

# ICT SME M&A: An Introduction

Using mergers & acquisitions  
successfully to grow a small  
business in IT or Communications.



A series of Marketing Briefs to business owners & operators with transactions, how to prepare for them and use them, and (of course) how we can assist.

- I: ICT SME M&A Introduction
- II: How SME M&A is Different
- III: The M&A Process for ICT SMEs

# Executive Summary



Summary:	<p>Small &amp; medium Enterprises (SMEs) in the Australian IT and Communications industry (ICT) often follow similar paths as they grow to achieve the key target – annual revenue exceeding \$10M. Many get stuck at one of several common ‘growth hurdles’ along that path – overcoming these hurdles takes creativity, perseverance and considerable hard work - many fail to pass.</p> <p>One development option, often overlooked due to perceived complexity, is combining two firms through a merger or acquisition (M&amp;A). Executed well, M&amp;A can help with several hurdles, while accelerating growth and bringing forward key benefits of being larger – enhanced operational capability, improved valuation and exit prospects, further growth opportunities, etc.</p> <p>This brief introduces M&amp;A, while later briefs describe how to make it happen.</p>
Audience:	<p>Equity owners, chief executives of second-tier ICT firms in the \$1-30M revenue range, and those who might wish to acquire such firms.</p>
Purpose:	<p>M&amp;A requires specialist skills and knowledge, and usually outside assistance - ICTSC’s speciality - and we would like you to use us when working in this area.</p>
Further Information:	<p>Available from ICTSC directly, including subsequent briefs in this series, or direct discussions of this topic, your prospects, and how we can help.</p>

# Agenda



## Idealised Growth Path for ICT Businesses

*The ideal business will grow through 4 stages, and must surmount 3 key hurdles, in our experience*

### Start-ups: Limited M&A Potential for Unproven Businesses

*Businesses must develop on their own, until proving enough value to support any viable deal*

### Proven Product: Clear Core Asset to Build a Team Around

*As the business develops, the M&A potential increases, offering strategic step-change possibilities*

### Proven Team: Foundations Laid for Corporate Processes

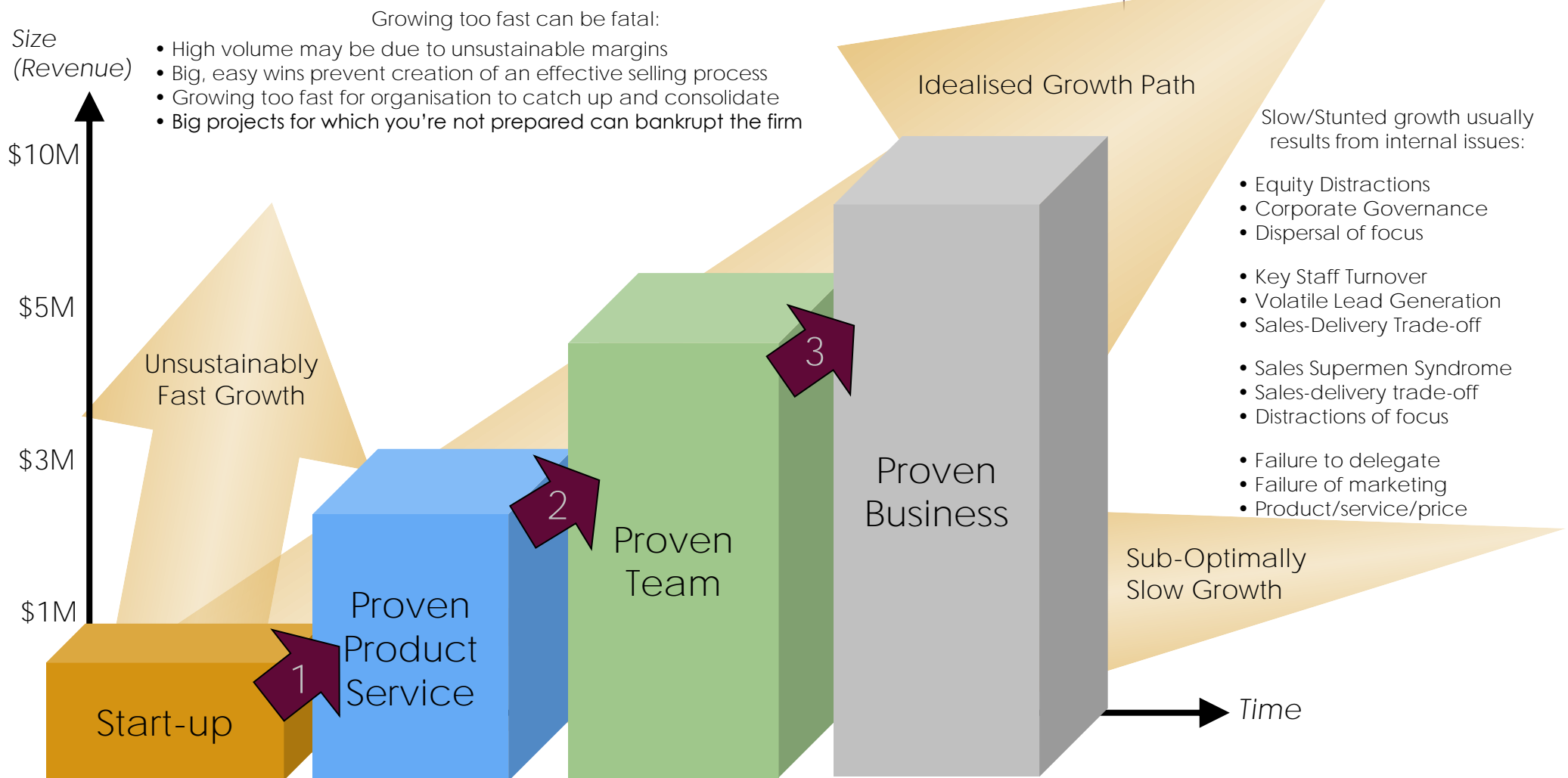
*With key skills in place, M&A prospects increase – particularly to help build key sales & marketing capability.*

