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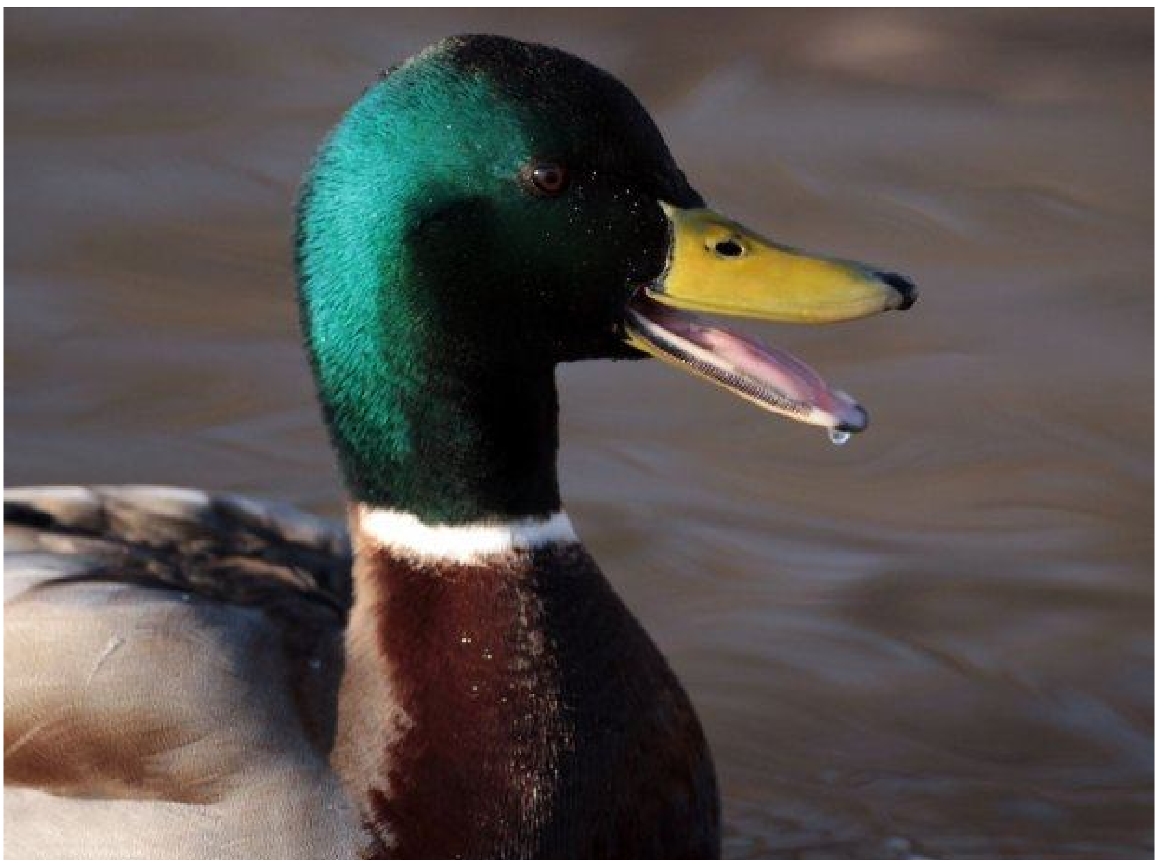
Here’s what to look out for to drive growth through acquisitions

Brad Cherniak | July 13, 2014 7:30 AM ET



Matt Cardy/Getty Images *Behind the scenes, small business growth is like the legs of a swimming duck: Its seems to be sailing serenely, but its legs are pumping madly under water.*

Small business growth is very unlike that of large companies. There is a continual internal evolution, even revolution sometimes, that takes place largely behind the scenes as SMBs grow, like the legs of a swimming duck, which seems to be sailing serenely across the water, but its legs are pumping madly under the water.

The operations of the business are its legs. When a business owner wants to start thinking about acquisitions, he or she must first assess growth from two critical sides — both legs of the business:

The outside leg To create growth, you need to look out for outside considerations. How is your customer mix changing, and the nature of your business with it? Are you moving up-market, or are more nefarious things going on? Are you being forced to take on bad business to keep your sales volumes up? Or are you taking on more and different kinds of customers or deals (ie. increasing the overall complexity of your business)?

The answers to these questions are often borne out in the “resource throughput efficiency” of your business: The amount of effort (measured by the use of company resources, including staff and management time) for each dollar of sales.

Another way to look at it is whether sales per unit of output is increasing or decreasing. For example, many technology-based industries must cope with a consistently downward price curve, and their costs may not be ramping down proportionately.

Bottom line, is your business getting harder or easier from the customer side?

The inside leg This is often the leg even the best entrepreneurs trip on — generally the less sexy and exciting part of the business, that of operating systems and costs.

While it is known that capital costs occur at a less predictable rate, staffing and other operating infrastructure costs such as manufacturing processes and operating procedures can also be unsteady.

Up to a certain size, many employees of a company are forced to play multiple roles and few will specialize. Also, the reporting and performance tracking procedures will be largely ad hoc. This is not a bad thing, it is just the reality of the nature and economics of a small business as it develops.

The evolution to a more structured (and costly) system is not linear. Often it can jump upward after, say, a senior sales or marketing individual or programmer is hired.

Bringing in a star performer to buttress a growing business can require making fundamental changes to the company, to more tightly define the role of the new hire to better match the practices of the larger companies that were likely also wooing them.

Again, this is not a bad thing, but it can have unanticipated consequences.

The balancing act Do you execute a nice scissor kick or flounder?

Managing growth is about flexing both the inside and outside legs of your business at the same time, recognizing that they don't necessarily move in unison. And they can have a considerable impact on each other.

Your revenue-generating capability and your cost structure can flex in ways that give you the worst of both worlds: reduced revenue power on a larger cost structure. For SMBs, this often means losses and even cash crunches.

It is in this context that the business owner should consider acquisitions as a growth weapon.

However, if you pick the wrong time to do an acquisition, say, just before you expect a jump in operating infrastructure requirements, you reduce the chances of its success. Or worse, you put your company at risk.

You need to first decide whether you are you ready for an acquisition, of if it would be better to hold off until your company is in a position to better handle the integration of an acquisition and its impact on the sales and cost sides of your business. This question drives your return on investment, and more.

It isn't just a matter of whether the deal is good and the target is attractive. Or even if it is a good fit business-wise or culturally. It is a question of whether the buyer is truly ready for it. This is the hidden factor that drives whether acquisitions work, or turn into burdens or even disasters for the buyer.

A badly-timed acquisition for a large company can hurt returns, but they have more financial and operating leeway to absorb the effect of errors.

For a smaller business, it can be fatal. So being aware of all the dynamics in play above and below the water line is critical.

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