Buy-and-build strategy: Evidence from a survey of private equity general partners[1]

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Abstract

Frame of the research: *Private equity (PE) general partners (GPs) are increasingly active in 'buy and build' (B&B) strategies, in which a portfolio company serves as a 'platform' to make other acquisitions ('add-on acquisitions') to accelerate the portfolio company's growth. However, this topic so far has received limited attention from the academic community.*

Purpose of the paper: *The study aims to contribute to the academic literature by confirming some preliminary empirical results and adding new knowledge on PE investors' strategic approach and on the strategy's outcomes.*

Methodology: *We designed a survey that was administered to 77 PE investors with combined assets under management of more than €1.1 trillion.*

Findings: *A B&B strategy's potential entails an ex ante strategic decision that PE investors evaluate before acquiring a new portfolio company. PE investors combine add-ons to the platform to create a bigger group and enhance value mainly through multiple arbitrage, i.e., buying at a lower EBITDA multiple than the realised multiple at exit. Add-ons are smaller firms and usually are active in the same industry as the platform; therefore, a B&B strategy is akin to a horizontal M&A strategy.*

Research limitations: *We discuss whether GPs in the study might have been incentivised to report overly positive or otherwise inaccurate responses to present a more positive industry image to stakeholders, which could have affected our findings.*

Practical implications: *Our findings are relevant for entrepreneurs, limited partners and GPs when they benchmark their strategies, and for other players in the mergers and acquisitions (M&A) industry in terms of industry consolidation practices. Furthermore, this work identifies some benefits and drawbacks of the B&B strategy in guiding policymaking.*

Originality of the paper: *This paper provides new insights that advance understanding of the B&B strategy, leveraging primary data surveyed directly from market participants. This is particularly relevant for the PE industry, which has limited disclosure requirements, leading to little publicly available information.*

Key words: *private equity; add-on; buy-and-build; survey*

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1. Introduction

In recent years, the private equity (PE) industry has been growing dramatically in terms of assets under management, invested amounts and fundraising. PE is a professional investment activity conducted by financial intermediaries (PE investors or general partners [GPs]) that raise capital from pension funds, banks, foundations, endowments, insurance companies and family offices (typically referred to as limited partners [LPs]) to acquire both listed and unlisted firms. PE investors aim to advance value creation for their portfolio firms (Meuleman *et al.*, 2009), then realise a capital gain years later by selling their stakes at much higher valuations (Gilligan and Wright, 2020; Gervasoni and Sattin, 2020; Gompers *et al.*, 2016).

The use of financial engineering, the ability of market timing (i.e., buying low/selling high) and accelerating portfolio firms' growth through active ownership involvement are traditionally identified as value-creation levers fostered by PE investors (Jenkinson *et al.*, 2022; Gompers *et al.*, 2016; Manigart and Wright, 2013; Achleitner *et al.*, 2011; Guo *et al.*, 2011; Kaplan and Strömberg, 2009).

While financial leverage and multiple arbitrage's strategic importance seems to be decreasing due to increasing competition and maturity in the industry (Hammer *et al.*, 2017; Sensoy *et al.*, 2014), recent research has highlighted that PE investors recognise both organic growth strategies and external acquisitions (inorganic growth) as viable growth options (Bernstein *et al.*, 2019). Regarding the latter, GPs increasingly are involved in 'buy and build' (B&B) strategies, in which a portfolio company serves as a 'platform' to acquire whole firms or some divisions/subsidiaries. Such acquisitions are referred to as 'add-on acquisitions' or 'add-ons' (Cohn *et al.*, 2022; Hammer *et al.*, 2017).

To the best of our knowledge, this strategy has received surprisingly little attention in the academic literature. A few empirical studies have examined the characteristics of platform companies and PE investors that increase the likelihood of additional acquisitions (Hammer *et al.*, 2017), performance obtained by GPs (Hammer *et al.*, 2021) and the pricing of B&B deals compared with non-B&B buyouts (Hammer *et al.*, 2022). However, principal sources of B&B value creation remain unclear. Hammer *et al.* (2021) demonstrated that the strategy is not associated with EBITDA margin growth, and acquisitions imply significant risks, as deployment of operating synergies is costly and requires time, necessitating complex post-integration processes that are key for the success or failure of mergers and acquisitions (M&As) (Steigenberger, 2017; Datta *et al.*, 1992). For PE investors, which hold stakes in portfolio firms for a relatively short holding period (5.8 years on average for European deals, according to Joenväärä *et al.*, 2022), this might prove to be particularly challenging.