### Proven Business: Outgrowing the SME Business Model

*Critical elements are in place, bringing viable opportunities for exit, strategic growth, and acquisition transactions.*

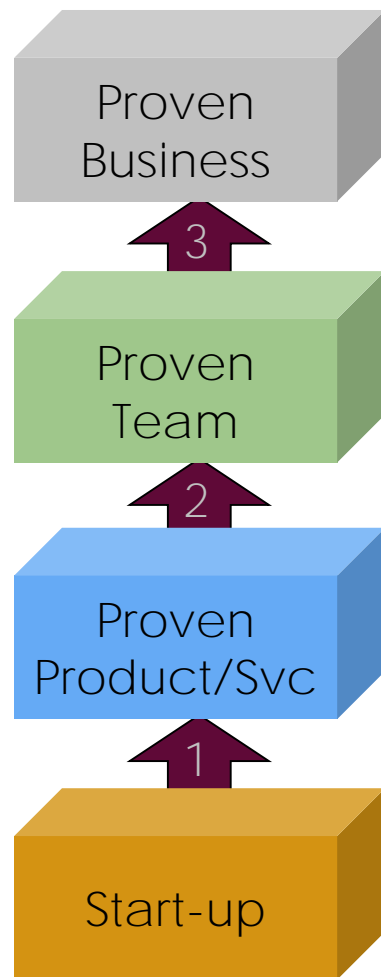
## Key Take-Aways

# The idealised SME growth journey...



**...shows three major 'hurdles' to growth.**

# **‘Organic’ growth: bread & butter sales...**



*Problem: "I'll want to retire soon, and extract my investment"*

Possible Solutions: Management Buy Out (MBO); exit through acquisition by a larger corporate; full or partial sale providing a non-executive role; independent management team supporting a non-executive role.

*Problem: We can't find the right salesman (to replace our founder)*

Possible Solution: Combine scale with a complimentary firm, implement a sales and marketing process and team at 'critical mass' to produce effective results without a 'super-salesmen'.

*Problem: We can't seem to get projects flowing one after another*

Possible Solutions: Align with a larger organisation to operate a marketing team independent of delivery resources, keeping the pipeline full; Acquire another firm that has an effective process, and integrate the businesses.

*Problem: We can't land our key foundation customer*

Possible Solutions: Agglomerate with a complimentary small firm targeting the same customer base; take the product/service idea into a larger corporate that can afford to invest more resources in the business.

