Bachelor’s thesis

Bachelor of Business Administration

2021

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INTRICACIES OF COMPANY ACQUISITION

– Identifying challenges

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TURKU UNIVERSITY OF APPLIED SCIENCES

BACHELOR’S THESIS | ABSTRACT

TURKU UNIVERSITY OF APPLIED SCIENCES

Bachelor of Business Administration

2021 | 34 pages

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INTRICACIES OF COMPANY ACQUISITION

- Identifying challenges

The company acquisition complexity essentially draws from the high number of stages in the process. Because of this alone, many challenges come onto surface when planning and conducting company acquisitions. Many acquisitions fail due to insufficient planning and not taking into account every aspect needed.

The purpose of this thesis is to identify challenges within the process while providing a clear roadmap to successful acquisition deals. It is crucial to plan the acquisition ahead and make sure there are enough resources available in every stage.

This study is a research-oriented thesis, including qualitative methods, such as analyzation of previous literature and knowledge. Regarding the nature of the topic, some information are considered as trade secrets and therefore the sources for this research only consist of publicly available materials.

The theory part consists of the fundamental knowledge to understand the company acquisition and the components in the various stages. In this part, the valuation aspect is also visited.

The results of this research are intepreted using the Deal Flow Model by Galpin (2014) as a roadmap, which provides a clear view of a company acquisition process. The challenges are defined in the various stages of this model.

Companies and investors engaging into company acquisitions might find this research helpful in their future activities. This thesis creates a roadmap to help identify challenges in different stages and therefore will appear beneficial in the planning phase to avoid possible pitfalls.

KEYWORDS:

company acquisitions, company valuation, business strategies, inorganic growth

OPINNÄYTETYÖ AMK | TIIVISTELMÄ

TURUN AMMATTIKORKEAKOULU

Bachelor of Business Administration

2021 | 34 sivua

Oskari Hotti

YRITYSKAUPAN KOUKEROT

- Haasteiden tunnistaminen

Yrityskauppojen monimutkaisuus johtuu lähinnä prosessin suuresta vaiheiden määrästä. Jo pelkästään tämän seikan vuoksi yrityshankintoja suunniteltaessa ja toteutettaessa tulee esiin monia erilaisia haasteita. Monet yritysostot epäonnistuvat riittämättömän suunnittelun ja puutteellisen näkökohtien tarkastelun takia.

Tämän opinnäytetyön tarkoituksena on tunnistaa prosessin haasteet ja tarjota selkeä etenemissuunnitelma onnistuneisiin yritysostoihin. On erittäin tärkeää suunnitella hankinta etukäteen ja varmistaa, että jokaisessa vaiheessa on käytettävissä riittävästi resursseja.

Tämä tutkimus on tutkimuslähtöinen opinnäytetyö, joka sisältää kvalitatiivisia menetelmiä, kuten aiemman kirjallisuuden ja tiedon analysointi. Aiheen luonteesta johtuen joitakin tietoja pidetään liikesalaisuuksina, joten tämän tutkimuksen lähteet koostuvat vain julkisesti saatavilla olevista materiaaleista.

Teoriaosa koostuu perustiedoista yrityksen hankinnan ja komponenttien ymmärtämiseksi prosessin eri vaiheissa. Tässä osassa käydään läpi myös yrityksen arvonmäärityksen perustietoja.

Tämän tutkimuksen tulokset on koottu yhteen käyttämällä Galpinin (2014) Deal Flow -mallia tiekarttana, joka itsessään antaa selkeän kuvan yrityksen hankintaprosessista.Haasteet määritellään tämän mallin eri vaiheissa.

Yritysostoihin osallistuvat yritykset ja sijoittajat voivat hyödyntää tätä tutkimusta tulevan toimintansa ja yrityskauppojen suunnittelun kanssa. Tämä opinnäytetyö luo etenemissuunnitelman, jonka avulla voidaan tunnistaa haasteet yrityskaupan eri vaiheissa, ja se toimii siksi hyödyllisenä oppaana suunnitteluvaiheessa mahdollisten virheiden välttämiseksi.

ASIASANAT:

yrityskauppa, yrityksen arvonmääritys, liiketoiminnan strategia, epäorgaaninen kasvu

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FIGURES

LIST OF ABBREVIATIONS (OR) SYMBOLS

1 INTRODUCTION

According to Davis (2012), many acquisitions fail due to different expectations of the buyer and seller. Therefore companies and investors may find a detailed interpretation of the stages in the acquisition process helpful.

The start of the process is making a strategic plan to which the acquisition must be based on and because of the nature of the acquisition as an investment it can take from months to years. Target companies are first searched and analyzed using publicly available documents and information and then the process is proceeded in the stages of further investigating which includes initiatives for target companies.

For the means of this thesis, the process is divided into three phases to which the "Deal Flow Model" by Galpin (2014) provides a more defined and complete view. The phases are Pre-deal phase, deal phase (in the middle) and post-deal phase.