This paper aimed to contribute to the literature by conducting a survey of 77 PE investors with combined assets under management of more than €1.1 trillion. The use of survey data to improve extant knowledge on B&B strategies, as Bansraj *et al.* (2022) has suggested, is particularly relevant for an industry with a relative scarcity of publicly available information.

Our findings are relevant for PE and M&A industry stakeholders, posing several managerial implications. The possibility of making acquisitions during holding periods is a strategic option that PE investors evaluate, i.e., before acquiring a new portfolio company. As early as the due diligence period for a new investment, the potential to function as a platform is an investment criterion analysed by GPs, and long lists of future potential acquisitions already have been identified.

PE investors realise B&B strategies to create value mainly through multiple arbitrage, buying small add-ons at a lower EBITDA multiple than the realised multiple at exit on the combined new group of firms. GPs also make additional acquisitions late in a platform's investment period, with a holding period similar to portfolio companies that only grow organically, even though this might restrict their ability to deploy operating synergies fully. B&B strategies allow GPs to spend their dry powder investing a certain amount (the acquisition price), rather than more uncertain (in time and size) resources, to fund new internal investments. Bigger GPs are more likely to diversify the business of their platforms, acquire add-ons active in different industries and execute cross-border M&As, thereby reducing the risk of exposure to specific countries.

In this study, we aimed to ensure that the answers received from the PE participants were accurate. The PE investors involved in the survey were assured that their responses would be aggregated; thus, no individual firm had any clear incentive to report overly positive or otherwise inaccurate responses. The survey also allowed GPs to benchmark their B&B practices against those of other PE investors. However, some answers might be biased through a desire to present a more promising industry scenario to stakeholders, particularly LPs (limited partners). We discuss how such behaviour could affect our results.

The remainder of the paper is structured as follows. First, Section 2 briefly outlines existing literature. Section 3 lays out the methodology, research design and characteristics of the PE participant sample. Section 4 reports the main findings, while Section 5 discusses the results and potential bias deriving from the survey's research design and concludes with avenues for further research.

2. Theoretical framework

PE funds typically are based on a contractual agreement between a GP, who manages the fund and acquires and disposes of firms, and LPs, who agree to provide capital for the fund in exchange for financial returns.

The academic literature has studied how GPs generate these returns, identifying three main value-creation levers: (i) use of financial engineering; (ii) multiple arbitrage (i.e., buying low/selling high) and (iii) growth of portfolio firms through active involvement (Jenkinson *et al.*, 2022; Gompers *et al.*, 2016; Manigart and Wright, 2013; Achleitner *et al.*, 2011; Guo *et al.*, 2011; Kaplan and Strömberg, 2009). The strategic importance of these value-increasing actions, which are not mutually exclusive, has changed over time. Even though recent studies have indicated that on average, PE investors can create value by timing financial markets (Jenkinson *et al.*, 2022), the industry has become more mature and competitive, with financial engineering techniques and M&A knowledge viewed as a commodity (Hammer *et al.*, 2017; Braun *et al.*, 2017; Sensoy *et al.*, 2014).

Gompers *et al.* (2016) pointed out that the main return driver that PE investors identified is the ability to accelerate their underlying assets' growth. PE investors function as facilitators of strategic growth and entrepreneurship for their portfolio companies (Collewaert *et al.*, 2023; Nary and Kaul, 2023; Gompers *et al.*, 2016; Kaplan and Strömberg, 2009), enhancing organisational processes, increasing revenues, reducing costs, improving governance schemes (organic growth) and/or making additional acquisitions (inorganic growth), e.g., implementing a B&B strategy. Both options offer advantages and disadvantages: internal growth strategies are more difficult for competitors to copy, but might take longer to materialise, whereas the latter can offer external opportunities for resource redeployment and generation of economies of scale and scope, but post-acquisition integration and deployment of synergies are difficult to attain (Collewaert *et al.*, 2023).

