



# How to Decide Whether Your Business Should Build or Buy

Think your business is ready to expand? Here's what you should consider before heading down either path.  
By Matt Quinn | May 18, 2010

**Deciding whether to expand** your business organically or through acquisitions is the ultimate “build or buy” decision. It's similar to the choice between buying an existing home or building your own, but we're talking about your livelihood here—not to mention your employees' well being and your investors' returns.

Mind you, for businesses, the buy and build paths aren't mutually exclusive. You can certainly grow your business in hopes of adding more operations down the road and you can buy new businesses with the intent of growing them organically.

But for a business of limited size that doesn't have the benefit of a full corporate development arm, pulling both off simultaneously is likely impossible.

Still, both strategies have a lot in common. They require similar disciplines in terms of cost-benefit analysis and careful execution. And the hazards along each path often pop up to varying degrees in similar areas.

## **Build or Buy? The Basic Benefits – and Costs**

On the surface, expansion through acquisition makes a lot of sense if you're looking to enter a new product line or a new market. Setting up shop in a new location and building from scratch is costly and time consuming. Finding acceptance for a new product can be a slog.

“The time that you want to buy a business is if you really want to get into a market fast. That your go-to-market timing is of paramount importance,” says Robert J. Chalfin, a lecturer at the Wharton School of the University of Pennsylvania and CEO of The Chalfin Group, a Metuchen, New Jersey-based firm that advises on the purchase and sale of closely held businesses.

What you get is an instant infrastructure, customer base, cash flow, inventory, physical plant, distribution network and supply chain – all the vital ingredients for a functioning business.

But remember that you're inheriting a process. Someone else's process. And that process may not be what you want, warns Chalfin.

By buying instead of building, you're sacrificing the ability to tailor the business to all of your specifications. Building can allow you to move at your own pace, pull back if circumstances change quickly on you and guard your business culture. However, the pace of execution could cause you to miss a market opportunity.

**Dig Deeper:** [Understanding Cost-Benefit Analysis](#)

## **Build or Buy? Know Your Own Business First**

Whether you're embarking on a buy or a build strategy, you want to make sure that your existing business is on solid ground. In particular, you want to have [a stable management team](#) and one with enough depth that it can focus its attention on an acquisition or a build-out without harming the business you already have.

"It's very hard to grow without having that kind of group already assembled," says Craig Frances, a managing director in the Palo Alto, California office of Summit Partners, a private equity and venture capital firm that invests in growing, profitable, privately-held companies worldwide.

You also have to determine if you even have the account management team to support the growth. The success of your current business is based on your ability to offer your existing clients top-notch service. Any growth strategy could put that at risk, and render any possible benefits moot.

"There are a lot of stories about companies that grew quickly and then quickly had enormous customer churn," says Frances. "They outran what they were doing very well initially."

Then there's the matter of your financial infrastructure. How strong are your financial controls? How well do you measure your cash? If you're getting ready to grow, there's going to be a lot of stress on your working capital and your ability to measure your financial health.

Those three things – the strength of your team, infrastructure to support new customers, and solid financial controls and metrics – are essential to any building strategy, as well as an acquisition strategy. But if you're seriously looking at pursuing acquisitions, there is another critical element: experience at deal-making.

In an ideal world, your whole top management team would have some expertise in closing and integrating an acquisition, but that's seldom the case. Hopefully someone in your top ranks has solid experience in the area. But failing that, you're going to have to bring in a corporate development person, which can be a considerable cost depending on how long the integration takes.

Such advisors, Chalfin warns, carry their own risks if their goals aren't aligned with yours. One way to match up objectives is to offer a success fee, where the advisor is paid for results achieved over the first few years and not just for closing a deal.

In short, if acquisitions aren't already a core capability of yours, expect the advisory fees to mount.

**Dig Deeper:** [How to Develop a Business Growth Strategy](#)

## **Build or Buy? Know Your Industry and Market**

Now that you've sized up your staff's strengths and weaknesses, it's time to assess your industry and market. If you're growing organically, you need to figure out how much growth your market can actually support.

"Usually in industries that are very fast growing, you don't see acquisitions for a while," says Frances. "The reason is that the companies have a much better return on their capital by just plowing it back into their growth versus buying other businesses."

Conversely, if your market is mature, you need to figure out how much return you can reasonably expect from your investment. "The simple truth is that it's hard to create private equity-like returns in industries growing 5 to 10 percent," Frances says.

By expanding in your existing market, you might risk cannibalizing your existing business, so you need to closely examine where you fit in with the marketplace.

“Have you just gotten lucky in your existing market?” Chalfin asks. “Are there changes to your market on the horizon that could affect that success?”

**Dig Deeper:** [Strategies for Challenging Markets: Growing Market Share Via Acquisitions](#)

### **Build or Buy? Weigh All the Different Costs**

When expanding, the costs keep coming. And as [the National Federation of Independent Businesses warns](#) in a guide about expansion on its website, a “common problem when expanding a business is the underestimation of costs.”

The business group points to building costs, equipment costs, tax costs, inventory costs, changes to accounts receivables, and the addition of support staff as things you need to carefully weigh when building your operations.

As for acquisitions, most will require some outside help, such as lawyers, attorneys, and other intermediaries. That translates to a bounty of fees. And the more complex the transaction is, the larger those fees will grow.

Then there are other obvious integration costs such as those for IT and accounting systems.

The success of the acquisition will rest on your ability to realize all the cost savings and revenue opportunities that looked so appealing on paper. Though your acquisition might provide you with vast economies of scale—extra office space and savings on rent, procurement and insurance, and more—you may also end up with new employees that were promised extra vacation, bonuses, and promotions by the previous management.

Try as you might to turn over every rock during the due diligence process, be prepared for some serious, potentially costly surprises no matter how you decide to expand.

**Dig Deeper:** [How to Avoid Five Common M&A Pitfalls](#)

### **Build or Buy? The Verdict**

So you still think your managers, infrastructure and industry have what it takes to support an expansion strategy and that the costs won't run you into the ground? Then ultimately the decision on whether to build a new business versus buying another company comes down to whether you want to get into a new geography or product line right now. If so, making an acquisition is likely the way to go. But if you're the more methodical type who needs to put your stamp on every aspect of your business and does not handle well the fear of the unknown (and every deal has an unknown), then a build-out strategy is probably the best course of action for you.

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