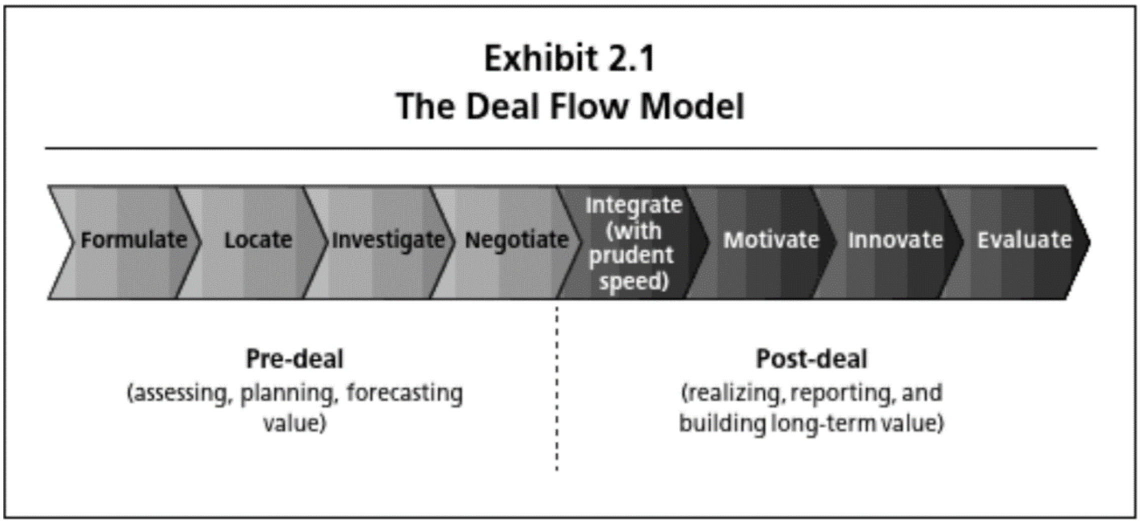

Figure 1. The Deal Flow Model (Galpin, 2014)

The first phase involves mapping out the main interest for the acquisition and a strategic approach is suggested. Factors like market capacity, geographic expansion, product and market expansion, R&D intellectual property and human resources play a key role when defining a strategic vision. For private buyers the cost factor can play a major role during this stage. During this stage it is also suggested that publicly available documents, financial statements and news are reviewed with expertise. The Due Diligence is usually very intense and research in this for this topic is tailored to the needs of company acquisition process. The risk management analysis has many possible pitfalls that must be addressed and due to this fact, companies and investors must be aware of the details. However, it is one of the most important factors while conducting a valuation of a company and needs to be treated as such and therefore credible sources about the topic are reviewed for this thesis.

The second phase, deal phase, including the actual negotiations, involves legal aspects and price expectations which is highly related to the due diligence and company valuation sub-process. This stage is final part of the acquisition process before post-deal phase. Many companies find this stage very exhausting as it can be very intense and full of analysises be implemented further. (Davis, 2012)

The third phase, post-deal phase, consists of integration and managing the change in the company culture. This is a phase in which many challenges appear.

According to Galpin (2014) the main pitfalls are lack of depth in the stages of analyzation methods and due to this, management is unaware of negative aspects that hinder in the future of the target company. The companies and investors conducting an acquisition plan may find useful to be aware of the problems that can occur and different methods about how to avoid them during the process. Also, it is mentioned by Galpin (2014) that opportunistic versus strategic intent of the transaction needs to be addressed accordingly.

Moreover, the findings will be mirrored to the “Deal Flow Model” to accurately to map out the problems during the stages on the model. The model provides a clear view of the acquisition process and thus is a valuable tool for both buyer and the seller.

1.1 Most acquisitions fail

In modern world, the competition between companies is very intense, and to survive, organic growth may not be simply enough. That is why companies also need to acquire other firms. It is also common for companies to use acquisition to get rid of competition. (Liimatainen, Lähteenmaa, 2020) The acquisition process can be seen as an alternative to organic growth (Hakutizwi, 2021), and the acquisition decision can be based on a number of factors.

Comparing with organic growth, an acquisition is easier and faster to do. However, the success to make an acquisition highly depend on the ability of management to make the new company work well in operational actions. The integration process is a difficult task because many factors are involved in it.

According to Liimatainen and Lähteenmaa (2020), 50-90% of the acquisitions fail. However the success highly depends whether the acquisition is viewed as a strategic investment or a financial instrument for added profits to the shareholders. Reason for this high rate of failure is that is almost impossible to predict whether the acquired company fits perfectly in the buyer's strategy. In addition, many of the underlying challenges typically come onto surface in the integration phase. It is also suggested that the failure rate is due to lack of detailed and well-structured roadmap for planning ahead, which could hand out a myriad of holistic knowledge about profitability of the acquisition in addition to deep understanding of company values and culture of potential targets as well. (Galpin, 2014)

1.2 Defining success

A successful acquisition can be determined by the fact that it allows a long-term benefit for the company, whether it is achieved through savings or entry into a new market. The acquisition can also improve the corporate culture and employee satisfaction. (Katramo, Lauriala, Matinlauri, Niemelä, Svennas and Wilkman, 2013)

The acquisition could result in increased global presence or access to new markets. Acquiring a similar company could help eliminating competition between rivals, making it more convenient for customers to choose who they do business with. However, it is also important to note the possibility of threats that may come with an acquisition. For example, it may result in increased debt. On the other hand, it helps you to reduce the risk of being left behind by your competitor.

