The role of sales and acquisitions in company growth in Scotland

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Abstract

The paper presents an overview and analysis of company acquisition activity in Scotland over the period 2003-12. An acquisition remains a rare avenue for company growth, and data demonstrates that Scottish companies are less likely to acquire other companies, or be bought, than those in other comparable countries. Scottish companies are also less likely to be involved in international acquisition activity. Company motivations for pursuing acquisition as a growth model appear to relate to speed and risk and include: securing investment, accessing skills and knowledge, expanding products and services ranges, quicker entry to new markets and being able to compete for larger contracts. This research demonstrates that acquisition activity can be an important trigger for sustained growth for Scottish companies.

I Background

Existing evidence of the impact of acquisitions paints a complex picture. The Mergers and Acquisitions Research Centre [1] (MARC) note the gains of a minority of successful firms [2] make it appear that acquisition activity is a positive contributor to the UK economy when the overall picture is more uncertain[3]. Whilst there are differing opinions regarding larger takeovers, there is a prevailing view that smaller acquisitions have a greater chance of success[4].

Harris (2009) found that inward acquisition leads to an increase in labour productivity but a decrease in labour intensity as the acquirer makes investment not only to achieve the desired profitability gains but to bring the acquired company's operations in line with the new owners' requirements.

Evidence of the impact of acquisition on employment suggests that while there are examples of increases in employment at corporate level, most acquisitions are generally followed by a reduction in employment within the acquired firm[5]. Previous research by Scottish Enterprise (SE) on corporate headquarters found acquisition has the potential to lead to a loss of autonomy and loss of functions in the domestic HQ; that acquired companies are more vulnerable to closure; and that within about a decade of acquisition, employment in the acquired company had more or less halved[6].

However, Denison et al note little evidence that considers the *"role of M&A in a corporate growth strategy"*[7] and as such organic growth and growth via acquisition are often presented as alternative strategies. Research by SE (2012) demonstrates that company growth typically occurs periodically through a series of 'trigger points' which suggests organic growth can be complemented by acquisitions

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[1] *Based in CASS Business School at City University London*
[2] *Such as BP, AstraZeneca and Reckitt Benckiser*
[3] *2011, p.5*
[4] *Cardinali & Wikren (2012), Gotton, Kahl & Rosen (2005) and KPMG (2007)*
[5] *Harris, (2009)*
[6] *Botham, & Clelland (2005)*
[7] *2011, p.112-113*

which trigger or accelerate a period of growth. Subsequent work by Nesta (2014) has identified that acquisition is increasingly becoming a feature of high-growth firms[8].

Whether a trade sale can be seen as part of a growth strategy with benefits to the economy depends in part on the location of the acquired firm and the actions of the acquiring firm. The acquiring firm may choose to keep activity (for example employment and output) at the acquired firm's current location. If activity remains domestic following a sale, the economic impacts are likely to be restricted to the potential 'loss' of profits should the acquirer choose to repatriate them back to their home nation. Any shift in the high value aspects of the acquired company would similarly result in a loss to the economy. However, within this perspective there has been little analysis of the shape and scale of acquisition activity in Scotland and how companies use acquisitions to help their growth.

The ZEPHYR database[9] provides detailed statistical data to give a robust and accurate indication of the nature of acquisitions within the Scottish economy, and is considered to be one of the most comprehensive and authoritative sources of such data in the UK.

The analysis of the ZEPHYR database was complemented by face-to-face interviews with a group of Scottish Enterprise Account Managed companies[10] that have either been subject to a trade sale or acquisition. The aim was to explore the underlying motivations that drive and influence this activity.

It is important to note that SE Account Managed companies are selected for their high-growth potential; therefore the evidence presented here may not therefore fully reflect the range of acquisition activity across Scotland's wider business base.

II The Scottish acquisitions market in an international context

From 2003 through to 2012, ZEPHYR recorded the following number of deals involving Scottish companies:

- 664 inward acquisitions (a non-Scottish company acquiring a Scottish company)
- 458 outward acquisitions (a Scottish company acquiring a non-Scottish company)
- 284 intra-acquisitions (a Scottish company acquiring another Scottish company).

