business, usually over the course of a few years but potentially over decades. An entrepreneur should assess whether this model for value-accretive growth makes the most sense for their firm. To increase the chances of success, this decision should take into account the firm's capabilities and constraints and the context of the industry in which it competes.

Furthermore, programmatic acquisition is not a monolithic approach to value creation. Firms pursuing this strategy operate along a spectrum. On one end are firms that create value primarily through operational excellence. These programmatic acquirers buy assets at reasonable prices and drive returns by seamlessly integrating them into the base business with strong operational and financial execution from then on. The result is that the enterprise generates higher profit margins at a lower capital intensity than would be expected for the sum of its parts. On the other end of the spectrum are firms that create value primarily through financial engineering. Programmatic acquirers that follow this path drive return through multiple arbitrage (i.e., using acquisitions to assemble a company that commands a higher valuation multiple than the constituent assets would on a standalone basis) and capital structure optimization (i.e., using as much debt as possible to do deals and capitalize the enterprise). At the same time, they place less emphasis on integration and execution activities, investing the minimum amount in these areas and hoping for the best until they can realize value creation through an exit (at the aforementioned higher transaction multiple).

Between these two poles exist many possibilities, and before embarking on a PAS, each entrepreneur should thoughtfully consider where along this spectrum they want to be. There is no right answer, but in our experience, it benefits an entrepreneur to know whether they intend to be more of an operator or a financial engineer since this decision is foundational, affecting many of the other choices they will have to make.

Buy vs. Build Economics

There are many ways to grow a firm, and they fall into two categories: organic and inorganic. Organic growth involves expanding a business through a firm's internal efforts. Examples include increasing prices, winning new customers, selling more goods or services to existing customers, and entering new markets, whether industrial or geographical. Inorganic growth, on the other hand, occurs when a firm expands by purchasing other companies. Clearly, programmatic acquisition belongs to this second category.

Before an entrepreneur decides to pursue a PAS, it is crucial that they determine why inorganic growth makes more sense for their business than organic growth: the entrepreneur should be able to articulate a clear and compelling logic for buying as opposed to building. This means identifying the value levers that the firm could pull when purchasing other companies but not when growing organically. However, a qualitative understanding of these factors is not sufficient. Before committing to programmatic acquisition, the entrepreneur should have a fairly good sense of how greatly the firm's unit economics could be improved by pursuing the strategy. Thoughtfulness, both qualitative and quantitative, is a much better approach than hoping to figure things out along the way.

Defining Success

To succeed, a programmatic-acquiring firm must have a clear definition of success. Success can take various forms, each with unique implications for strategic decision making. For example, a firm might prioritize revenue growth over profit margin expansion. If so, a different set of acquisition targets will likely become more attractive, and the approach to integrating and operating them after they are acquired will probably change as well. Another dimension of success is the pace of acquisition activity. Obviously, a firm that aims to complete five deals a year, and actually does so, looks very different from one with the same aspiration that manages to close only a single transaction. The firm should also establish a vision of success from an organizational perspective: from the outset, the entrepreneur should know whether they are building a single, tightly integrated enterprise or a portfolio of fairly autonomously operating companies.

However, it is not enough for programmatic acquirers to identify success metrics; they must also define the relevant measurement periods. The entrepreneur should carefully consider all relevant timelines. For example, some performance indicators can reasonably be assessed on an annual basis (e.g., revenue growth, customer service satisfaction, number of deals completed, and profit margin expansion). Others might be more amenable to monthly or quarterly evaluation (e.g., status of post-acquisition integration, working capital intensity, and leverage ratios). Some measures of success will need to be tracked over long periods (e.g., size of the assembled firm, equity value, and distributions to investors). It is a good idea for an entrepreneur to establish milestones along the journey at which to evaluate progress for these metrics and course-correct if necessary.

Finally, programmatic-acquiring entrepreneurs should consider the many stakeholders in a firm, with the two most influential being investors and employees. Different stakeholders may have different visions of success, and without aligning them, the firm may struggle to achieve any or may satisfy the objectives of some constituencies while disappointing others. Either way, conflict is likely to arise and should be avoided as much as possible. The best defense against conflict is proactive engagement with various

stakeholders to ensure that everyone agrees about what measures will be used to define success and that they understand how the firm is performing against these metrics over time.

Team

Success in programmatic acquisition depends on many factors, but entrepreneurs should never overlook the critical role played by the team they assemble. Without the right people in the right roles, the chances of a PAS's success are slim.

The first step is to determine which skills and capabilities an entrepreneur's firm needs to implement a PAS. While some requisite skills and capabilities are common to virtually all contexts (e.g., the ability to source targets, negotiate deals, close transactions, and integrate acquired assets), others will be unique to the firm's specific industry. It is incumbent on the entrepreneur to identify both types.

Then, with knowledge of the skills and capabilities needed for the firm to succeed, the entrepreneur must turn their attention to roles and staffing. This requires the translation of skills and capabilities into actual jobs with tangible responsibilities. In other words, the entrepreneur must define the spots on the team before seeking out the right players to fill them. Once that definitional work is completed, the entrepreneur can focus on staffing. It makes sense to first consider whether the current employees of the base business or the acquired assets are suited to the jobs that were defined, but an entrepreneur should not shy away from bringing in outside talent. The goal is to end up with a high-performance team that can implement the strategy, and in most cases, that will involve a mix of internal resources and external hires. Of course, when the firm needs to recruit from outside, they should develop a plan to find the best possible talent. The entrepreneur should thoughtfully consider the right recruiting channels for each role and how best to source candidates through those channels. Generally speaking, the entrepreneur will want to use their personal network to both identify prospective hires and vet their qualifications and cultural fit with the organization.

The team-building process includes finding advisors. Advisors are non-employees who are an essential part of the programmatic acquirer's ecosystem. Legal advisors, technology assessment advisors, accountants who provide diligence and quality of earnings services, and other experts are all critical parts of a programmatic acquirer's team and help build proficiency in the acquisition process. An entrepreneur implementing a PAS must identify these key partners and determine whether they will use the same partners in all deal opportunities regardless of their size, geography, and complexity.

Competing for Deals

Since programmatic acquisition by definition involves the purchase of many assets over time, the ability to consummate transactions at reasonable valuations is essential for any firm pursuing the strategy. As a result, the programmatic-acquiring entrepreneur should develop a plan by which their firm will compete for (and win) deals for compelling assets. It is critical for the entrepreneur to identify the unique advantages the firm brings to potential sellers. Without clear differentiators that are both understandable and meaningful to sellers, the programmatic acquirer will have to rely on price to overcome rival bidders. That would be suboptimal because, all else being equal, the higher the purchase price paid for the acquired asset, the lower the return.