Use of the B&B strategy is growing in the market. Hammer *et al.* (2017) highlighted how B&B strategies have been utilised in nearly 40% of all deals in the market, and Cohn *et al.* (2022) identified add-on acquisitions for 44.2% of their sample. According to PitchBook, in the United States, add-on transactions accounted for roughly 43% of PE companies' deal volume in 2004, whereas the market share soared to approximately 71% as of 2020. Data from the Centre for Private Equity and MBO Research at Nottingham University Business School reported that in the United Kingdom, add-on buyouts exceeded stand-alone buyouts in 2021, whereas in Western Europe, add-ons represented 47% of PE-backed buyout deals. A 2022 study by the Italian Association of Private Equity, Venture Capital and Private Debt (AIFI) found steady growth from add-on deals in the Italian market, which accounted for nearly 12% of the whole PE market in 2012, reaching 41% in 2020 and 2021. However, to the best of our knowledge, extant research on the B&B strategy is limited.

Hammer *et al.* (2017) reported that the probability of making additional acquisitions is higher if the platform company operates in an industry with a moderate degree of fragmentation and has previous M&A experience. Moreover, Hammer *et al.* (2022) reported that PE investors pay a premium EV/sales multiple for platform deals. Thus, we expect that during the due diligence period of a new investment, PE investors consider whether there is potential to function as a platform during the investment period. Thus, we propose:

Hypothesis H1: PE investors assess the potential to be a platform before investing in a new company.

Previous research has found that add-on acquisitions generate a higher average internal rate of return than stand-alone deals (BCG and Leipzig School of Management, 2016; Valkama *et al.*, 2013; Nikoskelainen and Wright, 2007). However, they also might result in detrimental performance when executed near the end of the PE investor's investment period (Hammer *et al.*, 2021), as they would lack the time needed to generate synergies. Thus, we propose:

Hypothesis H2: PE investors do not make add-on acquisitions late in their investment periods.

In terms of value creation, Cohn *et al.* (2022) found that buyouts with add-on acquisitions achieve larger sales growth than those without add-on acquisitions. Hammer *et al.* (2021) reported similar findings. However, these studies do not specifically decompose among the source (organic vs. inorganic) of the growth. Moreover, Hammer *et al.* (2021) demonstrated that the B&B strategy is not associated with EBITDA margin growth, which suggests no capacity to reach performance gains from scale and scope economies. However, as firm size influences market share and bargaining power (Moatti *et al.*, 2015), and bigger groups are usually valued at higher multiples, PE investors might create value mainly through multiple arbitrage. Thus, we propose:

Hypothesis H3: PE investors aim to realise higher multiples at exit through the B&B strategy.

PE sponsor size should play a role in add-on companies' characteristics. We expect bigger GPs to invest in platform companies that are more structured and ready to diversify their business through M&A, and that can leverage more developed international networks and connections, which can help reduce information asymmetries in cross-border M&A deals (Humphery-Jenner *et al.*, 2017). Thus, we propose:

Hypothesis H4: Bigger PE investors are more likely to acquire add-ons to diversify the platform's business and make cross-border M&As.

Empirical observations have indicated that strategic buyers might offer higher bids in M&A markets than financial investors, as they anticipate future synergies' potential in the valuation (Gorbenko and Malenko, 2014). However, add-on acquisitions are the result of a strategic choice that aims to create a new industrial group worth more than a simple sum of the single companies. Thus, PE investors might value add-on acquisitions more than non-B&B buyouts, thereby incorporating synergies into the valuation, exactly like strategic buyers do. Hammer *et al.* (2022) found that the enterprise value-to-sales (EV/sales) multiple is 19-24% higher for B&B deals than non-B&B buyouts, implying that a premium is paid for future benefits from consolidation, scale and scope economies. Thus, we propose:

Hypothesis H5: PE investors value add-ons as strategic buyers.

M&A acquisitions' success or failure is affected strongly by post-merger integration (Steigenberger, 2017), which is viewed as a principal source of value creation (Angwin and Meadows, 2015). However, this process is risky, costly and takes time. PE investors, which usually hold stakes in their portfolio companies for a relatively short period of time, might affect the platform's holding period while executing a B&B strategy (Hammer, 2017), as the new combined entity would require more time to deploy operating synergies. Thus, we propose:

Hypothesis H6: PE investors hold stakes in portfolio companies executing B&B strategies for longer holding periods.