Furthermore, there are culture differences between two companies. Different employees may have not necessarily same work ethic or values. Employees may be worried about their jobs and whether they can continue working in the new company or not. This factor alone can define whether the acquisition is successful or not.

RESEARCH QUESTIONS AND OBJECTIVES

The process of company acquisition is a highly complex process, requiring this research to have clear objectives that will be focused on. The following research questions provide a focused approach to this research, creating value for companies and investors undertaking the process of acquiring a small or mid-sized enterprise. These research questions are taking into account the need for a detailed roadmap for the process and its profitability factor.

- Identifying the challenges and reasons of failure in different phases of company acquisition
- What components play the most important role in the company acquisition process?

THESIS STRUCTURE

This thesis starts with getting familiar with the knowledge base, including company acquisition and valuation fundamentals. In the following part, the deal flow model by Galpin (2014) is introduced and used as a map for company acquisition process. As a result, the challenges are identified in every stage of the model according to their temporal occurence.

2 COMPANY ACQUISITION

Company acquisition is a process in which one company or an investor buys a company. However, it is different from a merger as it is not necessarily two companies coming together to create one larger company. Rather, it is buying of one public or private company by another private company or outside investor. In recent years, the number of company acquisitions has been increasing more than ever. (Liimatainen, Lähteenmaa, 2020) Therefore, private investors and companies seek new opportunities to increase revenue and gain better market share.

Many private companies grow their business by acquiring other small businesses. If a smaller company is purchased, the private company will also benefit from the previous owner's knowledge, resources and client base. The private company will have an advantage over other competitors because of this. Sometimes it is also cheaper to buy an existing company in a specific market than to build one up from the very beginning.

The key aspect to a successful acquisition is knowing how to manage the transition of your business into one wholeness (LMA Consulting Group, 2013) This way, it can be done with ease and security without losing any customers or investors.

Strategic approach is playing a major role when engaging in acquisition activity. Typically, the acquisition is a way to gain competitive advantages via inorganic growth, which is the counterpart for organic growth that includes actions like hiring new workforce, geographical expansion and development of new services and products. A planned, organized strategy is needed to avoid any negative surprises later on. The target company must be thoroughly evaluated before a purchase is made.

Buying a business is very risky and companies and private investors that are considering buying another company will need to have a solid knowledge of what they are purchasing. Buying a company requires much more than just buying the target company's assets and liabilities. The risk involved in purchasing an entire business does not only include the immediate financial costs of the acquisition but also the future risks involved with owning it, such as management, operations, new products or services that may not be profitable.

2.1 Difference between mergers and acquisitions

The core difference between a merger and acquisition is that an acquisition is when one company buys another company, with all the assets, knowledge and operational matters. Usually, a larger company will acquire a smaller one to gain access to the new market or product. Mergers, on the other hand, involve two companies coming together into one entity while maintaining separate ownership and managements. This is typically done for cost-saving purposes. (Majaski, 2021) This thesis has a sole focus on acquisitions.

Another important decision that any company has to make is whether it wants to keep its own name, or merge it with another company's name. This is important because a company's identity will influence how employees will react towards the new changes. It is important to keep in mind that a merger involves two companies, and both have to come together into each other's policies, which, on the other hand can reveal new challenges. A merger can be regarded as a more permanent decision than an acquisition, since acquiring companies are sometimes bought out with one intention: to sell the company at a higher price later. (Sherman and Hart, 2005)

2.2 Strategic reasons

The reasons for acquisitions have become largely strategy-oriented in the world today. The main driver behind all strategic intentions is growth, which is expected to be achieved via several different ways. (Katramo, Lauriala, Matinlauri, Niemelä, Svennas and Wilkman, 2013) For example, an acquiring company can use acquired company's brand image in its products, or acquire a small company to solve a problem it has been facing for some time. Regardless of the reason, the most important thing is that the acquired company is supposed to be contributing to overall growth of the acquiring company and accordingly generating positive cash flows. (Bragg, 2021)

Another common objective is to acquire already established companies in order to gain their market position, brands, and locations. The primary interest of such strategies is usually strengthening competitive advantages as well as access to new markets and sources of raw materials. The next strategy is targeting companies with niche products for manufacturing goods like pharmaceutical materials or buildings that have established reputation. (Goedhart, Koller and Wessels, 2010)

However, not only strategic acquisition is said to be a good idea. It turns out that the deals with financial objectives are also very "green". For example, equity investments are considered to be most appealing when a company is undervalued and when there is a possibility of capital gains. In addition, the effective use of debt can increase a company's cash flow. (Goedhart, Koller and Wessels, 2010)

Another important reason for acquisitions is considered to be economic efficiency. It means that the company or an investor achieves certain advantages in resource allocation and operational efficiency. The main advantage of acquisitions is said to be that the company or investor can enter a market that it would not be able to enter otherwise. This can increase the profit opportunities. Besides, a buyer company may manage to get rid of an expensive, unprofitable product line.