Comparing acquisition activity in Scotland with other European countries shows that inward acquisition activity is less common in Scotland than in other similarly-sized economies. The same can be said of outward acquisitions made by Scottish companies. Scotland's performance more closely resembles that of the major Western European economies of Great Britain, Germany and France; though this may not be surprising given that the Scottish economy is an integral part of the UK economy.

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[8] *Nesta, 2014*

[9] *Owned and managed by the Bureau van Dijk, the owners of the FAME business database*

[10] *SE works with companies that will make the biggest difference to Scotland's economic performance through our Account Management Service, selected as a result of their significant growth potential.*

Diagram 1 Total inward and total outward acquisitions as a percentage of the overall business base (2003-12), by country

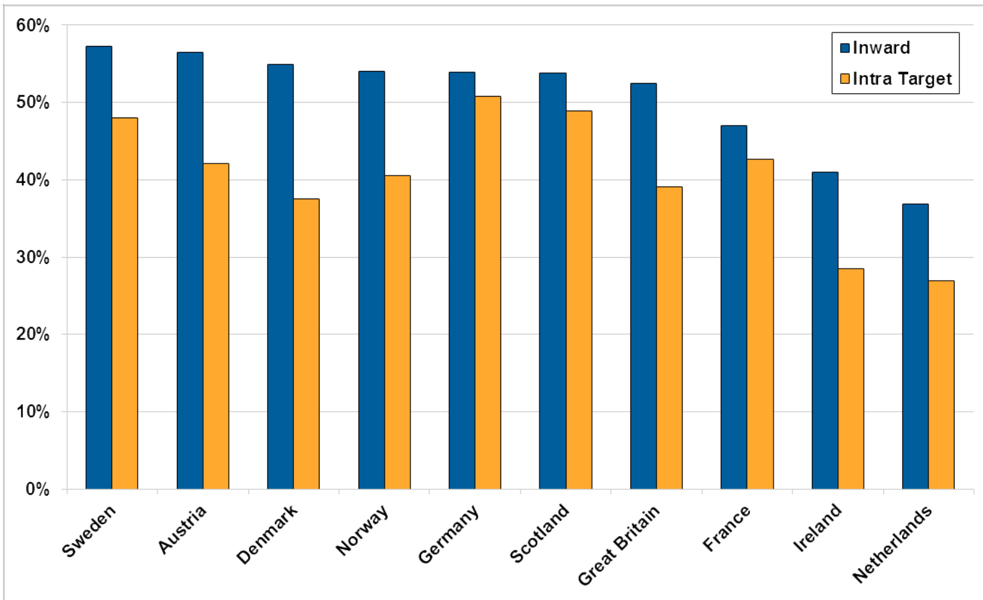


Table 1 Location of companies acquired by Scottish companies and acquiring Scottish companies (2003-12) and Scotland's top export markets (2012)

Location of companies acquired by Scottish firms		Location of firms acquiring Scottish companies		Top 10 Scottish export trading partners (2012)	
Rest of the UK	42%	Rest of the UK	44%	Rest of the UK	£47.6bn
Scotland	38%	Scotland	31%	United States	£3.6bn
United States	6%	United States	8%	Netherlands	£2.7bn
Ireland	2%	Norway	3%	France	£2.2bn
Australia	1%	France	2%	Germany	£1.5bn
Netherlands	1%	Ireland	1%	Norway	£920m
India	1%	Australia	1%	Switzerland	£870m
Norway	1%	Netherlands	1%	Spain	£830m
Canada	1%	Germany	1%	Ireland	£815m
France	1%	Canada	1%	Belgium	£735m

Source: ZEPHYR and The Scottish Government, Global Connections Survey (2013)

Data for both inward and outward acquisitions strongly mirror current export flows for Scotland with a dominant majority of activity with the United States, France, Ireland and Norway (refer Table 1)[11].

[11] *Ernst & Young (2013). No Room for Complacency. 20013 UK Attractiveness Survey – Scotland* *http://www.ey.com/Publication/vwLUAssets/2013_Scotland_Attractiveness_Survey/$FILE/EY_2013_Scotland_Attractiveness_Survey.pdf*

Despite their increasing importance in global trade and investment flows[12], less acquisition activity takes place between Scottish companies and those of BRIC countries.