In our experience, the most important differentiator for a programmatic acquirer is a good reputation. If the programmatic-acquiring firm can position itself in potential sellers' minds as a buyer of choice, paying top dollar will probably not be the only way to close a deal. Many potential sellers have dedicated their lives to building their business, and they want to know that their company will be in good hands if they

part with it. A reputation for competence, professionalism, and personal authenticity will go a long way in convincing potential sellers that the programmatic acquirer is not just another suitor with a checkbook.

The entrepreneur should also consider the settings in which they or their firm struggles before embarking on their programmatic acquisition journey, so they can develop a strategy for competing for deals. If the entrepreneur does not believe their firm has a clear advantage, whether because the industry is already too consolidated for enough interesting targets to remain, there are already several aggressive buyers operating in the space, or the firm itself lacks the ability to compete on anything other than price, then programmatic acquisition may not be the best approach.

Industry Context and Firm Readiness

To build on the previous point, the entrepreneur should assess honestly whether the conditions are right to pursue a PAS. Two important variables to consider are the industry context and the firm's readiness.

When programmatic acquisition works well, it tends to be in an industry context that presents certain opportunities or lends certain advantages to the firm pursuing the strategy. Generally speaking, the ideal industry is highly fragmented, with many small operators competing with one another in a fairly informal way, and in which few, if any, programmatic acquirers are already operating. Perhaps most critically, there must be a strong underlying economic logic for building a firm through acquisition in the industry. If an entrepreneur lacks conviction that their chosen industry matches the archetype sketched above, then they would be wise to reconsider whether pursuing a PAS in this context is a good idea.

But the industry is not everything. Even if an entrepreneur believes they are operating in the right industry environment for a PAS, they must also evaluate their firm's readiness. Programmatic acquisition is hard, and firms that succeed at it start with a stable foundation. If the base business is not sound, the entrepreneur will find the platform for growth crumbling beneath their feet as they try to scale up. Also, before starting down the programmatic acquisition path, the firm must have already built some, and ideally a fair amount, of the organizational infrastructure it will need to purchase assets, integrate them seamlessly, and operate them efficiently on an ongoing basis. Without the platform and scaffolding in place, success in programmatic acquisition is challenging to achieve. Prudence therefore dictates that any entrepreneur who considers this strategy should appraise whether the timing is, in fact, right for their firm.



Jalen Ross (Harvard Business School 2020) is the co-founder of [Ellery Partners](#), a programmatic acquirer of community association managers (CAMs). A CAM provides contracted administrative, financial, and site management services to community associations, including homeowner associations. The CAM industry typically has multi-year contracts with its customers and facilitates communication with owners, recordkeeping services, budget management, and vendor vetting. Its customers include single-family home associations, condo associations, and senior community associations. Ross was formerly a consultant at Boston Consulting Group and a political operative in the Biden presidential campaign.

I think this is a compelling industry to play in. Pull out a search fund industry screening list, and the CAM industry checks all the boxes: multi-year contracts with 90%+ retention, 20% margins, zero to negative working capital dynamics, and relatively simple operations. Add to that the fact that there are abundant targets (more than 6,000 in the US) and that acquisitions can be made for 5x EBITDA, and you have a recipe for programmatic acquisition!

When thinking about how I define success, I determined that my first quantitative goal is to build the business to a scale at which debt is efficient (around \$5 million in EBITDA) in three years. Fifteen years out, I will consider Ellery a success if I have built \$10 million in equity value. Qualitatively, I want to build something I can be proud of—a business known for being efficient but also fair, for growing and developing its employees, and for being owned by people who appreciate family time.

Human capital is critical in four places in a business: community managers on the front line, regional management, financial operations at the corporate center, and a lean, productive deal team. The labor market for community managers is competitive, so I hope to build a comprehensive apprenticeship and training program to grow high-quality managers from within. Because the CAM industry is tied to geography, we plan to build up regional density and allow these regions some autonomy to adapt our approach to their local dynamics. To do that well, I'll need general managers with real knowledge of these geographies, and I hope to find such managers within the business and, potentially, among sellers. Given this regional structure and the challenges of integrating disparate sets of financials, I also expect to quickly hire a talented controller. I'll build out a small deal team able to achieve our target of four to five deals per year. I'll likely recruit one to two associate-level team members who can provide broad leverage over sourcing, diligence, and execution.

Two large (\$1 billion+) competitors are the most active buyers in the space. I plan to become an attractive buyer by offering an alternative in several areas like maintaining the existing team and culture, designing flexible deal terms, focusing on the local geography, keeping the seller involved, and presenting myself as an entrepreneur adopting 'their baby' instead of a corporation looking to absorb it.

In an industry with 95% retention rates and reasonable entry multiples, it is unlikely that building will be able to compete with the efficiency of buying, and building also brings a much higher risk. That said, I intend to build after we buy, in part by pursuing relationships with developers that will unlock organic growth that most existing CAMs are not capturing.

Strategic Decisions

Types of Deals

One of the most critical decisions an entrepreneur following this path must make is what kind of deals to pursue. The entrepreneur must choose the right scheme for categorizing its target assets in the context of their specific firm, industry, and overarching business strategy. There is a potentially endless number of strategies that could be applied, but here we highlight a few that are commonly used. We also note that they need not be mutually exclusive; using them in conjunction often makes a lot of sense.

For starters, an entrepreneur could classify a target by what the business does. Usually, this scheme is applied in relation to the base business. In other words, a target might offer products or services that are the same as, complementary to, or substantially different from those of the base business.

The entrepreneur could apply a similar geographic lens to their analysis. A target might operate in the same market as the base business, have some overlapping territories, or represent entry into a completely new region.

Another paradigm is that of platforms and tuck-ins. Platforms are targets with the organizational capabilities to become a larger operating base that serves customers and supports other, smaller parts of the company. In contrast, tuck-ins are targets that will extend the company's reach on a relatively small scale and, in doing so, will leverage the firm's shared infrastructure.

Finally, there are strategic deals and financial deals. Strategic deals are those for which the primary motivation of the programmatic acquirer is qualitative. For example, the deal might allow the firm to enter a new market, add an increasingly in-demand product or service to its lineup, or take out a problematic competitor. Unfortunately, there is an all-too-common risk that a firm will justify on strategic grounds a deal that does not make sense from a financial perspective. On the other hand, financial deals are those that look great in a spreadsheet. The main rationale for pursuing such transactions is to create economic value with various financial levers, such as debt financing, multiple arbitrage, cost-cutting, or tax planning.

