Merger Mania: Are Mergers the Best Path for Growing Dealer Organizations?

The equipment dealer industry has seen significant consolidation over the last several years and the pace is not slowing as dealers and manufacturers are pursuing ever larger dealer organizations and the resulting benefits that can be achieved if growth is done in the right way. Unlike consolidation occurring within many industries, equipment dealerships often grow through "merger between equals" situations where multiple ownership groups continue to have influence on decision-making after the merger is complete. While a merger can have significant benefits, a "merger between equals" situation creates additional complexities and risks and both dealers and manufacturers should be aware of these potential issues when exploring strategies for growing dealer organizations. **Limited Equity Drives Mergers** A common issue that I hear is that dealer equity standards required by major manufacturers or their financing divisions drive dealers to use a merger to build organizational size. The reason for this is that a merger requires little equity or debt from either party and therefore does not usually have an adverse effect an organization's equity position after a merger. **Mergers Carry Additional Risks/Costs** Although a merger can address manufacturer/dealer desire for growth without an adverse impact on a dealer's equity position, is a merger always the right answer? Before adopting a merger approach to growth, dealers should weigh some of the risks and costs associated with a merger:

- Increased risk because each dealer is taking on all liabilities of the other dealer and the dealer's personal guarantee is now supporting debt incurred by the other dealer.
- Cultural/operational integration can be more difficult. If multiple ownership groups have a strong continuing say in the business, there is a higher risk for one of the following three scenarios to develop: (a) delay in development of policies and processes needed to improve the dealership (and create the expected efficiencies or value) due to a stalemate between owners; (b) dealership locations functioning independently under different styles of leadership; or (c) the organization compromises in a manner that weakens the strength of the prior practices of both organizations.
- Transaction costs will be higher due to efforts to limit the first two risks. This will include legal costs due to (a) more thorough due diligence to understand the liabilities to be assumed (including employment, customer and regulatory liabilities) and policies to be integrated and (b) negotiation of buy-sell agreements among the continuing owners. In addition, retaining a consultant to facilitate discussions regarding leadership/culture and processes (both pre and post-merger) is highly advised.

Alternative Capital Structures – Reducing the Need for Mergers To facilitate non-merger transactions, I would encourage dealers and manufacturers to consider improving dealer equity in advance of transactions through capital injections from additional investors, including private equity groups or high net worth individuals. Capital could come in the form of traditional equity, preferred equity or debt (subordinated or unsecured debt). To do this, dealers may need to embrace a partner that brings a different perspective to managing a dealership and understand that the different perspective may be a positive experience that facilitates additional growth and profitability. At the same time, manufacturers would need to be more open to flexibility in the structure of ownership groups, including the definition of equity requirements and consideration of alternative payment security standards in lieu of the traditional unlimited personal guaranty (e.g., entity-level liquid net worth requirements, limited guarantees, letters of credit, etc.). **Mergers Are A Viable Option for Growth, But …** With the increasing growth in dealer organizations, it is important that the industry doesn't allow mergers to be the default avenue for growth simply due to lack of capital. While a merger is certainly a viable option for growth, it is not always the right answer and can carry significant risks for the long-term success of a dealer organization if it is not properly implemented. Due to the growing size of dealer organizations, these risks should be of increasing concern to both manufacturers and dealers. The bottom line is that the stakes are getting higher for dealers and manufacturers as dealer organizations grow in size. As that happens, dealers will need to invest additional resources in either limiting the risks inherent in mergers or attracting additional capital and manufacturers will hopefully have an incentive to help foster those activities. The challenges that come from taking on additional investment may not be for everyone, but for those dealers and manufacturers willing to embrace it, the payoff in terms of growth may be worth the change.