Add-ons, Done Right

An executive summary of the Privcap thought-leadership series on the right ways to approach business integration
Add-ons, Done Right

Key Takeaways

1. Add-ons are adding up
2. Preplanning is the first step to add-on success
3. Strong integration requires M&A muscle
4. IT must be a priority in any integration
5. Blending two cultures is a complex process

The Experts

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Add-ons are adding up

It’s the golden age of add-ons.

Data from the first half of 2018 show that the majority of deals backed by PE firms were add-ons to existing platforms. So why the abundance of add-ons these days—indeed, these past few years?

“In the last half decade we’ve done 165 bolt-ons, or about three a month, which is an amazing pace for a portfolio of our size,” said Kevin Masse, chief portfolio officer at TA Associates. “We use M&A as a way to accelerate our organic growth plan. It gives us an opportunity to acquire cool technology and capability sets for our portfolio companies.”

Add-ons are a way to achieve synergies quickly—to identify technologies and business models that complement existing portfolio companies and plug them in to increase value. “The small add-ons are usually more affordable, so we can buy them at a lower multiple than what we originally bought the platform at,” Masse said. “And the more add-ons we can add into the platform, the bigger and better that company is. Then we can sell it at a higher multiple.”

Preplanning is the first step to add-on success

Every successful add-on begins with extensive preparation. You can’t just take two companies and slap them together. “We make sure we have stakeholder commitment and engagement from both parties,” said Gavin Backos, a principal at RSM US LLP. “Not just ink on paper, but actual involvement in integration to make sure that things go well. That’s a key to lasting success.”

Another important part of the planning process is market research. “Before we close on an initial investment, there is an M&A strategy that has been developed,” Masse said. “We’ve canvassed the market. We’ve assessed businesses we think are a fit from an acquisition perspective, and we do that in collaboration with our management team.”

This ensures alignment with key stakeholders, as well as alignment at the board level regarding the M&A strategy and the desired outcome, whether it be geographic expansion, product and technology capabilities, or additional bandwidth at the management level, to name a few.
The Riverside Company, for its part, assesses three sources of value when it sizes up an add-on, according to Tom Anderson, an operating partner at the firm. One is commercial gaps at the legacy company that can be filled by the add-on, such as new markets, geographies, or customers. “The second is synergy on the cost side,” Anderson said. “Oftentimes we’ll have overhead costs that we can take out. And then third would be best practices. A lot of times we’ll buy a company that has specific practices that can be leveraged by the platform company.”

Strong integration requires M&A muscle

The successful integration of an add-on company with a platform company depends on the seamless combination of many different elements, from HR to IT systems to financial reporting. “That’s what we call M&A muscle,” Anderson said.

It’s the heavy lifting done by PE professionals, management teams and often third-party advisors like RSM’s Backos to merge two companies into one. “A lot of what we do with our clients is advise them out of the gate on an initial integration plan, operating model, whatever you want to call it,” Backos said. “But the playbook needs to remain behind and be a critical component of the integration.”

Calling the plays is the CEO—who should be the leader of any integration effort. “Not the private equity firm, not the consultant, it’s the CEO who must lead,” Anderson said. “Lead the vision, the communication, and make sure everybody knows why this is so exciting to do. You have to communicate early and really overcommunicate with all of your stakeholders, customers, vendors, and employees so they understand why you’re doing this, why it makes sense for the company, and why it’s ultimately going to be good for them.”

IT must be a priority in any integration

These days IT is vital to just about every company, and as such, it is also a vital concern in an integration. After all, IT does not just live in the IT department—it touches every single part of the modern enterprise.

This means that, in the course of an integration, the IT team can quickly be overwhelmed. “Every other division has a short list of projects for day one, day 30, day 100, and beyond, but IT has a list of those for every single functional area for every single day,” Backos said. “One of the biggest risks I see in an integration is IT having too much to carry, so milestones aren’t met, synergies aren’t met, and the integration doesn’t come together.”

