Startup, Acquisition, or New Programs and Services: A Framework for Choosing the Best Business Expansion Strategies

BY DEXTER W. BRAFF

In crafting an aggressive expansion strategy, a home care business or any other type of business for that matter, will typically consider three basic development strategies; (1) start-up, (2) acquisition, or (3) new programs and services. While the options are relatively simple, choosing among them can be extremely difficult. And often, absent full examination of all the factors that should be considered in making these decisions, well meaning executives can easily select (or rule out) ill advised (or promising) paths.

In its simplest form, expansion strategies should be weighed based upon their return on investment (ROI). Clearly, the better the return, the more viable the strategy. However, we tend to focus primarily on the financial aspects of the investment and return, ignoring, or minimizing harder to measure factors that contribute mightily to the equation and its interpretation.

We begin with the investment side of an expansion strategy. In virtually all situations, it costs real, measurable, dollars to expand a business. Startups require investment in new operating infrastructure, employees, marketing, equipment and supplies, not to mention the funding of losses that occur on the way toward breakeven. Acquisitions may be profitable from the onset, but they typically require greater investment in upfront dollars than a start-up of similar scope. And new programs and services, such as telemedicine initiatives, disease management programs, managed care initiatives, diversification strategies, etc., while frequently the least expensive of the three paths, nevertheless require investment in staff, training and marketing materials.

Each of these strategies demands non-financial resources as well, resources that are often as constrained (or more so), than cash, notably management strength and time. An organization with a strong and deep management team has the human capital necessary to invest in start-up strategies that are typically the most demanding of such resources. Absent such management strength, other alternatives may simply be more viable. Organizations must also expend time in their development plans – time which may be plentiful (or not) depending on the company's and principal's business, personal, and financial goals. Consider a private equity group that typically has a relatively short investment horizon (generally three to seven years). It comes as no surprise then that, though costly, acquisitions which typically deliver large returns in the shortest period of time, are often at the core of private equity development strategies. Contrast this to a young entrepreneur that has developed a business lean on cash but rich in energy, enthusiasm, and time, and therefore can afford to invest in slow-build opportunities.

Finally, and perhaps most important of the non-financial resources demanded of an investment is the psychic cost associated with taking on risk. For those with a great tolerance for risk, these "costs" may be minimal. However for those that are risk averse, they can be substantial,

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and troublesome, especially for development initiatives that require significant upfront cash. Notably, such psychic costs, which are highly individual in nature, appropriately, and inevitably – lead investors to evaluate similar alternatives in extremely different ways.

The investment of dollars, management resources, time, and psychic resources in development strategies hopefully generates returns, notably in the form of increased revenues and profits directly related to the initiative. But there are often many other indirect proceeds that should be considered in evaluating the full return on a particular investment. Consider "first-mover" market advantages that can be gained when being the first to deploy a cutting-edge technology or initiate a ground breaking program, or acquiring a market leader that can no longer be acquired by a competitor. Or the intellectual and human capital and resources that can be gained in an acquisition and then be leveraged post-transaction to "fund" start-up and/or new program and service development initiatives. For publicly traded firms, in addition to revenues and profits, executives must consider how their development strategies impact stock prices as well, a not-too-simple task in a Wall Street environment in which long term vision is lauded yet scrutinized quarterly. In addition to direct profits, acquisitions in particular can also offer buyers added returns in the form of arbitrage. Such favorable arbitrage can come from acquiring acquisition candidates in proprietary transactions without competition that drives up pricing, or by acquiring smaller companies at competitive pricing which, when combined with the acquirer, garners and contributes to valuation premiums bestowed to larger entities. Lastly, we note that in home care markets with restrictive certificates of need or other regulatory barriers to entry, a buyer's return on an acquisition is often measured less on the profits that a candidate can deliver than the opportunity to gain access to potentially lucrative markets that are otherwise completely closed.

With an expanded view of (a) the investment resources that may be necessary to support a startup, acquisition, or new program or service development initiative, and (b) the full measure of returns that each can generate, management's task is to choose expansion strategies that offer the greatest ROI. To make this all work however, management must resist the temptation to succumb to pre-conceived notions of the "best" options available or reflexively drift toward the latest strategy du jour, and aggressively consider and develop multiple alternatives, preferably several from each basic development strategy because the best returns exist not in a vacuum, but in comparison to others. And the more comprehensive the development of alternatives, the greater the likelihood that those with the best and fully informed, ROI will emerge.

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