**...‘inorganic’ options help solve specific problems.**

# Growth: shareholding & equity issues...



## Getting off the Ground

- Product/Service
- Price to Sell At
- Initial Sales & Clients
- Hiring Some Staff

## Capturing Initial Success

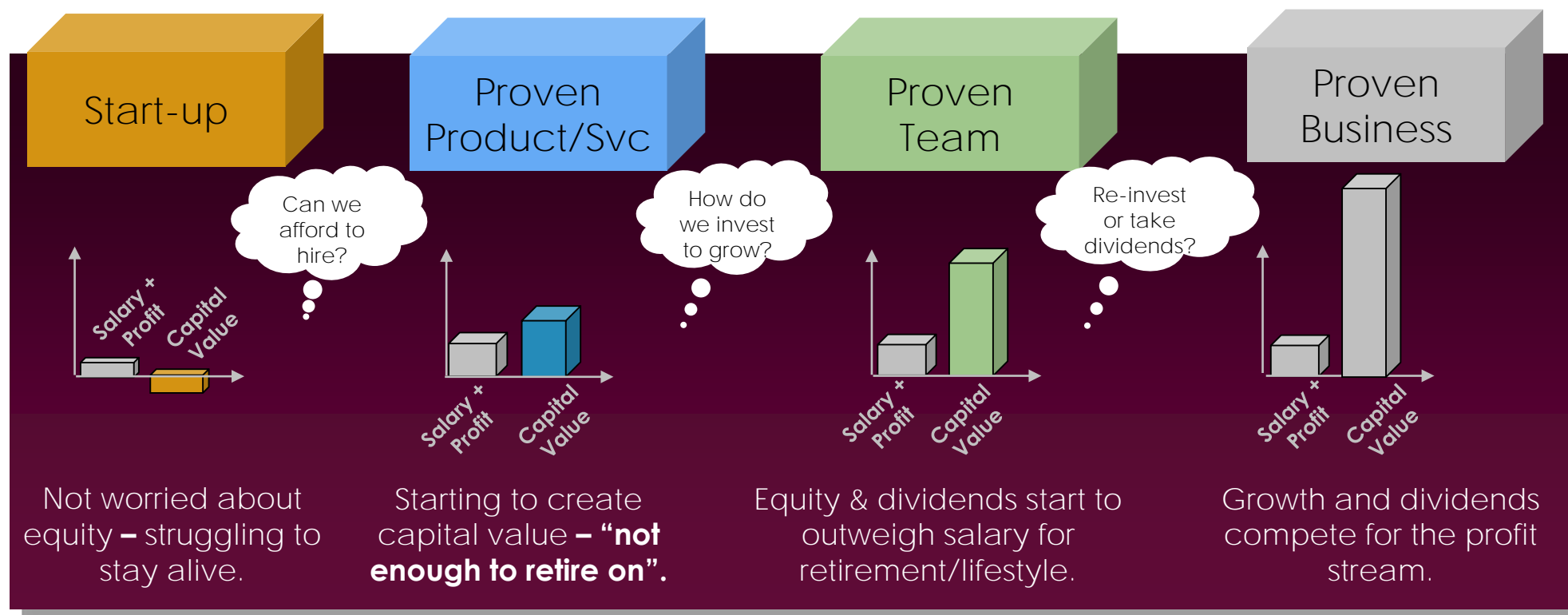
- Keeping Customers
- Achieving Profitability
- Laying a Foundation
- Hiring Key Staff

## Building an Organisation

- Business Processes
- Scalable Sales Team
- Key Man Dependency
- Customer Satisfaction

## Strategic Direction

- New Products/Services
- New Markets or Partners
- Managing the Culture
- Strategic Planning



***...diverge from operational issues and goals.***

# Each stage is unique and different...

## Key Organic Growth Stages

## Implications for M&A



**...and the game changes at each hurdle.**



# M&A: hard for **'Micro-businesses'**...

- **'Pre-Revenue' Start-ups** - Often focused on raising capital to bring their product or service to market, but until proven in the market, valuations on which to raise funds (or sell) remain low.
- Sole Practitioners, Family and Hobby/Lifestyle Businesses - Businesses with years of stable revenue & profits may suit owner-operators, but investors and/or acquirers want growth, and refocussing is notoriously difficult.
- Frustrated Growth Companies - Very small businesses who've sought growth, but failed, are valued for their assets – customer base, contracts, staff with difficult-to-attract skills - but not future potential, as buyers must create that themselves.