Good Investment vs. Good Business

Like any other entrepreneur, a programmatic-acquiring entrepreneur exercises considerable discretion over the type of asset they will build. In our experience, an entrepreneur can locate their firm along a spectrum from being a good investment to being a good business.

When a firm is a good investment, the entrepreneur's focus is, first and foremost, on driving financial results. Any tradeoffs between optimizing returns and other priorities tend to be resolved in favor of the former. Such a firm will generally, and unsurprisingly, earn a reputation for sacrificing things like customer service or employee morale to the goal of greater profitability.

When a firm is a good business, the entrepreneur takes a more holistic view of their company. Profits still matter, but so do other factors. The firm will emphasize operational excellence in all aspects of the business, not just the income statement. Product and service quality, customer support, and workplace culture are all taken very seriously. It is not an exaggeration to say that entrepreneurs who follow this approach strive to build assets they can be truly and completely proud of.

None of this is to say that there is a right decision. Each entrepreneur will, and should, make their own choice. Plus, most firms don't end up clearly on either end of the spectrum; they will rather lean in one direction. We advise entrepreneurs to be especially thoughtful on this point because their choice will impact decisions related to, among other things, how to finance a PAS, the types of assets sought for purchase, and the pace of execution.

Build to Hold vs. Build to Exit

Programmatic acquisition is a powerful mechanism for creating economic value, and entrepreneurs have used this strategy to great effect over a wide range of timelines. However, despite the considerable heterogeneity of programmatic acquisition, we can classify strategies executed over varying durations into two broad categories based on the entrepreneur's underlying goal in building their firms: build to hold or build to exit.

When an entrepreneur uses programmatic acquisition for a "build to hold" company, the time horizon is long. Economic value will build gradually as the firm steadily purchases assets, integrates them into the base business, and optimizes the operations. The lion's share of the return generated for equity owners

will come from the effect of compounding: in other words, they make money by reinvesting internally generated cash flows inside the firm to grow them further over time. Not surprisingly, investors in a programmatic acquirer pursuing a “build to hold” approach can expect consistent performance and predictable cash flows, perhaps in the form of a reliable dividend.

The strategic rationale of a “build to exit” strategy for building a firm is to create a highly saleable asset in a relatively short amount of time, generally a few of years. While durability is the name of the game in “build to hold,” speed is the priority in “build to exit.” Since the holding period is fairly brief, taking this path generally requires the entrepreneur to compress deal-making into a narrow window and invest the minimum amount in post-merger integration. The reason for this haste is that the majority of the return will come from the exit multiple, not the slow and steady compounding of internally generated cash flows.

Timing, Duration, and Pace

One of the most important strategic decisions facing an entrepreneur is when to engage in programmatic acquisition. There are three chronological dimensions to consider: timing, duration, and pace.

Timing refers to the firm’s entry into programmatic acquisition. The decision to pursue the strategy looms large, as it starts the clock on the strategy and should therefore not be taken lightly. The entrepreneur should thoughtfully assess whether the right moment to implement the strategy is now, a year from now, some other time, or perhaps never, considering their specific firm and industry context.

Duration refers to the period over which the firm employs the PAS. Before the entrepreneur heads down this path, they should have a clear idea of whether they expect to pursue the strategy for several years, a decade, or indefinitely.

Pace refers to the volume of deals the programmatic-acquiring firm expects to complete in a given year. We use the term volume because the entrepreneur may define it in terms of the number of deals or the amount of EBITDA purchased. The right volume will depend on the firm’s situation, but it is critical that a clear goal be set at the beginning. Otherwise, it will be difficult for the entrepreneur to assess the speed with which the firm closes deals and whether the firm is on track to achieve its longer-term objectives. The entrepreneur would also be wise to consider at the outset how they will solve two common pacing problems experienced during a PAS: completing a sufficient volume of deals each year without sacrificing quality and ensuring a relatively smooth and steady cadence of transactions within a given year to avoid overloading or underutilizing the firm’s acquisition infrastructure.

Identifying Good Targets

The programmatic-acquiring entrepreneur must have a clear picture of a good target for their firm. Without one, the firm likely will struggle to maintain discipline in its acquisition process and end up acquiring a hodgepodge of disparate companies instead of a coherent collection of complementary assets.

To construct a profile of the archetypical good target, the entrepreneur should consider various dimensions. For starters, most programmatic acquirers think about targets in terms of size, generally measured by the desired range of either revenue or EBITDA. This is an important variable because it presents a clear tradeoff in deal-making. Acquiring larger assets usually involves more risk in deal execution and post-merger integration, but purchasing a small company often involves just as much work as closing a transaction for a large one. Besides size, some programmatic acquirers also define their target by other quantitative measures. For example, a firm might seek to buy assets that earn a minimum level of profitability or are growing their top line at or above a certain rate.

Numbers do not tell the whole story about a business, and they are usually not the only factor programmatic acquirers use to identify acquisition candidates. Virtually all such firms screen targets from multiple qualitative perspectives, including industry, geography, and asset quality.

Starting with industry, a programmatic acquirer should generally determine whether the firm is looking for targets that sell mainly the same goods or services or for targets that fall clearly outside the core business, whether they are adjacent or further afield (for more on this, see the “Diversification, or Not” section below.)

The entrepreneur should also consider how targets advance the firm’s ambitions as they relate to geography. Typically, the choice is between expansion (i.e., entering new territories) and densification (i.e., adding depth to existing markets).

Finally, there is asset quality. Asset quality is best thought of as a spectrum, with “rehab” (i.e., assets that need a lot of work) on one end, “fixer-uppers” (i.e., assets that have some problems but can be fixed fairly easily with a few high-impact actions) in the middle, and “pristine” (i.e., assets that command high prices because they are already in great shape) on the other end. Along this spectrum, the valuation required to buy the asset and the risk involved in integrating it into the base business vary substantially. We do not believe there is a single right point on the spectrum for all programmatic acquirers, but “fixer-uppers” offer a good balance between risk and reward in most situations. We do believe that a programmatic-acquiring firm should know the quality range it is shopping within because the successful execution of a robust integration and operational improvement playbook depends on standardizing the processes for and optimizing a fairly narrow scope of assets.

