

Acquiring a Supplier

Branching out into a new realm of business by buying the assets of a former supplier has its pros and cons. Just ask these entrepreneurs.

By Chris Penttila | March 31, 2006

Entrepreneur Tom Amoruso is used to working with suppliers as the founder of Shelving Concepts, a Houston company that sells storage shelving and had \$1.7 million in 2005 sales. But as Amoruso is learning, buying one of your suppliers is another matter altogether.

Last July, Amoruso, 46, acquired the assets of manufacturer Dixie Shelving along with another former supplier, Dura Rack, at auction for \$100,000. He bought the company names, phone and fax numbers, website addresses, and Dixie Shelving's equipment. He purchased Dura Rack's name for potential future use, but not its equipment. "I would always tease [Dixie Shelving's owners] and say, 'If you're ever interested in selling, I'd be the guy to buy,'" says Amoruso, who's delving into manu-facturing for the first time because he sees wide growth opportunities. "Dixie Shelving had a really good name, and I intend to make it even better," he says.

At least 250,000 businesses are sold every year, and 82 percent of them are small businesses, according to BusinessBroker.net. "There's a lot more [M&A] activity this year than there's been in recent years," says Chris Trimble, co-author of Ten Rules for Strategic Innovators--From Idea to Execution and a professor at the Tuck School of Business at Dartmouth in Hanover, New Hampshire. Many companies "are no longer acquiring to achieve scale and reduce costs; they're acquiring to build a better future."

Irrational Exuberance?

For Amoruso, lower production costs are one big advantage of buying a former supplier. He used to pay 22 cents to make a certain type of shelving clip; now he can manufacture it for 4 cents under his own roof. "The product is much cheaper now," he says.

Buying the assets of a former supplier, however, requires new skill sets. "All of your accumulated experience may not only be worth little here, it may actually mislead you," Trimble warns.

Just ask Mark Carle, 36, and his fiancée, Joann Monaco, 37, who sold their Madeira Beach, Florida, gift and clothing store in 2004 and took some time off to decide what to do next. In February 2005, they spent \$20,000 to buy the name and formulas of a defunct candle manufacturer that had supplied their former retail store. They figured they could be up and running within weeks. "We knew [the product] sold, because it had sold well for us in our retail store," says Carle. "I knew we could probably do the business end of it if we could learn how to do the manufacturing end of it."

Their wake-up call was discovering the color supplier used by the previous owner had gone out of business. "That was probably the first time we said, 'Well, this is going to be a little bit different than what we [expected],'" Carle says. Finding new suppliers took time, and they weren't able to recover. Along the way, they sunk an additional \$40,000 into operating expenses and R&D. They sold the assets in December for considerably less than they had initially invested. "A simple candle isn't so simple," says Carle, who has since become a real estate agent. "Really get to know the industry you're getting into before you purchase [a business]."

Dealing With the Deal

How the deal is inked can cause head-aches down the line if you're not careful. If the seller's assets are overvalued, it could lead to lawsuits and affect your ability to secure a bank loan. If you're buying a defunct business, you could find it difficult to rebuild relationships with suppliers. In the worst cases, "Suppliers won't do business with [the buyer] except c.o.d., even though it's a new company," says Ted J. Leverette, founder and president of Partner On-Call Network LLC, a North Palm Beach, Florida, firm whose franchisees help clients buy or improve businesses.

Amoruso has invested \$270,000 into upgrades on Dixie Shelving's manufacturing equipment since July and says he could spend as much as \$300,000 before everything's up and running. He's learning about manufacturing, and his workload is now double because he's effectively running two businesses. Manufacturing "is a whole new game," he says. The Dixie Shelving purchase has also put Amoruso in the interesting position of supplying his main competitors, some of whom remain apprehensive about sharing their price lists. "There are two dealers struggling with it," he says.

Buying a supplier is very different from buying a direct competitor, where the immediate goal is to consolidate and reduce costs. "The temptation is to standardize everything," says Trimble. "[But] be much more wary of taking the business apart and folding it into your existing infrastructure."

You'll have to bring deep pockets, seek ongoing support from the previous owner, and if you can, hire a few of the supplier's former employees to retain a sense of corporate memory. "I feel like it's been a lot of work for me," Amoruso says. "But it's going to be worth it."

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