## ***...but can still be relevant...***

- ☺ Unique assets, market position or product/service may attract a larger player who can build the business with their broader resource base;
- ☺ Where the SME 'fills a gap' or holds a lynchpin technology for a larger player, they may seek to acquire the business at a reasonable value; but
- ☹ Acquiring at such small scale will often be seen as a 'hiring decision', rather than a business acquisition – realising a much lower value for the principals.



Generally below \$1M pa revenues, and often centred on one individual, who is responsible for all business functions.

If revenues have been flat for 3-5 years, the business may require assistance – more often consulting or training than M&A.

Principal(s) may be happy to stay at this level, but exit value will remain limited, and businesses seldom move from a flat to a growth profile alone.

## ***...and a variety of other assistance is available.***



# Small Teams: **greater capital value...**

## Proven Product/Svc

At \$1-3M revenue, firms must transition from principal-centred business, towards teams with shared responsibilities divided into specialised functions.

In ICT, by far the most common failing is in Sales & Marketing, which suffers when key selling staff focus on customer delivery – until the work runs out.

Firms at this stage are beginning to build capital value, which creates the range of M&A options available to 'leapfrog' these growth barriers.

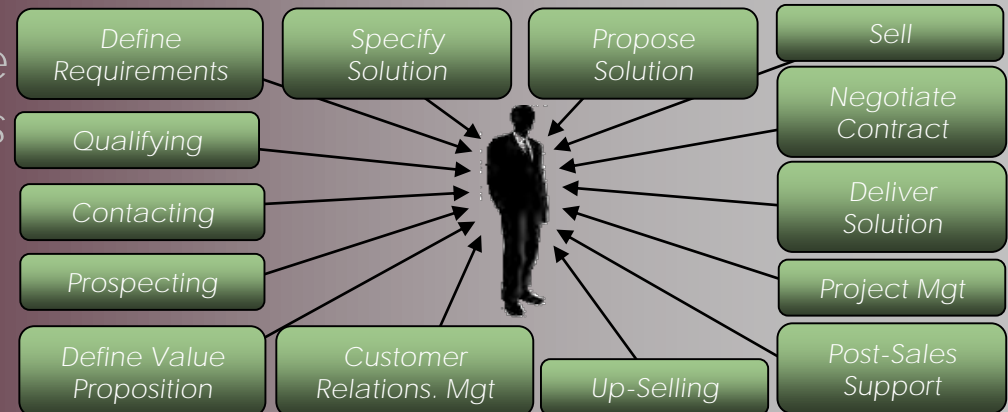


*Sales & Delivery  
Resource  
Contention*

(Shared resources - insufficient scale for dedicated teams)

## Process Failure – Sales Soloists

(Would you take  
your own job?)



**...but** critical operational growth challenges.

# Significant scope & scale are required...



- ✓ As a Channel Partner
- ✓ As a Marketing Partner
- ✓ As a Customer



- ✓ As a Supplier
- ✓ As an Employer
- ✓ As a Trusted Advisor

**...to be a truly viable strategic partner.**

# Inorganic options: join **larger players...**

## *Advantages:*

- 'Play at the next level'
- Greater resources
- Extract maximum value
- Staff career paths extended
- A future for the product
- Stakeholder security enhanced

## *But:*

- Entrepreneur as Employee?
- Compatible Cultures?
- Is this a Buy-Out or Buy-In?



**...or** merge similar businesses with similar goals.

## *Advantages:*

- Retain greater control
- Enough resources
- Retain maximum value
- Staff seniority maintained
- Control of the product
- Stakeholder growth profile
- Can sell to large player later

## *But:*

- Who gets to be the boss?
- Can the businesses work together?
- **What about 'culture'** and staff?



## Customers' most **frequent request...**

Q: *"Can you find a business just like us, but where we've solved 'the delivery problem,' they've solved 'the sales problem' ?"*



A1 - The Bad News:  
*Probably not, as relative valuations would make a deal unattractive ('you can't afford them').*

A2 - The Good News:  
*Getting over this hurdle yourself, will attract the same capital value premium for you.*

**...seeks the rarest of counterparties.**

# The Sales Struggle takes **hold...**

## Proven Team

Many firms exceed \$3M revenue through great efforts from key staff, with an excellent product/service value proposition for customers.