Another important factor is the ability to create synergies between two companies where all resources and operations are combined into one system. The existence of some degree of synergy can increase overall value of acquired company compared to its costs. In addition, this factor makes it possible to lower the cost of operations by reducing the number of employees and branches. (Anderson, Havila and Nilsson, 2012)

When a company acquires another company, it implements its own management philosophy. For example, if the acquiring company is focused on return on assets and capital and has a goal to minimize the invested capital in relation to other factors (such as research & development), it will probably choose not to merge two companies with different philosophies. (Martic, 2019)

3 VALUATION

Valuation is an integral part of the acquisition process. Before anything can be finalized, the buyer must have an idea of how much the company they are interested in is worth. For this to happen, the potential buyer needs to have a reasonable estimate of a company's value. (Massari, Gianfrate and Zanetti, 2016)

3.1 Factors affecting the valuation of a company in acquisition

Valuation involves an estimate of the value of a company. While this might be easy to do for most companies, it is more complex for companies that are in transition, have uncertain situation or are just beginning to develop. For these kinds of companies, valuations may consider the market environment, the business structure and management.

There are three typical approaches to company valuation:

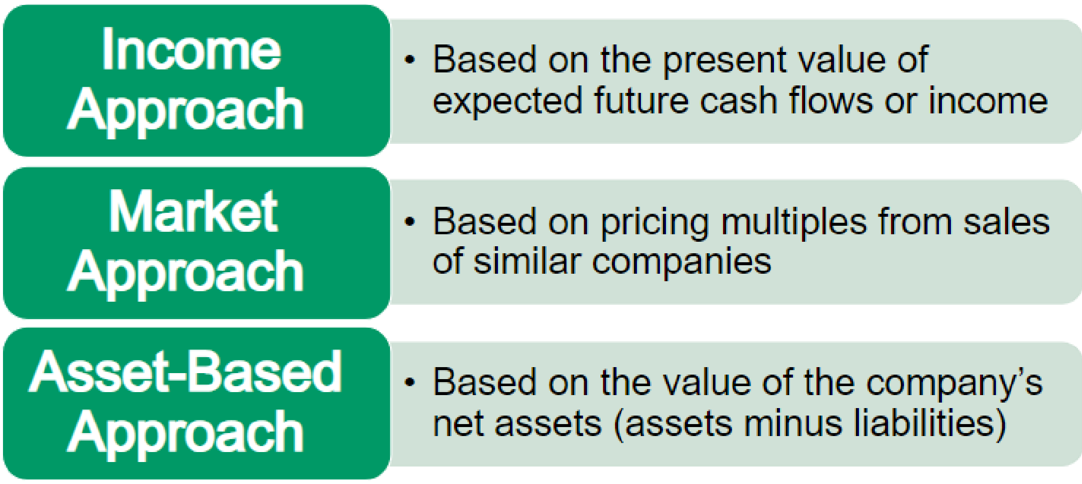

Figure 2. Three approaches to valuation (https://slideplayer.com/slide/7415425/)

Income approach: This valuation approach is based on the idea that the worth of a company is equal to its earnings. The more a company earns, the more it has to offer to its shareholders.

Market approach: This approach is used in situations where there are no verifiable or tradeable assets, and the value of a company cannot be forecasted by using an income-based or total asset approach. (Liimatainen, Lähteenmaa, 2020)

Asset-Based approach: In the asset value approach, a company is valued based on the value of its tangible assets (such as buildings or machinery) and intangible assets (such as brands and patents). The use of intangibles can be quite difficult at times.

All three methods attempt to estimate the value of a company in different ways.

3.1.1 Income Approach

The income approach is also known as the Discounted Cash Flow method. It is a practical valuation method used in business valuation to determine the value of a company or business enterprise by projecting the profits the company will make in the future. Essentially, the DCF method indicates that the value of a company is the present value of its estimated cash flows in the future. The income approach is a useful valuation method for a business that does not have easily tradable shares, since it values the company itself instead of its stock. (Kumar, 2015)

The income approach focuses on the future financial performance of a company. The sales, costs, and expenses for a firm are combined into an equation that solves for the net present value of future cash flows. (Eqvista.com)

Discounted cash flow calculation is a highly complex valuation process. It is based on a strict set of rules that include assumptions about interest rates, growth and risk. The valuator must know how to calculate cost of capital, book values, taxes and growth rates. These individual components must be included in the final calculation. The growth rate is largely influenced by trends, competitive matters and environmental conditions.

The income approach is based on a reasonable expectation that the company will earn a certain cash flow each year in the future. Projected cash flows are discounted to present value using an appropriate cost of capital rate for the specific company or industry in question. (Katramo, Lauriala, Matinlauri, Niemelä, Svennas and Wilkman, 2013)

There are three basic DCF models that are widely used:

1. Dividend Discount Model (DDM)
2. The Free Cash Flow to Equity (FCFE)
3. The Free Cash Flow To Firm (FCFF)

The DDM is the most widely used model because of its simplicity. In other words, a discount rate can be calculated for each year in the near future for a given company, and it will be based on its business riskiness, as reflected by the cost of capital. The DDM allows you to project any number of years into the future to determine how much one euro is worth in real terms at some future point in time.

The FCFE is used in situations like a company that has not historically paid cash dividends. In this case, it can be used to estimate a value for the firm's equity. The FCFE is calculated by subtracting the sum of the firm's cash flows from the value of its equity.