Diversification, or Not

Building on our discussion above, we note that programmatic acquirers have considerable discretion over the profile of assets that they buy. Typically, with time, the inclination to exercise this discretion gets stronger. For one thing, as the firm acquires targets that meet its original specifications, the universe of remaining options might shrink. In addition, the natural evolution of the firm’s industry, in both expected and unexpected ways, will cast opportunities in a new light. Whatever the precipitating factor, the entrepreneur must eventually decide whether to use programmatic acquisition to diversify their firm’s business, and they should be ready when the decision to potentially diversify arrives.

Diversification typically comes in two flavors. The programmatic-acquiring firm will diversify either by buying a different type of asset or by buying assets in a different geography. When it comes to the type of asset, programmatic acquirers will usually focus their initial efforts on purchasing targets that provide the same goods or services as the base business. Over time, however, the question of whether to consider targets that sell goods or services complementary to the firm’s core offering will arise. Generally, if programmatic acquirers diversify at all, they will stick to adjacencies, but in some cases, they will take a holding company approach by purchasing assets in largely unrelated industries. Of course, the further a firm strays from its main business through programmatic acquisition, the more it risks something going wrong.

The second type of diversification relates to geography. Using programmatic acquisition to enter new territories can be a tempting proposition, especially after the firm saturates its home market. However, we caution entrepreneurs to thoughtfully consider whether diversification into new geographies actually carries tangible strategic benefits for their firm. Unfortunately, it is all too common for programmatic acquirers to set a goal of geographic diversification only to realize that the underlying economic logic for doing so was weak. To maximize the chances of success, the programmatic-acquiring entrepreneur should determine how entering new geographies will create value, not just increase the enterprise’s size and

complexity. Within the context of geographic diversification, entrepreneurs should define whether they aim to grow concentrically or are willing to leapfrog into new markets that are not adjacent to their home market.



Al Franjoine (Kellogg School of Management 2009) is the CEO of [USA Sealing](#), a Buffalo-based supplier of wear parts to industrial end markets. These components are low cost but critical and require constant replenishment to sustain industrial operations. The company specializes in sealing and gasketing, tubing, hose, pipe, and fittings. The market is highly fragmented, with low customer churn and high returns on tangible capital. Franjoine has differentiated USA Sealing by leading with eCommerce strategies in an industry that embraces legacy catalog sales.

The most attractive deals are small companies (\$5 to \$10 million in revenue) with a quality product category that we do not offer, that we cannot easily develop organically, and that fits our customer base. An example would be a metal service center that buys sheets, rods, and shapes of metal directly from metal mills to sell to their local market; we would purchase them, expand their warehouse to hold more inventory, and use their supply chain and machinery to fabricate thousands of parts.

We are not looking for turnarounds. We want small, well-run companies that can be expanded to play in a different customer space. Those that focus on either local or regional distribution or the OEM space are ideal. Then, by adding our large distributors into the fold, their growth is incremental. The most attractive opportunities are tuck-ins. There are many well-run but antiquated small manufacturers and distributors that we could fold into our platform. We can improve those businesses because we focus on establishing modern-day internal operations that are data-driven, efficient, and scalable.

We are focused on building a fantastic business with compelling financial returns over the very long term. As we aggregate, we build value for investors by offering a possibly higher exit multiple. From a business standpoint, each acquisition also brings new products, new customers, and new distribution channels to sell to and cross-sell to customers. The larger we are and the more we can offer, the more powerful each new customer acquisition becomes.

Our acquisition pace will be a brisk walk, not a sprint, perhaps starting with one to two targets for the first two years and ramping up to three to five over the following years. I want control and growth but will not sacrifice service and control entirely.

Operational Decisions

Degree of Centralization

When building a company through programmatic acquisition, an entrepreneur faces the critical decision of which systems, processes, and functions to centralize and which to leave up to the acquired assets. The choice has significant implications not just for the enterprise's ongoing operations but also for the financial model of the strategy itself. This is because programmatic acquisition fundamentally assumes that the acquired assets can be run more efficiently and profitably together than on a standalone basis. This

decision comes down to whether the entrepreneur wants to build a robust shared-services function that serves field operations or not.

The exact proportion of the combined operations that can be centralized shared among the acquired businesses will vary from firm to firm, and the entrepreneur must figure out what works best in their specific situation. For the purpose of this exercise, a business's functions can be classified into two broad categories: back-office and customer-facing. Back-office functions are general and administrative infrastructures that support operations behind the scenes. Examples include the finance, accounting, human resources, and legal departments. Customer-facing parts of a company include sales, distribution, and customer service. From our experience, it is easier to centralize back-office functions than customer-facing ones, because the former do not directly impact the customer experience. While we offer this general observation, we strongly emphasize that there is no hard and fast rule. A programmatic acquirer might find plenty of ways to centralize customer-facing functions (such as a call center), and if that is the case, we certainly encourage pursuing this centralization to reap the cost savings. However, entrepreneurs should not be disappointed if they find that most of the centralization opportunity comes from the back office, as is usually the case. After all, as we explain below, achieving decreased shared services expenses as a percentage of revenue while the business scales is a hallmark of a successful PAS.

Degree of Integration

The issue of integration is closely related to the above discussion of centralization, but we differentiate the two concepts in the following manner. Centralization refers to the consolidation of infrastructure and decision-making authority into a single part of the organization. On the other hand, integration involves harmonizing and synchronizing newly acquired assets with the rest of the company's systems and processes. If a specific function is centralized, it is, by definition, integrated, but when a function is integrated, it is not necessarily centralized. For example, a firm might centralize the responsibility for implementing and operating a computerized customer relationship management (CRM) system for the entire company with the IT department at headquarters. However, an acquired asset would be considered integrated once its salespeople were shifted onto that CRM system from the system used before the acquisition, even if those salespeople were expected to manage their accounts without any direct involvement from the head office.

Once a programmatic acquirer closes a deal, the process of integration formally begins. At that point, the key decisions facing an entrepreneur are the extent to which the firm should integrate the acquired asset into its operations and over what period this integration work should be completed. See **Exhibit 1** for a list of potential integration decision points to consider. When it comes to the extent of integration, the entrepreneur must think about the steady-state level of operational efficiency they want to achieve, with an eye towards the cost-savings assumptions they have baked into their financial model. There is no right answer to how tightly integrated the acquired assets should be, but from our experience, it makes sense to integrate the functions or aspects of their operations that would benefit from standardization and for which the firm has developed best practices.