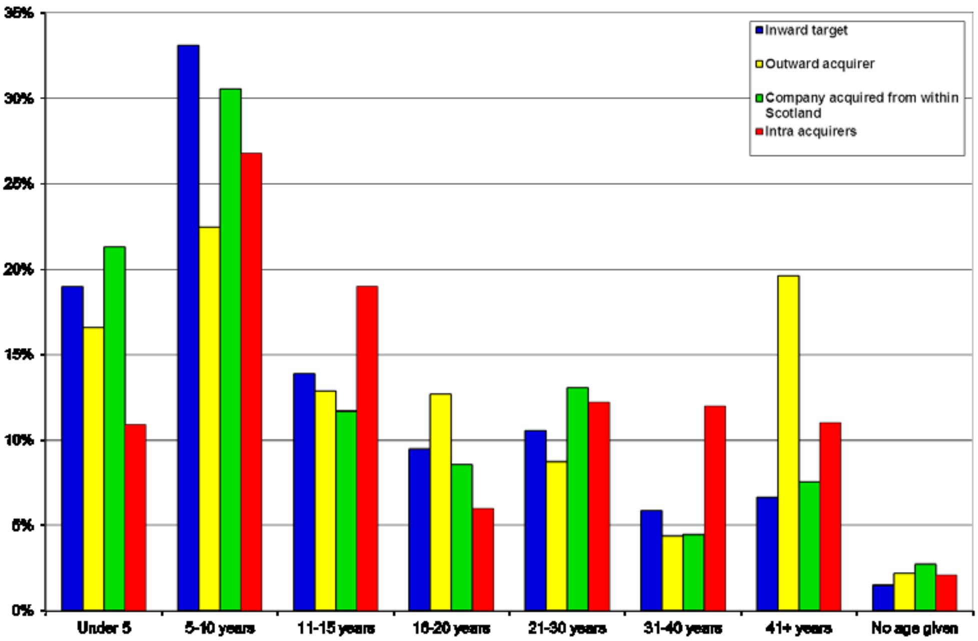
The vast majority of acquisition activity involving Scottish firms takes place within the UK market. This rate of intra-country acquisition is noticeably higher than in other comparator nations. This lower international propensity to acquire or be acquired perhaps reflects the low level of internationalisation of the Scottish business base (a lower proportion of Scottish SMEs export than those to other countries) and the importance of the UK market to Scottish companies.

The greatest proportion of Scottish firms being acquired (be that from outwith or within Scotland) as well as making acquisitions are companies that are under ten years old. Between 2003 and 2012 such companies accounted for:

- 52% of all inward acquisitions
- 39% of outward acquisitions
- 52% of intra-acquired companies
- 37% of intra-acquirers

Acquisition activity by younger companies is greater in Scotland, and to a lesser extent the UK, than in other European countries. The reasons for this are unclear as there is no evidence that Scottish firms engaged in this activity are different in any other way e.g. company size. This is a potential area for future research.

Diagram 2 Scottish companies involved in sales and acquisitions, by company age (2003-12) [13].