The FCFF is used when the company pays out all of its cash flow to investors. In this case, the FCFF is calculated by subtracting the sum of the company's capital numbers, depreciation from the value of its equity. (Corporate Finance Institute)

3.1.2 Market approach

Market approach for valuating a company is a method to value a company by understanding the company's market on financial values. The market approach can be divided into two sub-categories which are 'comparable companies' and 'regression-based models.' The comparable companies approach is based on the value analysis of similar companies in terms of size, growth rates, profitability, financial ratios, risks and other parameters that are publicly available in the stock market. (Bernstrom, 2014)

Generally, both approaches to valuing a company, comparable companies and regression based models are used for valuation of the investment.

The comparison of two or more companies makes it possible to determine the structure and performance of a company. With the help of comparable companies approach, buyers can compare the performance of their target company with other companies that operate in similar markets. This approach is used by the managements to identify which company to buy.

For example, in order to identify whether a company's current value is over-valued or under-valued, it is needed to compare the financial performance of the company with its competitors. However, it is important to know that some companies with similar product can be viewed as comparable depending on the purpose for which they are being compared.

The regression-based approach is used by the investors to understand the real value of a company's financial performance. There are many mathematical models and formulas used for this purpose. Two approaches related to the regression-based approach for valuating a company are 'intrinsic value approach' and 'operating cash flow approach.' Both approaches can be used depending on the industry in which a company is operating. (Liimatainen, Lähteenmaa, 2020)

The advantage of the market approach is that it enables one to identify enterprise values for companies and management teams. This approach can be used for the valuation of a company in the form of its stock price or value; it can also be used for the performance measurement.

3.1.3 Asset-based approach

The two main types of assets are tangible and intangible assets. Tangible assets include buildings, machinery, and fixtures. Intangible assets refer to anything that is not physical but that has value. This can include patents, copyrights, or trademarks. To conclude, intangible assets have no physical form but they can be converted to cash in a short period of time.

The values of both tangible and intangible assets are stated at book value in financial statements. The book value of tangible assets include the original cost of the asset, any additional costs related to its purchase, and any costs incurred to maintain the asset. Depreciation may have an negative effect on the book value of tangible assets.

In addition, intangible assets usually have very long lives and therefore by the time they are replaced the company is able to fully take advantage of them. In other words, they have a huge amount of value.

Generally, asset approach in company valuation is a method for valuing a company by determining its assets. There exists two largely used methods for asset valuation, which are cost of reproduction and cost of replacement. The first method is fairly basic and it is based on the cost that would be incurred if the buyer were to purchase the sellers assets today, while the second method is based on the cost that would be incurred when bringing up assets from zero. (Sherman and Hart, 2005)

As far as asset valuation is concerned, the difference between the two methods has become a great issue. This is because the replacement cost method weighs assets in their role as part of a business (i.e. operational value) and not solely to measure their market value, while the cost of reproduction method weighs them in terms of their market value. (Massari, Gianfrate and Zanetti, 2016) In other words, the cost of reproduction method can be applied only to a company that has all its assets put to rest or that will not continue to use assets after their lives have expired. This cost is calculated by multiplying the book value of the assets by a predetermined depreciation rate, using it as an indicator of the current value of the asset. In contrast, asset valuation based on replacement cost requires more effort in terms of research because it involves gathering information from suppliers and stakeholders in order to calculate the actual costs, leading to a more realistic assessment. (Massari, Gianfrate and Zanetti, 2016)

3.2 Due Diligence

Due Diligence is a comprehensive investigation into target company's assets, history, financing and management. It is an information gathering process conducted by potential buyers and a typical part of the deal-making process as they investigate whether to acquire it or not. The investigation itself involves other parties, such as financial institutions and banks, on many occasions as well.

It is important for someone considering buying the company to be aware of all aspects that could affect them later as well as what has been happening recently with the target company. It is their job to know as much as possible about the company that they are considering investing in. This process starts with finding out as much information about the company and all its assets, liabilities, and legal obligations. It also includes researching the financial stability of the company and how it has managed itself in the past. (Sherman and Hart, 2005)

Due diligence can be compared with background checks that companies do on employees. The goal is to get information that can be used to make an good decision. Though traditional due diligence focuses on risk assessment, it is beneficial to see possibilities and uncover value in the actions of the target company.

It is important for the buyer to be aware of all the risks and costs that could arise from investing in this company. They also want to learn about the financial stability of the company and whether it has had any major mistakes in the past. Information can be gathered through different sources. For example:

- Annual reports
- News
- Website
- Financial statements

The information should be used accordingly when reaching a decision on whether or not to acquire a company. Though most of the information that is acquired during due diligence is positive, it is also important to recognize the warning signs that could have been missed during their preliminary investigation into the company like additional debt, assets don’t match liabilities, past problems of employee misbehaviour or other unethical activities in the company.

These are all things that a potential buyer should be aware of when considering investing in this company. The outcome of the due diligence will determine the value that the investor places on the company. An important thing to remember when performing due diligence is that it is not 100% accurate. It is simply an investigation into what could go wrong or right with this company.

4 DATA COLLECTION METHODS

To achieve the goals of this thesis, the reseacher conducted a qualitative research. This includes investigation of publicly available literature, excluding any material that is considered a trade secret.

Thus, the approach of this thesis is limited to the demonstration of investigative approach to balance the trade secret limitation.