As for the timeline for integration, we again stress the variability across firms but provide the following three-stage integration framework, based on our experience and research, to serve as a guide. The first phase is stabilization. During this period, which typically lasts for 90 days after the deal is closed, the firm takes over the asset and learns the ins and outs of its operations. The second stage, which generally takes six to nine months, is integration. The goal here is to harmonize and synchronize the acquired asset's core functions with those of the rest of the company. Critical tasks include migrating the acquired asset onto common software systems, transitioning most back-office functions to shared services, installing any new managers, and reengineering customer-facing processes. The third and final step, which occurs between

one and three years after the transaction is completed, is optimization. In this step, the firm improves the acquired asset such that any remaining performance potential is fully achieved.

Not all integration issues are operational. A critical non-operational decision is naming and branding practices. When an entrepreneur programmatically acquires businesses, they can choose to embrace and support the acquired company's name and brand, building a portfolio of names and brands. Alternatively, all legacy names and brands can be shed and the acquiring company's name and brand deployed through all acquired assets. This decision can send powerful signals to the customers and employees of acquired businesses. There are valid reasons for both retaining and dropping legacy names and brands. If the acquired company has a formidable reputation and name recognition in a market that is geographically distant from the acquiring company, it might make sense to keep the legacy name and brand. On the other hand, if the programmatic acquirer is keen to build a large, fully integrated, centralized, and cohesive business with brand and reputational value, it might be prudent to operate all acquired businesses under a single name and brand.

Seller Retention

After the programmatic acquirer purchases a target, they must decide what sort of professional relationship they would like to maintain with the seller. This choice is especially important when a highly engaged owner-operator runs the target. In such cases, the seller is likely to have a strong emotional attachment to the business they have built, and friction could arise as the new owner makes changes and puts their stamp on the acquired asset. Such friction not only distracts from post-merger integration but can be personally draining for the entrepreneur, who has to deal with any contention while running their firm.

Broadly speaking, the entrepreneur has three options when it comes to seller retention: have the seller exit immediately, define a specified transition period during which the seller will help with integration, or incorporate the seller into the ongoing management of the acquired asset. There is no answer that works in all situations. We advise entrepreneurs to thoughtfully consider what operational know-how and management capabilities each seller brings to the table. From our experience, the entrepreneur should also assess the seller's cultural fit with the programmatic acquirer. If the entrepreneur is leaning toward replacing the seller, they should develop a robust plan for identifying their replacement. The key decision in that process is whether to fill the role with an internal hire, to recruit from the outside, or to source candidates from both pools.

Bandwidth Constraints

Implementing a PAS is hard work, and its success depends on adequately resourcing the firm's deal-making engine. Ideally, before embarking on a PAS, as well as periodically along the journey, the entrepreneur should analyze the full sweep of the acquisition process, from sourcing through post-merger integration, to ensure that each step receives sufficient time and attention.

A number of concrete staffing decisions arise for thoughtful and highly engaged entrepreneurs. First, they must choose how much labor to devote to the firm's deal-making efforts. The choice boils down to making acquisition and integration a part-time job for everybody or a full-time job for a dedicated team. Important variables to consider when choosing an approach are the desired volume of deals per year, each deal's complexity, and the tangible knowledge and expertise needed to complete the job. Once the entrepreneur figures out how much staff to involve, they must decide which specific employees to bring into the deal-making process. The goal is maximum impact with the minimum possible resources; the entrepreneur will face a constant tradeoff between the extra cost of adding bandwidth and the increased focus and flexibility this bandwidth offers.

Financial Decisions

Capital Structure

One of the most important financial decisions facing an entrepreneur in the context of programmatic acquisition is how to fund deals. Each transaction will have to be paid for, and the entrepreneur has two primary toggles at their disposal.

First is the timing of payment. Deal structures vary, but broadly speaking, the choices are to pay the sellers the full consideration up front (i.e., upon the transaction's close) or to spread it out in stages (pursuant to a schedule negotiated as part of the deal). While paying up front is the more straightforward approach, it requires the firm to disburse compensation sooner (which, all else being equal, is less desirable for the programmatic acquirer).

Second is the mix of the funding sources used to finance deals. A firm may use one or some combination of the following: internally generated cash, incremental debt (from a bank or investment firm), seller financing, and equity. This decision matters because each funding source involves a different cost of capital, with equity typically being the most expensive. In addition, the choice of how to finance an individual transaction will impact the firm's overall capital structure, meaning that each deal influences the risk and return profile of equity owners. From the perspective of equity owners, the holy grail is for the firm to fund deals entirely with incremental debt. However, it is worth noting that leverage amplifies return as well as risk, so while debt increases the potential upside, it also magnifies the possible downside. In addition to this amplification dynamic, another critical factor to consider is the time it will take the firm to de-lever after completing a transaction. This is important because the balance sheet is a finite resource; the firm cannot take on endless amounts of debt for deals. In other words, if a firm takes on more debt, it will take more time for the firm to return to its pre-transaction leverage level, constraining its ability to do deals in the meantime. The key takeaway for an entrepreneur is that a firm's method of financing one transaction will have an effect, potentially a large one, on its entire acquisition program.

Currency

As mentioned above, one option for funding deals in a PAS is to issue new equity. When firms take this approach, they issue that fresh equity to existing shareholders, the sellers of the asset being acquired, new non-seller shareholders, or some combination of these groups. The important thing to remember is that new equity, no matter who ends up owning it, represents permanent dilution for existing shareholders, so the decision to use it should not be taken lightly. In addition to its financial impact, when sold to parties other than existing shareholders, new equity also brings new people into the ownership equation. That might not sound like a major concern, but we caution entrepreneurs to take the human element very seriously when contemplating equity issuance to finance deals. New shareholders might not be in harmony with legacy shareholders and this can potentially lead to a very painful and tense situation.

Ultimately, even if an entrepreneur is naturally averse to using equity for acquisition consideration, when setting out on their PAS journey, they should still consider the situations in which it might make sense to do so. They should seek to identify strategic reasons for using new equity that might offset the negative financial consequences for existing shareholders outlined above. They should determine the maximum amount of equity (measured in terms of a stake in the surviving entity) they are willing to part with in the context of a single deal. Thinking ahead on these issues will help the entrepreneur make better decisions about equity issuance should they ever face this situation in the heat of negotiations with a potential seller.