Lacking are reliable, formal processes for scalable results.

Few such firms have core expertise in S&M as well their own product/service field, and a battle to retain staff prevents implementation for the longer term.

Principals often begin to assess their capital value for retirement planning.

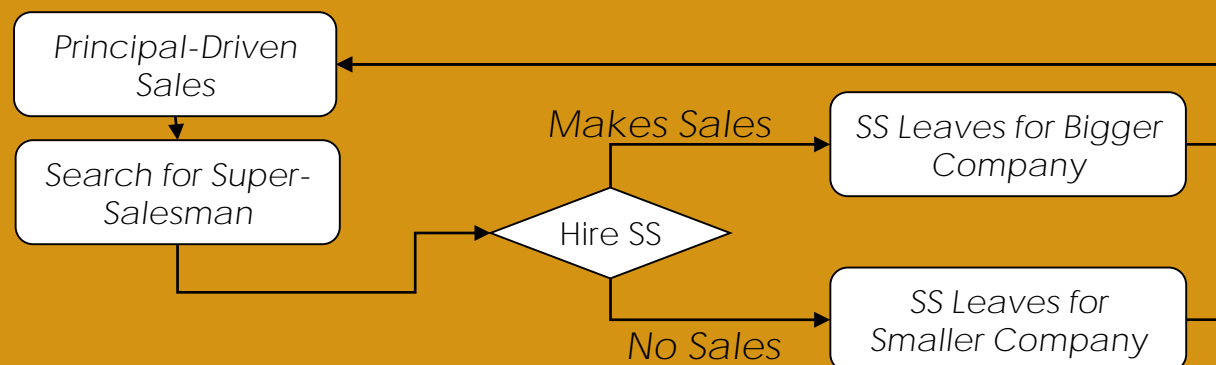
## The Plan – build sales capability as growth allows

*"We need to hire a salesman to take the pressure off our principal, (rainmaker) so he can focus on the longer term."*

Or

*"We're not big enough for a sales team – first we hire one salesman, who will help grow us into a full sales function."*

## The Reality – replacing sales staff every 6 months.



**...when a strong team targets 'the next level'.**



# Sales success is a **'critical mass' issue...**

Solo Salesperson (or Super-Salesperson) in a team of engineers is seldom happy or comfortable – almost all leave within 6-12 months.

Capex: 75k  
Opex: 225k  
Total: 300k  
10% of \$3M Revenue

OR

Sales & Marketing Teams with three or four specialist staff can be effective, happy, and generally self-sustaining, as well as having a lower average cost-per-FTE.

Capex: 250k  
Opex: 350k  
Total: 600k  
20% of \$3M Revenue

## No Process – **Can't Scale or Assist**

Reliance on Personal Networks  
Chasing Big, Unlikely Deals  
Frustration at Missed Targets  
Endless Turnover of Sales Staff



Sub-critical mass S&M is expensive, and works poorly.

Proper S&M can fuel growth, but cost 20% of revenue.

Merging 2X\$3M firms supports proper S&M, at 10% of revenue – to support growth.

The new scale alone may improve valuation multiples.

Growing Customer Base  
Growing Revenue Base  
Driving New Products  
Focus on Forecast Accuracy  
Moderate Staff Turnover