The output of this research is based on analysis and interpretation of information accessible in public literature. This is mainly because access to relevant and high-level information was not possible due to the aforementioned trade secret limitation.

Moreover, the thesis is a literature review and therefore the research methods are general and not based on any specific method. The research methodology is intended to accommodate future needs. The focus of the research was to identify, analyze and interpret information about challenges of company acquisition.

The conclusions of this thesis are based on the analysis of publicly available literature. Therefore, all the major findings have been provided in a structured manner to avoid any confusion in future projects. Alternatively, this thesis could be used as a reference for similar ongoing projects.

5 DEAL FLOW MODEL AS A ROADMAP

The deal flow model is known to be a very useful tool for acquisition processes. It is essentially a map for business acquisitions.

It is a well-known fact that the majority of corporate deals fail.(Liimatainen, Lähteenmaa, 2020) Therefore, it is very important to streamline the acquisition process. The deal flow model helps with that. It also helps to create a better structure for business acquisitions and helps to focus on the essential success factors.

When looking at why the majority of corporate deal fails, there are numerous reasons - lack of vision, strategy and cultural issues, among others. It is suggested that the success is relying on two key factors, being the financial knowledge and secondly the clear map of how the acquisition process is going to go forward. The deal flow model is a solution to the second key factor. (Galpin, 2014) It helps you to understand what the issues are, how you are going to explore them and how you are going to deal with them. It makes it easy for you to achieve your goal of getting a successful acquisition.

The deal flow model is divided into three main sections, that is, pre-deal, deal phase and post-deal phase; each section has its own key challenges that need to be addressed:

These three stages are needed because an acquisition process has a unique set of challenges. Therefore, each stage has a specific set of goals that need to be achieved.

As previously mentioned, this is pre-deal phase of the deal flow model. In this phase, there are several stages that need to be taken in order for the deal flow model to run smoothly: formulating, locating, and investigating.

In this phase, the focus is to understand the business that you want to acquire. The deal flow model helps to understand all of its issues and challenges, as well as how they can be overcome.

The second phase of the deal flow model is the deal phase. Being essentially the negotiation phase, it includes a myriad of challenges and pitfalls that need to be addressed with proper focus. The main challenges in this phase are connected to the process of negotiation, allocating resources and being able to manage the time correctly.

In the final stage of deal flow model, the post-deal phase, there exist integration, motivating, innovating and evaluating stages. The challenges in this phase are mostly related to the process of integration and dealing with resources. The major benefit of using the deal flow model is that it minimizes the risk of acquiring a company that may fail. It gives the business a clear map in how to approach the acquisition process, and as such helps them examine all of the issues that they need to look into before making a final decision.

5.1 Pre-deal phase

The Company acquisition process starts with the pre-deal phase. There are many challenges and tasks to complete in this phase before the company can be acquired. Strategy is the process of defining a clear and distinctive purpose for the business. It is also that which can ensure long term success. A common reason for bad performance in this stage is the lack of thorough strategic analysis. The most important aspect is to identify the main goal of acquisition and the best way to approach it. The strategic reason can be getting rid of competition, acquirement of assets or getting into new markets.

5.1.1 Formulating

A strategic analysis is about defining the knowledge gap between competitors, customers and company products. This would give an insight on how to beat the competitors. Moreover, it would also help in identifying what product lines to develop or abandon. (Rappaport, 1979) During this stage, the selection criteria would be ideally established, too.

The suitable target companies should fit into the business model, strategies and overall organizational goals.

5.1.2 Locating

Companies have to identify who constitutes their target market, which companies constitute their target company as well as other aspects of the acquisition process. At this stage, the target market is investigated and the target company for acquisition is chosen based on the criteria decided in the formulating stage. Main challenges that are presented when defining the market and choosing the company are information and power.

During this stage the buyer must analyze the target market in an effort to identify trends, competitors, strengths and weaknesses. The target company is chosen based on company strength, personnel, future products as well as the relationship with the target company, reflecting to the main goal of the acquisition. The buyer has to understand what kind of information they have access to and be able to utilize that information during their competitive strategy. Other challenges are determining the best time to buy the company is as well as allowing for sufficient time to close the deal. Lastly, legal aspects such as the laws regarding the target market must be considered during this stage. (Davis, 2012)

The basic approach to analyzing the target market is by identifying what customer segments exist within the market. The major competitor or competitors and its position within the industry should be identified. There is also a need to identify different buyers and suppliers for product information. An analysis of trends within the market should be conducted in order to identify new ways of selling a product or creating demand for an existing product.

During this stage, the target company is chosen based on how it can benefit the acquiring company's overall goals. Also, the initial contact to the target company is going to be made.

5.1.3 Investigating

At the investigating phase, the Duel Diligence assessment is conducted. The team or person will review legal agreements, collect information on the financial position and structure of the company, analysing the market in which they operate. They also review financial statements and assess internal matters, such as the management and its history.

There are many challenges when conducting due diligence in company acquisitions that include potential changes to the business strategy and outlook after acquisition or changes to management during an acquisition which can affect operational performance. Typical challenges in this stage are:

- The skills of the buyer's review team need to match the level needed for the complexity of the company's financial documents. The documents that seller is providing may be very technical, thus special field-related skills might be needed. Finding qualified people with these skills can be costly and time-consuming. The financial reports can vary between companies, which makes it difficult to compare them.