Improvability Quotient

A large part of the value creation of a PAS comes from improving the acquired assets. We refer to the degree to which a programmatic acquirer can enhance the acquired assets' earning power as the improvability quotient. An asset with a high improvability quotient will experience a significant improvement in its EBITDA margin as a result of actions taken by the programmatic acquirer. Before purchasing a particular target, an entrepreneur should carefully assess the improvability quotient size, determine what the programmatic-acquiring firm will have to do to capture the potential benefits, and establish how long it will take to realize this upside.

From our experience, the ideal situation is for the programmatic acquirer to identify three to five value levers, each with 100 to 200 basis points (bps) of margin expansion potential. Since a firm pursuing a PAS plans to purchase many assets and capture the expected 300 to 1,000 bps of total EBITDA margin upside on each, the entrepreneur should figure out how to systematize operational improvement. The alternative of relying on ad hoc measures to boost efficiency is neither optimal on a small scale nor workable as the firm gets larger.

Add-on Economics

Closely linked to the improvability quotient is the concept of add-on economics. Add-on economics refers to the incremental profitability of bolting an acquired asset onto the platform for growth, which reflects the underlying industrial logic for building a business through tuck-in acquisitions. In other words, add-on economics answers the following question: How much more profitable will the acquired business be as part of the overall firm than on a standalone basis?

Estimating add-on economics is critical to the successful implementation of a PAS. An entrepreneur must first identify the sources of margin upsides, with savings from eliminating duplicative back-office functions being the most obvious candidate. One aim of programmatic acquisition is for expenses related to so-called shared services to decline as a percentage of revenue as the firm grows. However, cost synergies may be achievable in field operations too, and the entrepreneur must find these opportunities wherever they exist in the cost structures of the acquired assets and the overall firm. Then, the entrepreneur must underwrite the potential margin expansion in the firm's base case financial model. Considerable discretion is required here, but a conservative approach often makes sense. After all, predicting lower potential savings leaves a buffer of safety against worse than anticipated circumstances.

Valuation Discipline

It is all too easy for a programmatic-acquiring firm to overpay for deals, especially in the middle of a bidding war for an attractive asset. Avoiding overpaying is often easier said than done unless, of course, the entrepreneur put clear safeguards in place at the outset of the PAS journey to ensure valuation discipline.

An important check against the risk of overpaying is to establish clear valuation ranges within which the firm will consider acquiring assets. From our experience, the benefits of this exercise are greatest when a firm defines the maximum multiple it will pay for the various types of assets it might buy, with the two main categories being platforms and tuck-ins. When setting these upper bounds, the entrepreneur should be mindful of multiple arbitrage as a value creation lever in programmatic acquisition. In other words, the entrepreneur should not pay so much for assets that the whole firm cannot be worth more than the sum of its parts. The goal, of course, is for plenty of headroom to exist between the multiples paid for acquired assets and the target exit multiple of the overall enterprise.

However, setting maximum multiples will not do much good if it is a firm's only valuation discipline mechanism. A programmatic acquirer should implement whatever mechanisms will work best in their specific situation, but all firms are trying to avoid the same problem: making one exception, then another, and then another, until all valuation discipline has gone out the window.

Kirk Harn (Harvard Business School 2018) launched Outsourced Bookkeeping Solutions in 2020 to purchase and operate bookkeeping, tax preparation, and payroll services companies. The Seattle-based business is pursuing programmatic acquisitions throughout the United States. While Harn is eager to scale the business rapidly, he also knows he needs to continually engage with and thoughtfully manage employees and deliver excellent customer service to clients. He plans to move briskly, but not so fast that employees or clients would be alienated.

I think this is an exciting situation. The bookkeeping industry is highly fragmented, with many attractive businesses to potentially acquire. I think we can purchase high-quality businesses for approximately 3–5x EBITDA. Revenues are pretty sticky, but we certainly have some churn. EBITDA margins are high, and there is little CapEx. This is a desirable industry in which to pursue a PAS.

I have completed two deals to date, so I am at the beginning of my journey. We used some of our equity in the first transaction purchase. The situation was complex, involving multiple shareholders with different needs and objectives. As we scale the business, it might be simpler and cleaner not to use our equity as currency.

I don't think EBITDA margins will go up for us post-acquisition; they might actually attenuate a bit as our improvability quotient is low. We are buying good businesses that are already quite profitable and stable, and our strategy to grow the nominal EBITDA is to invest in an organic growth program to augment the PAS. By investing in organic sales, we think that we can build EBITDA significantly with attractive returns on invested capital. This is a two-pronged growth strategy: acquisition and sales.

Valuation discipline is essential, and it has been pretty easy. Because there are many desirable businesses in the space, I spend much of my time sourcing deals. I have many options, so I can avoid deal heat and stay within our targeted buy zone. Of course, I respect sellers who want more for their business than we might pay, but we build choices in our acquisition pipeline to avoid valuation creep.

I am still thinking about how to achieve the best add-on economics. Part of what I am wrestling with is whether to build a robust shared-services function. If we go down that path, I think we may achieve desirable add-on economics, but if we pursue a highly decentralized strategy, I think there will be less opportunity for add-on leverage.

Conclusion

We believe that entrepreneurs who choose to pursue a PAS should consider each of the issues outlined in this note. Taking a proactive approach and using the programmatic acquisition framework before embarking on this entrepreneurial path will increase the likelihood of a successful implementation, as thoughtful planning will enable the entrepreneur to make, with confidence, the many important decisions they will face in programmatic acquisition, as we know from our experience and research. We encourage

aspiring entrepreneurs to use the framework as they contemplate the three crucial drivers of success in this strategy:

- The ability to implement incremental acquisitions without using additional equity
- The ability for shared services to make up an increasingly smaller percentage of revenue as the firm grows
- The ability to achieve multiple arbitrage where the EBITDA multiple used to value the assembled firm is sustainably higher (at least 2x) than the weighted average EBITDA purchase multiple of the acquired assets

We hope that aspiring entrepreneurs have found our analysis helpful in their study of programmatic acquisition and will keep our framework in mind as they pursue a PAS of their own.