## ***...so you must consolidate critical mass first.***

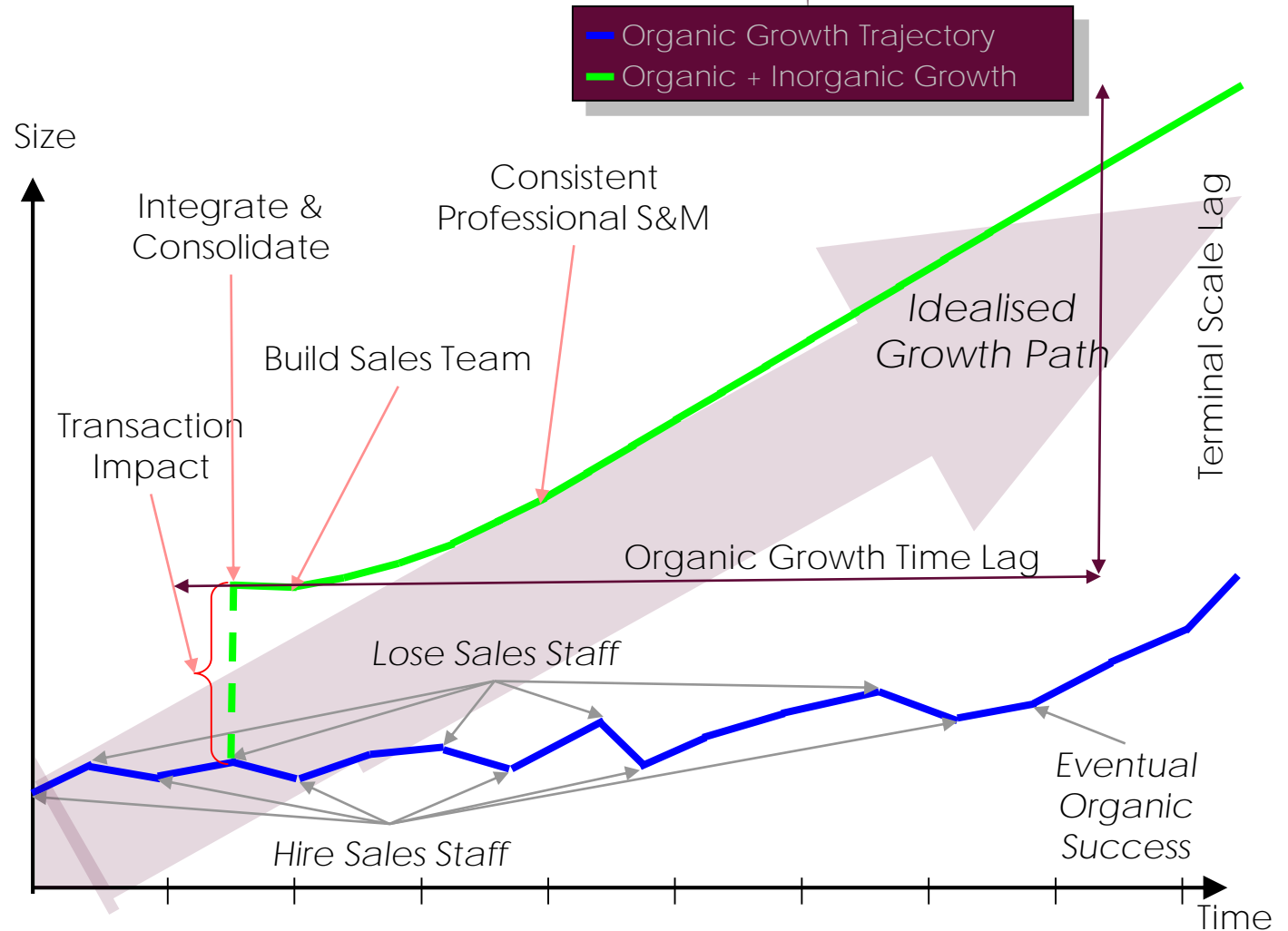
# Transactions **accelerate growth by years...**

## Proven Team

For ICT businesses, beyond \$3M revenue, the potential for principals to achieve a reasonable exit by selling the firm is real.

Continuing to grow will continue to build capital value in the business, as perceived risk decreases with size, and scope increases strategic value.

The value in surmounting a growth hurdle can be considerable, particularly if some time has been spent 'stuck' there already.