- The communication between the parties is not clear and open at all times. Misunderstandings can take place if the parties are not on the same page. The reason can be the nature of the acquision, which can be friendly or unfriendly.

- The due diligence questionnaire questions must be planned with care and expertise. This will ensure that the team collects the relevant information. The process relies on documentation collection, verification of facts and evaluation of credibility, completeness and accuracy of information. The process of acquiring additional details is quite challenging because sometimes the questions are not answered clearly or completely.

- The time needed for proper due diligence is typically not taken into account, which can mean the process cannot be conducted with care. The acquisition deal may not be closed on time because it is taking time to complete the due diligence, which is often linked to the quality of service and information received from the seller.

- The respect between parties may not meet the standards of good cooperation. The acquirer may have a poor reputation, which can affect their ability to obtain information from suppliers or other business partners.

- Seeing the real reasons behind the numbers needs experience.

The documents provided by the seller can be incomplete or even incorrect. It is often hard to verify all information from the documents provided, since there are no officials on site who would be able to provide confirmation. (Sherman and Hart, 2005)

5.2 Deal phase

When a company is acquired, it's typically a tense time for the company leaders. Important details around the acquisition can be obscured, timelines are short, and confidentiality agreements prevent many details from being revealed until after the transaction has occurred. The negotiations usually turn out successful, if substantial level of objectivity is present. It's important to understand that while there isn't much can be done about these challenges as they arise, buyer and seller can prepare in advance by knowing what to expect during this phase of negotiations and use their preparation accordingly for better outcomes for the deal. Typical challenges in this phase are related to finding common ground on the price, restrictions on the seller's private information, and who will be included in deal-related decisions.

5.2.1 Communication

In acquisition deals, there can be friendly and non-friendly negotiations. According to Galpin, a key factor in successful deals is having a friendly negotiations. Unfriendly negotiations dont provide the benefit of accessing essential private knowledge that can reveal hidden future value. One of the common reasons for unfriendly acquisition negotiations is a hostile bid.

5.2.2 Company Objectives

The first key point to understand about this stage of acquisition negotiations is that the company objectives are very different for the buyer and seller. When buying a company, the objectives of the buyer are to negotiate the lowest price possible for an acceptable deal structure while protecting their due diligence efforts and legal obligations. The seller's objective is to sell their business for as much money as possible with as quick a closing date as possible. While these may seem like conflicting interests, there are ways in which they can both be accomplished. (Galpin, 2014)

5.2.3 Seller Objectives

First, it's important for the seller to understand what their goals are in the deal and also what the buyer's objectives are. Then, look at all of the possible deal structures and decide which would be ideal under each potential structure. While most sellers want to get a quick closing and sell for as much money as possible, this may not always be the case. For the seller, the most ideal deal structure may be one that requires a longer closing time to meet their objectives. Knowing what you're trying to accomplish will allow you to tactically plan for a longer closing time in order to get more money.

5.2.4 Buyer Objectives

Second, it's important to understand what the buyer is trying to accomplish. This is going to depend on the industry and the buyer's previous experience for the company. If the buyer is familiar with the company, it will be easier for them to negotiate a quick closing and possibly pay less for it if it's a good deal.

5.2.5 Transaction Details

When company acquisition negotiations are complete, the next step is to actually sign a transaction document. While some discussions may be held before signing, this will typically be a short timeframe. Just as in a personal transaction, there are documents to be signed and sometimes other fees that will need to be paid. It's important for both parties to understand this timeframe and the process required for signing the deal.

5.3 Post-deal and integration

The integration of human resources, company culture, the information systems, and financial matters are typically the most challenging part of an acquisition. (Sherman and Hart, 2005) At the same time, it is also an important and integral part of any acquisition. For a successfull integration, It is crucial to have a plan.

The key elements to a successful post-deal integration are:

- An extensive market and financial due diligence with a complete assessment of the target's assets, liabilities, and operations and a close look at the information.
- Integration support from key departments such as legal, accounting, risk management, finance, HR
- Stakeholder analysis and communication: one has to be able to identify each stakeholder's goals for the deal
- The integration plan must contain specific objectives that illustrate how the target company will be integrated into possible existing business
- It is important that management and employees in both organizations understand what is expected of them and how they can help in the integration process
- An assessment of issues and risks that may come to surface during the integration.

Small companies are more likely to fail an acquisition than large ones, largely due to the integration process. This failure has its roots in poor planning, cultural challenges, misconducted incentives, limited resources, financial problems or personnel problems. (Liimatainen, Lähteenmaa, 2020)

Many challenges at this stage are related to human resources. Uncertainty can have a negative effect on the workforce, because all the important changes may not be communicated to the employees. Businesses may try to preserve as much of the culture as possible, but often this is not successful. This can result in a separation between management and employees. If the integration does not work out, it can negatively affect employees for many years. (Davis, 2012)

The way that managers handle these situations will have an enormous impact on how employees respond to change. During the integration process, there is a major communication challenge because there are so many people involved in any acquisition and they often have different goals, perspectives, and agendas.