One way to avoid trouble here is to institute an integration-management office that prioritizes tasks for IT. Another way, Masse said, is to jump
on IT integration right away, not six months down the road. "We say, let’s integrate IT immediately, because we need everyone on the same performance-management system, the same pricing system, and the same CRM system. We try to get folks up on one consolidated system. We’ll have the conversation around what’s best of breed, but we get through it quickly and move on with conviction. We spend a ton of time making it happen within the first 90 to 120 days of an integration."

If IT is the heart of a company—and nowadays it usually is—then IT integration is the open-heart surgery, Anderson said. "The operation itself is short, but preparing for the surgery and having everything in place and thinking through everything, having all the materials ready, all the procedures listed—that preparation is critical."

Also important is accounting for each of the dozens, maybe hundreds, of minor systems running in various departments and cubicles. It could be a pricing tool, a minor CRM system, or a small warehouse-management app.

5. **Blending two cultures is a complex process**

There are all those variables in an integration that are definable and quantifiable. And then there’s culture. It’s hard to merge two different organizational personalities, and it’s just as hard to know when you’ve done it well—or not.

“When it comes to culture, I think of that saying from the ’60s: I can’t define it, but I know it when I see it,” Anderson said. "When it’s working, you know. But there are steps you can take as part of an integration that will help. One is just to be present. I find so often that management teams will buy a company, then they’ll just leave it.”

They don’t go to the new site, they don’t interact with the new management team, they just assume it will run as it always has. And it might. But often it won’t. The key is for the acquiring management team to be present in the company that they have bought, and vice versa. Mix it up. Share roles. Without this sort of interchange, two cultures won’t blend.

When cultures resist integration, many times it comes down to personalities. "I’ve had multiple situations where you have barriers among folks fighting to have their way," Backos said. "The best way to overcome that is to empower the right stakeholders and make sure decisions are made, and that people and emotions are managed effectively."

And that’s where M&A muscle really comes into play, Masse added. "Executives who are serial acquirers and know how to acquire a business have developed that M&A muscle. They can quickly identify potential issues. They have the intuition, the instinct."
Privcap: What is unique about a merger of two private-equity-owned companies that requires a mix of specialties?

Gavin Backos, RSM: The merger itself is not unique. There are playbooks that we've built, and that other firms have built, that get used over and over again. But what you find when you get into an integration is that there are certain areas that need someone who's been through, say, an integration of two finance organizations. They know how to integrate finance technologies, how to produce consolidated results, and how to develop reports that serve the needs of private equity.

But on the flip side, those finance individuals are not IT specialists. They don't practice in the world of IT, so having someone who truly has an infrastructure background or an application background is a better practice. We do the same with operations, HR, sales, and marketing. We don't try and create these jacks of all trades and masters of none. Our clients expect us to bring specialty resources that have the years of experience, and that can bring opinions and recommendations that are for the better good.

If a private equity firm is thinking of doing an add-on deal, at what part of the process should they give you guys a call?

Backos: Hopefully, we're involved in the pre-deal due diligence. The best successes we've had is when we're involved before the deal closes, where we're able to understand the deal thesis, we're able to understand some of the operational and some of the technical aspects of the integration, and we have the time to plan—pre-deal integration planning, operational planning, communication planning, stakeholder meetings.

These are all things that can defuse the risks that we anticipate coming down the line. We anticipate there's going to be challenges when bringing these organizations together. But how you defuse those issues with stakeholder ownership, with a regular cadence of communication? How to deal with the cultural issues beforehand? Anticipating these things as part of the pre-deal planning is a critical aspect.

There are endless amounts of tuck-ins and add-ons in private equity these days, so that must keep you guys pretty busy, right?

Backos: We're not the only player in the market. Being able to remain relevant and current in the market, and being able to maintain a brand that folks know, is key. I think people buy from who they know. But you're only as good as your last success. So when I talk about having a team that has worked together—a team with individual specialties but that works collectively toward a solution—that stuff is relevant in the market. We have some premier accounts, and we continuously develop our teams to serve these accounts well and provide added value.
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