Exhibit 1: Illustrative list of potential integration decision points

- 401k selection and strategy
- Accounting system and controls
- Accounts payable
- Accounts receivable collections
- Audit partner
- Bank checking relationships
- Balanced scoreboard metrics
- Board members
- Brand and logo
- CapEx programming
- Cash application
- Cash management
- Check approval and signing
- Communication patterns
- Compensation programs
- Customer relationship management
- Data security and hosting
- Email domains
- Equity compensation
- Executive retention
- Expense reports and reimbursement
- Fleet management
- General ledger
- Healthcare selection and strategy
- Hiring procedures
- Lockbox controls and protocols
- Overtime controls and management
- Payroll systems and processing
- People sourcing
- Quality controls and processes
- Sales commission
- Separation procedures
- State sales tax
- Telephone controls
- Training and development
- Travel controls
- Uniform procurement and maintenance
- Vendor selection and management

Exhibit 2: The Expert's Perspective

The Expert's Perspective



John Kenny (former CFO)
Iron Mountain
ironmountain.com



Adam Forste (Co-founder)
Lineage Logistics
lineagelogistics.com



<p>1</p> <p>Describe your business and please share approximately how many acquisitions you have completed?</p>	<p>Iron Mountain (NYSE: IRM) is the world's leading Records and Information Management company with 3 main lines of business: storage and on-demand servicing of paper records, storage and route-based servicing of data back-up magnetic tapes, shredding and recycling of paper records. IRM executed ~350 acquisitions over a 15 - year period. The vast majority of these involved consideration of less than \$25 million. Many, if not most, of these were proprietary transactions.</p>	<p>Lineage Logistics is a Novi, Michigan based operator of cold storage warehouses. The company provides supply chain and logistical services to all things related to the safe movement and storage of food products. The now global business was conceived as a long-term hold strategy in 2008 by partners Kevin Marchetti and Adam Forste when they acquired a single refrigerated storage business in Seattle, Washington. Lineage now operates more than 330 temperature-controlled warehouses across 15 countries. Lineage has \$3.3 billion in revenue and 16,500 employees. We have completed 72 acquisitions, 38 in 2020 alone.</p>
<p>2</p> <p>How have you thought about the pace of acquisition activity? What is the right pace of execution?</p>	<p>IRM's pace was the result of an abundance of inexpensive debt, a target-rich environment, the inherently low risk to revenue retention and a strategy as a first mover to capture the best targets and achieve scale before existing competition or new entrants. The "right" pace is different for different businesses but ultimately dictated by the level of risk to value-destroying business disruption and the readiness to integrate to manage risk. IRM's business was capital-intensive with high customer barriers to exit.</p>	<p>We completed our first deal in 2008 and took a full year until we did our second deal and almost another until we did our third. Our acquisition activity looks like a geometric curve – pretty slow at first and then building speed over time. It makes sense to go slower at the beginning in order to get a bunch of operational things right. You need to be available when a compelling opportunity is in front of you since you cannot force someone to sell, and it isn't always on the ideal timeline. We had to scramble a bit to do the Millard Refrigerated Services deal in 2014, but it was a transformational opportunity that we could not pass on. Pace is really a function of capability.</p>
<p>3</p> <p>What is the ideal acquisition target in terms of size, geography, and asset quality? Why is that the ideal?</p>	<p>The ideal target will vary based on the expansion strategy and the stage of execution. Strategies fall into two broad categories – add new products/services or expand within existing lines of business. The latter has two main thrusts – geographic expansion and in-market additions. When entering new markets, the ideal target is sizeable (well above breakeven), of high quality (good employees, assets and business processes) and adjacent to existing markets. Fixer-uppers in new, distant markets involve greater risk and will demand a higher level of resources.</p>	<p>All deals are special in their own way and we do deals for different reasons. At the outset it's important to not buy a business that is too fragile (less than \$2.5 million in EBITDA). Too small a deal presents idiosyncratic risk. Later, we focused on deals that had high strategic value for our customers – opportunities with value added services (like refrigerated rail) or new geographies (like Europe and Asia).</p>
<p>4</p> <p>How do you think about integration and centralization? What is the timing of integration?</p>	<p>Getting control of risk is job one. Achieving financial control and aligning employee practices is important, should not be deferred and are likely candidates for centralization. Customer outreach by both parties is a high priority and a detailed plan should ideally be in place before closing. That said, some customer-facing change should not be rushed to avoid unnecessary disruption. Customer service centralization and re-branding (especially in new markets) may be candidates for deferral.</p>	<p>We believe in centralizing immediately and full integration. This allows us to eliminate exception management and get everybody operating with a common language. When we did try to preserve legacy systems and procedures, terrible things happened, and we were constantly putting out fires. We focus on standardization - we are one Lineage. We honor and celebrate our acquired companies, but we are moving forward and that must be done in a unified and cohesive way. If we had taken a strong centralized approach earlier, we would have avoided some early missteps.</p>
<p>5</p> <p>How do you become a preferred buyer in a consolidating industry?</p>	<p>Deal fairly with good people; avoid transacting with sellers you do not respect. Get to know the counterparty personally and develop empathy for his personal (and often familial) situation; this may be the most important transaction of his/her professional life. Try not to talk price or enter an into an LOI without a reasonable level of diligence; avoid needing to re-price. Select and manage counsel carefully; emphasize deal-making versus an argumentative style. Plan, well in advance of closing, and execute quality employee and customer communication plans. Be flexible; do not needlessly rush to integrate or align practices that can wait. Perform retrospective reviews of all closed transactions to refine best practices.</p>	<p>This might seem obvious, but step one is just being a nice person and not being a jerk. We treat everybody in our industry with appreciation and respect. There are a lot of wonderful companies that some talented entrepreneurs have built, and we respect them. We focus on doing exactly what we say we are going to do – no surprises during the deal process. We listen carefully and intently, and craft deals that meet the sellers' needs. It's about them, not us. We are trustworthy and think of every deal as our calling card for the next deal. This all leads to a very high and positive reputation. Every single deal we have done is referenceable and people want to sell to us.</p>