Source: ZEPHYR

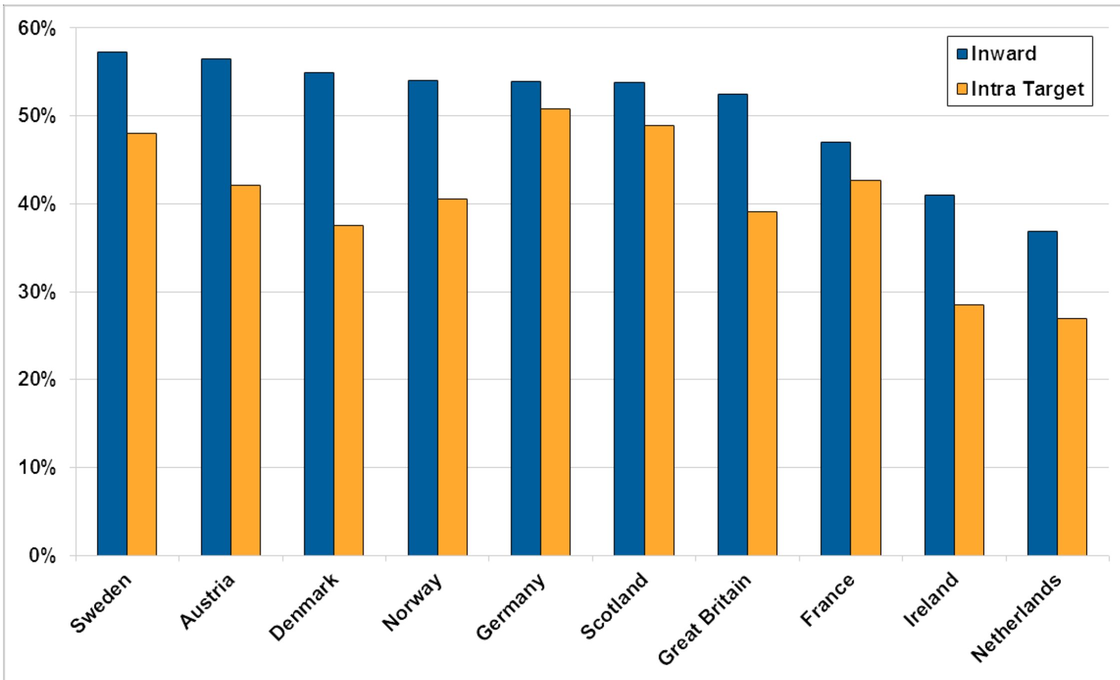
[12] UNCTAD Global Investment Trends Monitor, No.11 (January 2013), No.12 (March 2013) and No.13 (October 2013).
[13] The spike in outward acquisitions of 41+ is influenced by The John Wood Group PLC which made fifteen acquisition deals over the period thus abnormally inflating the data for this cohort.

The median deal size for Scottish companies bought by non-Scottish companies suggests that whilst both the purchase and sale companies involved are young, they are not necessarily small (when compared to other nations' median deal sizes). Similarly, Scotland's median outward acquisition deal size is similar to that of other countries, but as the Scottish companies are younger than their European counterparts, this may be an indication that these Scottish companies have undergone a period of early growth.

The post-deal status of a company can give some indication of the motivations behind, and the consequences of, each deal. Dissolution and an inactive status suggests the principal objective (or at least a strong consideration) may have been to acquire a company to eliminate it; either to extract valuable aspects (e.g. market share) or simply to eliminate a market competitor[14].

In contrast, a company that remains active once it has been acquired suggests a different set of motivations behind the deal. It suggests that the company has been targeted because it is, or has the potential to be, profitable and has, or has the potential to be, of significant value to the acquirer in its current location, with its current market and current customer base. This suggests that the strategy behind the acquisition/trade sale recognises the potential to achieve synergies from bringing together the two firms, which evidence shows is a key factor in achieving post-acquisition success[15].

Diagram 3 Percentage of companies remaining active post-acquisition (2003-12)



[14] *It should be noted that the period of this study covers Recession of 2008 – 2014 and this may be a factor in many of the dissolutions and inactivity of companies.*
[15] *Cardinali, A., Wikren, B. (2012), Berkovitch & Narayanan (1993), Raj, M. & Forsyth, M. (2004)*

Analysis of the trading status of firms shows lower post-acquisition active rates for acquired Scottish companies (54% for those acquired from overseas, and 42% for those acquired from within Scotland) than for those companies who make acquisitions.