**...making exits viable & lucrative.**



# Small Corporates: a range **of options...**

## Proven Business

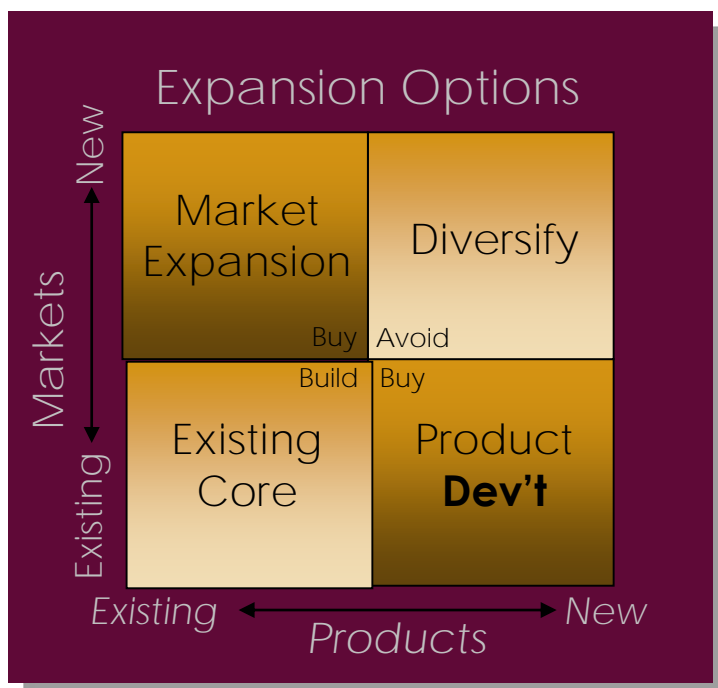
\$10M is a key threshold, above which many more potential acquirers have an interest, enhancing competition. Perceived risk decreases at this scale, which translates into higher 'multiples' hence higher valuations.

While management and corporate governance issues create challenges, opportunities to acquire, as well as being acquired (or 'merging') may become available – with or without capital backing.



***...and very different challenges.***

# Once scale **supports acquisitions...**



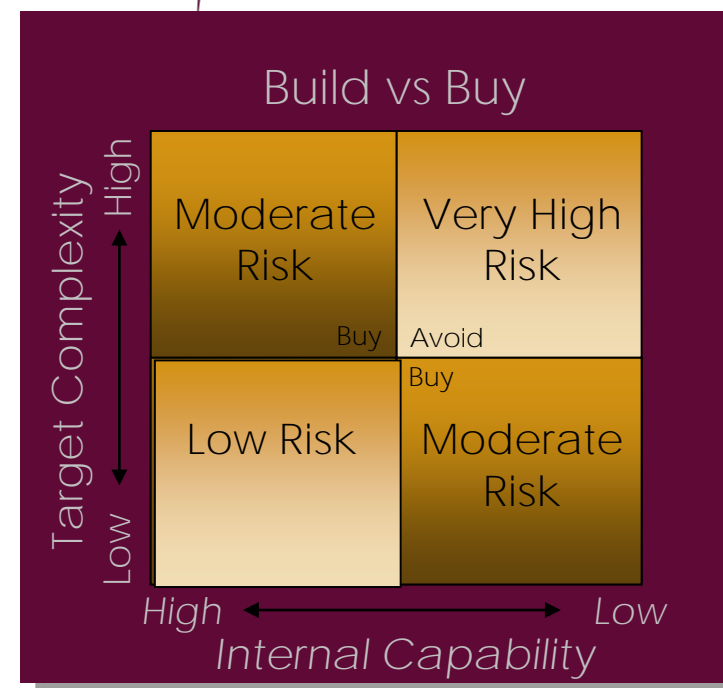
Too Hard?

Buy Externally?

Build Organically?

Combination?

Timing/Opportunism?



Acquisition should be a tool to support targeted growth initiatives

- Can acquiring outside expertise/resources/market share reduce risk?
- Do the elements we would acquire compliment our existing capabilities?
- Will eliminating a (potential) competitor help us in the new market?
- Opportunism – is there a good 'clean-up' or 'turnaround' opportunity?

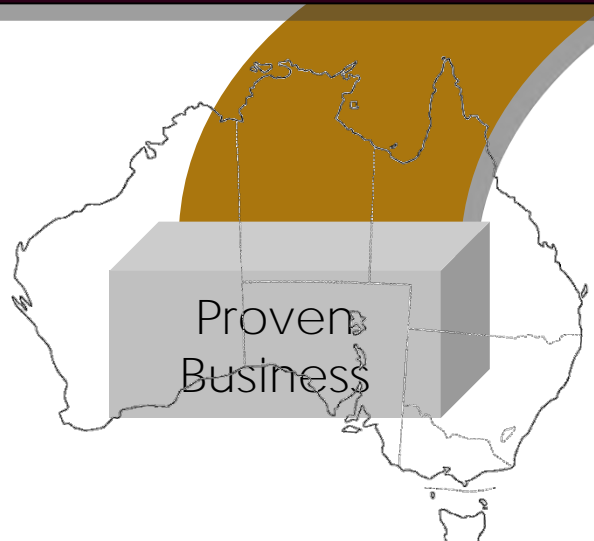
***...they must help drive agreed growth strategies.***

# Global/International: **a common target...**



Scale: Have we got resources to fund:

- Investing in relationships and developing markets;
- Finding, binding, and training partners;
- Funding markets until they become profitable;
- Supporting markets remotely;
- Lots and lots of overseas travel...



