One of the most efficient paths of growth is through business acquisitions. If executed correctly, acquisitions which are often cheaper and faster than organic growth, allow companies to grow and diversify their business models.

Common motivations of acquisitions include; achievement of synergies through consolidation, diversification to reduce risk, increased market power, accelerated growth and the purchase of assets at discounted prices.

The common types of acquisitions are:

Horizontal acquisition:

In which the acquiring company and the acquiree are in the same kind of business, usually as competitors. The main motivation behind horizontal acquisitions is the pursuit of economies of scale.

Vertical acquisition:

In which the acquirer buys another company in the same production chain, most often, a supplier (backward acquisition) or distributor (forward acquisition). The main motivation is cost savings and greater control over the production process in terms of procurement of raw material or distribution of finished products.

Conglomerate acquisition:

In which an acquirer purchases a company that is unrelated to its core business. The main motivation behind conglomerates is the diversification of business risk.

In frontier economies like Kenya, business acquisitions are expected to increase. Kenya was ranked the fourth most sought-after country for mergers and acquisitions in Africa by Mergermarket (UK). In Kenya, mergers and acquisitions are focused in the manufacturing, ICT and FMCG sectors.

As the Kenyan economy matures, competition from foreign businesses increase and existing players are forced to reposition themselves as market dominance shifts rapidly. Local businesses are likely to engage in acquisitions to improve competitiveness, achieve economies of scale and increase market power.

While sound reasoning and the identification of a suitable target is critical, the success of a business combination often rests on the execution and post-implementation phase. This includes legal agreements and management warranties, which, in many acquisitions executed in Kenya, do not receive the degree of scrutiny required to ensure a successful transaction.

Legal agreements form the backbone of the acquisition and provide protection to both parties. The core issue of a poorly drafted legal agreement in business acquisitions in Kenya is a poor link between the legal agreement and the financial terms. A breakdown in this link can raise disputes in the later stages of a transaction and may make dispute-resolution difficult and more complex.

To avoid post-implementation legal hurdles, we recommend that the legal agreements be drafted with the financial terms in mind. There should be a

close link between legal agreements and the financial terms, and the agreement should be stress-tested against common post-implementation pitfalls to ensure they are robust. One way to achieve this is to ensure the legal teams drafting the contracts and the lead transaction adviser (which is in charge of drafting the financial terms) work closely together.

Most business acquisitions are accompanied by warranties given by top management of the acquiree, to protect the acquirer against adverse events occurring post-implementation. Warranties are often required of top management only and do not cover middle or lower management. This poses a risk as middle and lower management have considerable operational and financial influence over a business and an unsuccessful integration of these levels of management may undermine the acquisition.

To mitigate against this risk, it is critical for the acquirer to obtain adequate warranties from all levels of management and ensure there is complete buy-in of the warranties provided.

RSMC has significant experience in the provision of end-to-end advisory services for business acquisitions in various sectors; including, manufacturing, hospitality, agriculture and the public sector.

Our services to acquirers include; identification of potential targets, computation of synergies and in-depth financial and operational due diligence on the target.

RSMC will also play an active role during the drafting of legal and financial agreements (including management warranties) to minimize the risk of post-acquisition disputes.

On the other hand, for companies looking for a strategic or outright investor; RSMC can perform pre-transaction due diligence to identify (and rectify) potential issues that may come up during the acquirers' due diligence, assist with identifying potential acquirers and valuation of the acquiree to ensure informed negotiation.

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