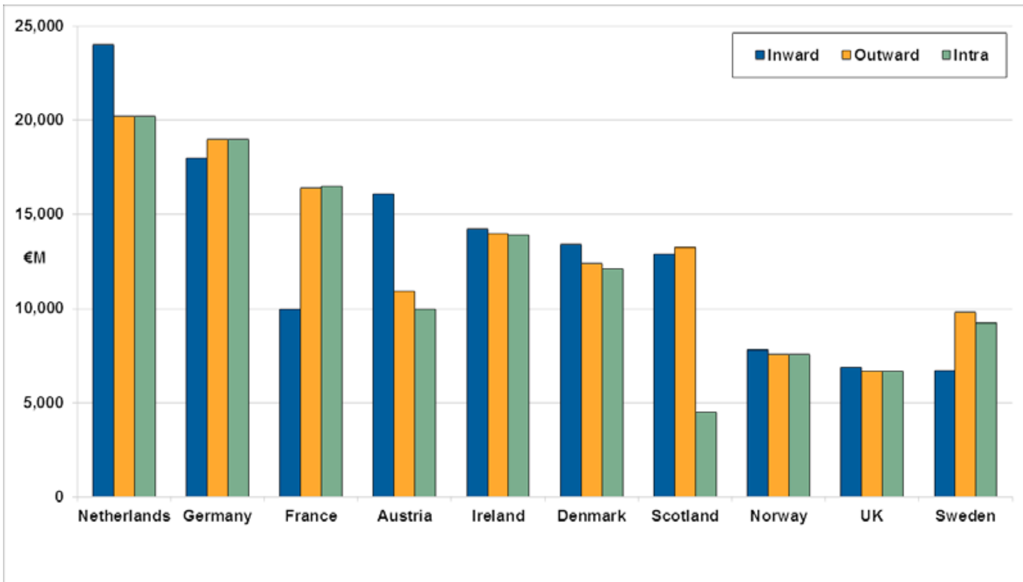
Scotland has one of the stronger post-acquisition active rates in Europe across all types of deal. For inward acquisitions, Scotland's rate of (54%) is higher than other countries such as France, Netherlands and Ireland. Scotland is also ahead of the UK and is only 3% behind top-placed Sweden at 57%.

The post-acquisition active rate for acquired Scottish companies is higher than some other countries. This suggests that acquirers recognise the value of Scottish targets in terms of the existing market as well as their supply chain and networks. This may reflect the acquired company's 'embeddedness' in the Scottish economy as well as other benefits such as access to markets and public sector support. In this regard, Scotland's acquisitions market may potentially offer an avenue to benefit not only Scottish firms, but also the Scottish economy through an expansion in jobs, supply chains and potential future unrelated activity within Scotland.

Median deal sizes suggest that most acquisitions take place at the SME level. The median figure for both inward and outward acquisitions is around £11m.

In comparison to other countries, Scotland performs within the mid-range for inward acquisition deal sizes, at around €12.9m (£10.8m); lower than the Netherlands but higher than Norway and Sweden as well as the United Kingdom.

Diagram 4 Median deal size by acquisition type and country (2003-12)



In terms of outward acquisitions, the median Scottish deal size of €13.25m (£11.1m) is higher than comparable countries (Austria, Denmark, Norway, Sweden and the UK). The data suggests that

Scottish companies that make cross-border acquisitions are very similar to Scottish companies subject to trade sales.

The greatest numbers of deals are by companies in the following sectors: technologies and advanced engineering; financial and business services; creative industries; and, energy sectors. This is true for each type of acquisition 'deal' (inward, outward and intra).

In summary, the Scottish acquisitions market demonstrates that:

- Compared to other similar-sized economies, a lower proportion of Scotland's business base is involved in acquisition and trade sale activity;
- Scotland is strongly dependent on the UK market for company sales and acquisitions, more so than comparable, independent countries;
- Scottish companies involved in acquisition are younger than those in other countries, but deal sizes are comparable, as are post-acquisition activity rates;
- Companies in technologies and advanced engineering; financial and business services; creative industries and energy are more active in acquisition activity both across borders and within Scotland.

III BUSINESS' EXPERIENCE OF ACQUISITION

In order to better understand some of the underlying factors behind sales and acquisitions activity, a series of interviews were conducted with twelve companies that are account managed by Scottish Enterprise. These highlighted three principal reasons for sales and acquisitions activity, namely to:

- achieve growth;
- facilitate a management exit ; and
- provide a return to investors.