M&A might help build the skills and scale internally, or amalgamate your business with one that is already over this hurdle.



Skills: Do we know how to:

- Chose to start in one market, or several;
- Identify and approach those markets;
- Choose to sell directly or through channels;
- Develop and support those channels remotely;
- Localise our product/service if and as required.

## ***...but relies critically on domestic skills and scale.***

## \$5-10M: common succession/exit point...

### Executive Management

- Organisational integration planning;
- Stakeholder roles and responsibilities;
- Strategic directions and key initiatives;
- Plans, forecasts and delivery targets;
- Governance and oversight policies;
- Operational procedures and safeguards;
- Capital and cash flow requirements;
- Etc etc etc

Ownership Boundary

### Shareholders

- Relative or market valuations of the firms;
- Dilution of shareholdings;
- Desires to remain invested or cash out;
- Further capital requirements and sourcing;
- Further options, rights and warranties;
- Dividend policy;
- Taxation issues – company and investor;
- Etc etc etc

Different Issues, Different Goals you must consider separately,  
despite people's overlapping roles.

***...though 'exit' is only one dimension of a deal.***

## Key M&A issues: **internal readiness...**

### Company A

- Corporate Culture
- Leadership
- Products/Services
- Customer Base
- Sales & Marketing
- Delivery Capability
- Investor Backing
- Capabilities
- Suppliers, etc

Must Fit

Must Choose

Complimentary?

Compatible?

Must Choose

Compatible?

Compatible?

Complementary?

Compatible?

### Company B

- Corporate Culture
- Leadership
- Products/Services
- Customer Base
- Sales & Marketing
- Delivery Capability
- Investor Backing
- Capabilities
- Suppliers, etc

***...cultural fit and target 'complementarity'.\****

(\* More on how to evaluate opportunities in a subsequent briefing.)

# M&A creates 'inorganic' growth...



- *Providing Scope and Scale for Specific Goals – Whether a new product/service, geography or demographic market, or a new scale of operations, you need a certain 'critical mass' for that goal, and inorganic options can help build that scale (as well as supporting the goal itself);*
- *Getting Over Growth Hurdles – Firms which have struggled to grow past the same revenue level for several years, often lack specific resources or expertise that agglomeration with another firm can supply;*
- *Accelerating the Growth Curve Years at a Time – Rapidly building scale can provide opportunities and capabilities that might take years for a small firm to grow into. Where a window of opportunity is open for a finite period, rapid growth can provide access to necessary resources;*
- *Playing on a Bigger Stage – with a Bigger Team – After years of hard work to drive organic growth, many principals look forward to 'playing the game at the next level,' with access to markets, products, scope, capital or other resources that their existing firm does not yet present;*
- *Positioning for Principal(s) Eventual Exit or Succession – At some point, everyone would like to step back from the day-to-day grind, and those building healthy companies can leave a lasting legacy, as well as potentially creating comfortable circumstances for retirement, or a base for their next challenge;*

**Critically, M&A is not about 'selling out' when a firm is failing** - when you have the least options, and a transaction can help the least.

## ...a normal part of the corporate growth cycle.

# ICTSC is keen to discuss the possibilities.



Further information is available at  
[www.ICTStrategicConsulting.com](http://www.ICTStrategicConsulting.com)

or

Dr Paul D Hauck, 0414 35 35 03

or:

[Paul.Hauck@ICTStrategicConsulting.com](mailto:Paul.Hauck@ICTStrategicConsulting.com)

*We're always happy to discuss your situation, issues, and prospects, or supply further information from this briefing series. We do this (partly) because we enjoy it, and appreciate the opportunity to help companies and people.*

***...and to assist, if that's appropriate.***