5.3.1 Motivating

Developing company culture in post-deal phase is key to structuring the new company policy and to ensure its sustained success. The main factor of importance is employee retention, followed by customer loyalty. Employee retention refers to the need for employees to grow accustomed with the new management team and feel comfortable with their surroundings, so that they do not leave. Failure to achieve this goal results in losing key individuals during a time when they are needed the most. Customer loyalty, on the other hand, refers to the necessity of customers in making a company successful. If they are not satisfied with the new business culture, they will probably leave for a competitor.

The difficulties that arise out of developing company culture in post-deal period mostly center around the previously mentioned two main factors (business and personal). Employee retention is difficult when there are leaders from the previous management team within the organization and they want to continue their activities as such. With this in mind, the scenario of the new leadership failing to retain them is a risk that must be avoided. The need for customer loyalty is also more important than what it was in the pre-deal phase. If they are unsatisfied with the company's new business culture, customers will likely choose to change their suppliers. This is another factor that has to be carefully considered as it may cause great damage if ignored. (Andersson, Havila and Nilsson, 2012)

5.3.2 Innovating and R&D

A strategic acquisition should be an opportunity for a buyer to access new products and technologies, new markets, or new ways of doing business. It should also provide the buyer with an opportunity to derive synergies by leveraging their innovation capabilities. In most cases, when acquiring a small or medium-sized firm, the buyer will inherit the managers and R&D team. Since they will have to deal with their existing innovation processes and assets, it is important that the buying firm is armed with the tools needed to ensure that the acquisition forms part of an innovative strategy.

Structuring the Innovation Process

The major challenge the buyer is to integrate the acquired firm’s innovation process and assets into its own innovation system, which include:

- A sustainable organization responsible for identifying and dealing with external opportunities

- A dedicated R&D group responsible for developing new products and technologies, and
- A company that continuously evolves with new products and processes

Strategic Innovation Management

Once the major organizational issues for the buyer have been addressed, the actual innovation work can start. It is important that an acquirer uses their resources efficiently and effectively during this phase to avoid multiple projects. In addition, there is a need to integrate the acquired team into the organization so that no cultural shock occur. (Katramo, Lauriala, Matinlauri, Niemelä, Svennas and Wilkman, 2013)

5.3.3 Evaluating

The success of an acquisition can be measured by using financial aspect or assessing the achievement of strategic goals. The financial aspects of an acquisition can come in the form of improved operating performance and increased company value. Between the two, increased company value is deemed to be more important as it is a direct effect of business operations. However, the measurement of the value creation can be challenging especially when there are multiple variables involved. In addition, it can also be difficult to determine the reason behind an increase in company value.

The measurement of a company's value is one of the most important aspects to determine the success or failure of an acquisition. This becomes even more crucial to publicly listed companies. A failure in predicting a company's value can lead to negative financials and shareholder losses. Therefore, it is necessary for companies to correctly forecast a company before proceeding with acquisitions. Many times the timeframe for stakeholder value to increase is five years. From this timeframe, the investors and management of a company can have a better understanding of the success of an acquisition. (Katramo, Lauriala, Matinlauri, Niemelä, Svennas and Wilkman, 2013)

From a strategic perspective, a successful acquisition program should generate synergies for both companies and enable them to pursue an aggressive growth strategy. It can be achieved either by reducing operating costs or increasing operating performance. (Liimatainen, Lähteenmaa, 2020) Typically, it can be done either by eliminating redundant roles or leveraging the acquired company's resources. The outcome of the strategic objectives should be to create value for the shareholders. If the synergies achieved from the acquisition are not substantial or fails to create value, then it can be said that the acquisition program has failed.

In addition, an acquisition program should also meet several other strategic objectives (i.e., financial and human resource management) in order to achieve success. It is necessary for an organization to look beyond cost cutting and increasing sales in order to grow their company. However, it is also essential for an organization to focus on additional factors besides sales such as improved organizational structure, culture integration and company morale.

6 CONCLUSION

The main goal of this thesis was to conduct research and identify the intricacies and typical challenges that exist within company acquisition functions, but not to be a complete guide to company acquisitions.

Firstly, fundamentals of company acquisition and valuation were used as the knowledge base and as a toolset for further analysis of the results. The results were achieved by qualitative methods which were reviewing existing materials and guides about company acquisitions.

Moreover, integral data gathering methods included reviewing previous literature and guide materials available for public. This literature consists of books and online guides for company acquisitions. However though, due to the competitive nature of acquisitions, company specific materials were not accessible.

Secondly, the deal flow model was used to present the different phases of the company acquisition process and it served as framework for identifying challenges. The challenges are presented in a contextual way, since the different phases overlap greatly at times.

6.1 Intepreting the results

As a result of this thesis, many detailed challenges were revealed using the Deal Flow Model as a map.

When intepreting the findings, some recurring themes appear, regardless of the phase. In different phases many challenges seem to be connected to communication and human interaction. This is not very surprising, taken into account all the pressure and timing that goes with the acquisition process.

Secondly, the matter of uncertainty seems to have a negative effect on the success rate, being connected to integration stage. According to the research, emplyees might find it difficult to commit to the company when all information is not accessible to them, resulting them seeing their careers being possibly in jeopardy.

Also, managerial issues may become crucial obstacles if there are no proper guidelines and new job descriptions set.

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