(i) To Achieve Growth

The primary objective for many companies' acquisition activity was to realise growth, using acquisition or a trade sale to either trigger a new phase or continue a current growth phase. Companies provided a range of reasons why they felt acquisition was the best route to maximise their growth potential, with strong similarities between companies subject to a trade sale and those making an acquisition. These included to:

- Source the quickest way to achieve and/or accelerate growth;
- Lower the risk attached to acquiring a company with knowledge, skills and customers compared to investing in the existing company and activities;
- Realise synergies and shared goals between companies;
- Access products and services and add more products and services to the company's offer;
- Give the Scottish company a stronger presence and/or a base in either an existing market or in a target market, particularly internationally, at a pace that could not be realised any other way;
- Provide instant access to skilled, trained and qualified staff;
- Provide instant access to networks, contacts and relationships to be exploited for further growth plans;

- Provide the company with a healthier financial position, a stronger balance sheet; often to remove debt and other financial constraints;
- Secure investment, particularly capital investment, which the Scottish company alone was not able to find or attract;
- Provide a level of technical support and expertise not previously available;
- Increase their customer base and reduce risks to the company

A common factor raised by the interviewees was the importance of finding the right acquisition or trade buyer. As one Chief Executive put it *"It's not the biggest cheque, it's who would work with us to grow in the long-term. It also showed our staff that they were valued and part of what we wanted to achieve."* Scottish companies interviewed showed a desire to secure the best fit for their company and staff, with some spurning larger financial returns in order to achieve this.

The overall conclusion is that each company felt that acquiring another company, or being acquired, was the quickest route to realising growth and also the safest option, providing the right condition were set. Companies were consistently of the view that alternative strategies would have found it harder to penetrate further into markets, make necessary investment and access the required knowledge, expertise or contacts. To build their companies organically would have, in their view, take too long, been too costly and have had a lesser chance of success. For each company, therefore, their decision to acquire or be acquired was the most logical step to ensure they grew.

(ii) To Achieve a Management Exit

In the case of two companies, the explicit aim of the owners from the outset was to achieve an exit and a return on investment. For a further two companies, an exit had gradually become the preference of the owner. The exit was ultimately used in each of these four cases as a 'trigger' point for further growth of the company as the experiences and skills of new members of the management team took the company *"to the next level"*.

Often, exiting owners sought to ensure that the company remained in Scotland by stipulating that sale contracts retain brand names, key accounts and guarantees to retain staff. This shows that despite seeking a management exit, it was not simply about securing an exit at any price or any effect and leaving the business to the whims of its acquirer.

"We spent years on this company; it's our legacy so we weren't going to hand it to just anyone. They had to make sure it worked for us beyond the sale, otherwise we'd have looked elsewhere."

One motivation was a desire by the owner to maintain their reputation to allow them to continue to work in their chosen field within Scotland. This also helped therefore to secure continuing benefits from the company's operation on the Scottish economy.

This desire to remain active after exiting the company, and the requirement that the replacement owner had to have relevant skills, expertise and experience, highlights the potential of acquisitions activity to 'recycle' individuals and entrepreneurs within the Scottish economy.

(iii) To Provide a Return to Investors

Interviews highlighted that companies with investment from angel investors and private financiers possessed a greater awareness of the potential role a trade sale could play in facilitating their growth plans. The eventual exit of existing funders was a central part of their overall business plan, which enabled the company to ensure their funders received a return as well as ensuring the deal enabled the company to continue to grow. Each such interviewee believed that a sale presented the best opportunity for them to facilitate this exit and achieve growth.

Reaching these growth goals only arose because of the drive to facilitate an exit for initial investors. It allowed the Scottish company to secure investment and higher growth in jobs, not just in the company but also the supply chain, whilst providing investors with a financial return and enabling them to re-invest in further companies.

Companies repeatedly highlighted that they companies are presented with opportunities for trade sales and acquisition on a consistent basis. As one Managing Director noted *"they're always coming across my desk, some I take a few minutes to think about, others I just ignore … They're always there and you never know when something might just appear at that right time."*

Some companies admitted that they were *"…always looking. We never stop. You just don't know what opportunities you'll miss… we're always talking with customers, clients. That's how these come about."*

Interviews highlighted not only the approach of some Scottish companies but also their acumen in using economic conditions to secure attractive deals. Whilst their long-term ambition is to grow turnover and profitability, management have been flexible in their approaches to achieve this. Rather than being rigidly committed to any particular strategy, they remained open to all viable opportunities as the economy, their industries and markets evolved.

IV Alternatives to Acquisition

Whilst both trade sales and acquisitions provide an avenue for growth, they are not the only option available to companies. Other routes include investing in existing structures (growing organically), a stock market listing, employee ownership or joint ventures.