The Expert's Perspective



Bob Galvin (former CFO)
NuCO2
nuco2.com



Dave Slott (CEO)
ARS/Rescue Rooter
ars.com



<p>1 Describe your business, and please share approximately how many acquisitions you have completed.</p>	<p>NuCO2 (former NASDAQ company) is the only national provider of beverage-grade carbon dioxide and draught beer-grade nitrogen gas solutions to the restaurant and hospitality industry. The company provides reliable, economical, and convenient beverage carbonation solutions to national chain and local restaurants, convenience stores, theme parks, and sports/entertainment venues. NuCO2 is the top beverage carbonation supplier to the top 100 national restaurant chains. The company has executed 30 acquisitions, resulting in a national footprint that serves over 150,000 customer locations throughout the U.S.</p>	<p>American Residential Services (ARS/Rescue Rooter) is a privately held Memphis-based company and one of the nation's largest providers of air conditioning, heating, and plumbing services. ARS/Rescue Rooter owns and operates a network of more than 70 locally managed service centers in 24 states, with more than 6,500 employees nationwide. ARS was acquired by the current management team as a divestiture from ServiceMaster. Over the past 15 years, ARS has completed approximately 15 acquisitions.</p>
<p>2 How have you thought about the pace of acquisition activity? What is the right pace of execution?</p>	<p>Early on, the strategy was to acquire strong-performing local businesses with good customer bases and strong leadership teams (operating owners). The pace of activity was generally dictated by a) high-quality/value-accretive opportunities, b) sellers' willingness to transition with deal incentives to maintain and grow enterprise value, c) availability of cost-efficient capital, and d) our ability to properly execute resource transition and integration. The company's success in closing transactions and integrating an acquired business was critical to continuing the consolidation strategy. Most acquisitions were small, family-owned businesses.</p>	<p>As a general matter, buying businesses is the easy part. Integration is the hard part. In thinking about acquisitions, ARS focused on the infrastructure necessary to assimilate acquired companies. Inherent in this critical work is the following question: Do you want the sellers to be a part of your team, or do you want them to leave? There is no right answer here, but ARS wanted to partner with owners because assembling a new team or promoting the next level of management from within is challenging and potentially risky. ARS looked at 100 acquisitions per year and executed three to five. Most were ruled out based on chemistry, and management prioritized like-minded owners/sellers.</p>
<p>3 What is the ideal acquisition target in terms of size, geography, and asset quality? Why is that the ideal?</p>	<p>As the business grew, the ideal acquisition target evolved from small local businesses with fewer customers and assets to larger regional businesses with bigger customers, including master service agreements (MSRs) serving multiple locations across many states. As the company achieved a national scale, it was able to win local customers organically through its product and service differentiation. On a regional and national basis, MSRs were entered with major accounts (e.g., McDonalds and Subway).</p>	<p>ARS sought to acquire undermanaged assets and operations that were performing but could also perform better with the growth playbook and horsepower of ARS. The average ARS acquisition pulled approximately \$15M in revenue, earning 10% margins. The company consistently grew acquired assets to \$30 million in sales, generating 20% margins. Approximately half of this profit improvement came from the elevated volume derived from more sophisticated and rigorous sales management, whereas the balance came from expense rationalization and centralized purchasing power.</p>
<p>4 How do you think about integration and centralization? What is the timing of integration?</p>	<p>Integration is critical to a successful acquisition strategy. Our plan was to acquire small family-owned businesses and require the sellers to stay on for a period to run the business after the acquisition was completed. Deal terms generally included rewards for growing the business and reduced purchase consideration if projections weren't achieved, usually for a period of one to three years after closing. Full transition of responsibility and integration of shared services and business practices usually occurred within 12–24 months of the closing date.</p>	<p>The mantra of ARS is "Be national, act local." Key finance functions, namely cash management and capital allocation, were centralized immediately post-closing. IT would follow quickly thereafter. Most of the integration effort centered around the oversight and tracking of KPIs, which sellers would not have done independently. A top salesperson at ARS produces \$4 million per year. A legacy company salesperson would produce \$1.2 million. ARS could win sellers' hearts and minds by showing them how much more efficient they could be. However, this approach was not heavy-handed; it was about teaching rather than mandating change.</p>
<p>5 How do you become a preferred buyer in a consolidating industry?</p>	<p>Becoming a preferred buyer in a consolidating industry is essential to achieving success. Small business owners talk. They share stories of good and bad acquisition experiences: fair valuation, minimal disruption (diligence) to their existing business, commitment to timely closing, retention and professional development for existing employees, and opportunities for sellers/owners to transition at a slow or fast pace, depending on their age and other family circumstances. Once we developed a favorable reputation, we almost never lost an opportunity, even against other bidders offering higher enterprise valuations.</p>	<p>You do what you say you are going to do, plain and simple. Conduct yourself with honor and enjoy a reputation for doing so. The leadership team at ARS has been a buyer many, many times, but the team has also been a seller more than once. By virtue of having been on both sides, ARS has an awareness of the other party's experience. In the end, that's the magic in all business: putting oneself in other people's shoes.</p>

The Expert's Perspective



Lawrence A. Cunningham (Vice Chair)

Constellation Software

csisoftware.com



- 1 Please describe your business and share approximately how many acquisitions you have completed?**

Constellation Software Inc. (CSI) is a global leader in vertical market software. It buys, builds, and permanently owns companies that provide mission-critical software for businesses in all fields, with heavy investments in health care, homebuilding, hospitality, transit, and utilities. CSI operates through six autonomous groups. These subgroups have made nearly 500 acquisitions over CSI's two decades of operation. I joined the board four years ago and have participated in the approval of 15 large acquisitions, reviewed scores of smaller acquisitions, and participated in retrospective reviews of a half-dozen.
- 2 How have you thought about the pace of acquisition activity? What is the right pace of execution?**

We want our investment teams to see as much of the potential market as possible. They like to have the opportunity to bid on all of acquisition opportunities that meet our investment criteria. We can't win them all, but those we do are integrated into our business by teams in their respective units. These integration teams aim to work expeditiously. The pace of search should be high, and the pace of execution should be rational. The larger we get, the more activity of both kinds we have.
- 3 What is the ideal acquisition target in terms of size, geography, and asset quality? Why is that the ideal?**

We generally prefer small investments but have made several sizable ones. We are global, so geography is no longer an issue. However, venturing into certain geographical regions can be difficult. Japan is an example due to its strong and distinctive business culture. High-quality assets are typically expensive; we have the know-how to improve low-quality assets, and if the pricing is right, that's often the sweeter spot.
- 4 How do you think about integration and centralization? What is the timing of integration?**

CSI is thoroughly decentralized. Every business unit is managed autonomously. We do use best practices, however, that are shared across all groups and the organization. Integration is the process of bringing a new investment into our culture. In a way, it begins during the courtship and continues indefinitely.
- 5 How do you become a preferred buyer in a consolidating industry?**

If you can't win on price, you win on intangibles that matter to your preferred seller. These intangibles can include an efficient closing process, permanent ownership, managerial autonomy, partnership attitude, and a learning culture. Building a reputation as a trustworthy business partner helps. Warren Buffett and Berkshire Hathaway are legendary for becoming the preferred buyer across many industries. His approach can be adapted for specific industries.

This case has been developed for pedagogical purposes. The case is not intended to furnish primary data, serve as an endorsement of the organization in question, or illustrate either effective or ineffective management techniques or strategies.

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Endnotes

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