Companies believed these other avenues would not have allowed growth to occur as quickly and not to the level desired and subsequently realised. The reasons for pursuing a trade sale or acquisition above other available alternatives seem to relate to *risk* and *speed*. On completion of the deal, companies had a ready supply of skilled staff, machinery, networks, knowledge and markets/orders. Securing these benefits almost instantly allowed growth to be realised much more quickly than attempting to build these organically.

It could also be interpreted that companies saw a trade sale or acquisition as a better value/lower cost route to growth. Companies had considered investment and diversification but concluded there was no guarantee if, or when, such a strategy would pay off. One cited an example of a competitor in Scotland who had chosen to invest to grow organically, but *"hadn't seen anywhere near the return they might have hoped for, and they have no real indication as to when they will, if indeed they ever, do."*

Some companies acknowledged that they did not perhaps consider all potential growth options open to them, giving two reasons for this. The first was knowledge of where to seek advice. The second was that, in some cases, the owner made a quick decision to sell and did not take time, or involve existing management, to explore other options. In such cases, outcomes had been ultimately beneficial for the company, but on reflection, one interviewee felt some external advice on alternative growth strategies may have been beneficial.

For those companies that considered their objectives and options and set out a clear plan to deliver these either via acquisition or trade sale, their experiences were positive. They had a stronger belief that they had achieved and, in some cases, surpassed their expectations. Whilst pre-deal diligence was viewed as exhausting and thorough, their reflection was that it was worth the time and effort.

Companies for which acquisition decisions arose more out of circumstance than any strategy, did not regret decisions that were taken, but acknowledged that post-acquisition benefits had emerged more by chance than design and that more due diligence could have been undertaken to ensure the deal was the absolute best outcome for the company.

VI Conclusions

It is clear that trade sales and acquisitions can and do form part of the growth plans for companies, bringing with them wider benefits for the regional economy. Scotland's market is similar to many countries, although acquisition activity involving Scottish companies is notably lower than similar sized countries. This suggests that the challenge to grow companies in Scotland is not a consequence of too many companies being acquired.

The motivation for companies to acquire others (or seek a sale) appears to be the speed and ease of access to markets: secure sufficient investment needed to grow; to enter new markets or deeper into existing markets through attracting larger clients. Companies that had these motivations had found themselves unable to fund additional investment from within or lacking the confidence to be able to attract sufficiently skilled staff, hence preventing them from adding new products and services in order to grow, both within their sector and geographically.

Evidence points to a correlation between the networks of companies and successful, growth-led, acquisition activity. Hence, increasing the level of Scottish firms trading internationally would most likely lead to an increase in company acquisitions. This fact heightens the importance of successfully embedding companies within the Scottish economy in order to maximise post-acquisition (or sale) economic activity in Scotland. We know from the research that the greatest benefits to both the company and the economy arise when companies that are acquired are embedded within the Scottish economy, with established links to growing markets, skilled staff, supply chains and strong growth potential.

The potential downside of acquisitions of Scottish-based companies is the leakage and loss of profits from the Scottish economy. However companies saw this loss as being an acceptable trade-off in order to access higher growth. Interviews highlighted that in the absence of a trade sale companies would not have experienced subsequent growth in sales and jobs, not have secured required investment nor been able to access international networks via attracting larger contracts without the acquisition.

This issue of how to further embed companies within the Scottish economy is worthy of further consideration given that acquisition activity increases as companies seek to internationalise. Future research could also develop a greater understanding of the extent to which post-sales 'recycling' of knowledge, skills and funds occurs and assess its benefits to the Scottish economy. Research could also consider the extent and impact of some of the barriers that companies face (e.g. access to investment finance, innovation and skills) which led to the choice of a trade sale or acquisition, as the best means to growth.

The evidence gathered in this study found a prevailing view amongst Scottish Enterprise Account Managed companies that acquisitions and trade sales had formed a *central* part of their growth plans. As such sales and acquisitions should be seen by policy makers as a regular characteristic of the modern business economy and be recognised as an effective route through which company growth can be achieved.

Acknowledgements

The authors would like to thank the Scottish companies who participated in the study for their time and considerations. Any views in this paper are those of the authors alone. The usual disclaimers apply.

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