Other understudied topics, such as funding for acquisitions or creation of new groups, are investigated further in this study.

3. Sample and design

In this section, we discuss our methodology and the survey process, and describe our sample of PE investors.

3.1 Design, delivery and response rate

As Gompers *et al.* (2020) noted, surveys recently have become more common in the financial economics literature. We reviewed other previous works focussing on the PE industry, such as DaRin and Phalippou (2017) and Gompers *et al.* (2016, 2020, 2022), and leveraged the methodology for our survey. The PE industry typically functions under limited disclosure requirements relative to public markets; thus, publicly available information is scarce. We attempted to design the survey to leverage primary data from GPs to shed some light on their strategic decisions, as Bansraj *et al.* (2022) suggested. Our survey was designed after an initial round of interviews with a small number of PE senior professionals in the spring of 2022, conducted using a semi-structured approach, with the goal of understanding the most critical aspects in the deployment of the B&B strategy. We then designed a first draft of the survey, which we revised with the PE professionals to ensure that it was clear and free of language ambiguity. After this process, we finalised a final survey of 16 questions.

Our sample of respondents comprised PE investors who were members of AIFI in 2022 and to whom we were introduced to senior investment professionals. We informed all potential respondents via e-mail, contacting a total of 93 PE investors and sending them a link with the survey. Even though not every respondent answered all the questions, we obtained a high completion rate: Altogether, 77 GPs filled out some part of the survey, and 68 completed the full range of questions. We started to distribute the survey to PE investors in the late spring of 2022, and we received our last response in the summer of 2022. Only PE investors who were AIFI members were sought for the sample, which was necessary to leverage direct contact with senior managers and collect complete answers. Moreover, as the AIFI board evaluates membership applications from PE investors to ensure that their members operate like closed-end funds, we did not suffer the issue of some potential respondents not actually operating as PE investors - a possible risk when gathering a sample from several public sources (Gompers *et al.*, 2020). Our response rate of more than 70% for the whole survey was higher than that of other similar studies (Gompers *et al.*, 2022; DaRin and Phalippou, 2017; Gompers *et al.*, 2016; Graham and Harvey, 2001). The sample comprised both Italian-based and international GPs; thus, the sample was quite representative of the industry as a whole, including PE investors with different investment strategies, size, industry specialisation and geographic focus.

3.2 Private equity firm characteristics

Table 1 provides some summary statistics on the PE respondents. We retrieved information on each GP from AIFI or other publicly available sources (websites, press reports, etc.) concerning cumulative assets under management (AUM), age in the business and headquarters (Italy or abroad) as of December 2022 to deepen the analysis based on different characteristics of PE investors. Indeed, location, experience and size may affect how B&B strategies are executed. The average AUM of PE respondents is just above €14 billion, but the first quartile of GPs manages less than €300 million, whereas the third quartile manages more than €7.1 billion. Overall, the respondents manage more than €1.1 trillion in AUM and are geographically diversified.

Tab. 1: Descriptive statistics on PE respondents

Categories	N	Mean	25th percentile	Median	75th percentile	Standard deviation
AUM (millions of €)	77	14,353.4	293	1.000	7.100	30,963.6
Age (Years)	77	20.8	10.5	19.0	28.5	13.0
GPs' headquarters						
- Italy	43					
- Abroad	34					

Note: The categories comprise cumulative assets under management (AUM), age in the business and each GP's headquarters (Italy or abroad) as of December 2022, retrieved from AIFI or public sources.

Source: Our analysis

Table 2 presents the distribution of PE investors, considering the size of the equity ticket they can commit to each specific deal. Different PE investor business models are included in the sample, as more than one-third of the GPs can invest more than €100 million per deal, whereas less than 25% are local players deploying no more than €20 million in equity for each transaction. Unsurprisingly, in examining our subsamples, GPs with higher AUMs and located internationally can commit more money for acquisitions.

Tab. 2: Size of GPs' equity investments

		AUM		Age		Headquarters	
Categories	%	Low	High	Young	Old	Italy	Abroad
< €20 mln	23.4%	37.5%	8.1%	30.8%	15.8%	37.2%	5.9%
< €50 mln	23.4%	42.5%	2.7%	23.1%	23.7%	37.2%	5.9%
< €100 mln	18.1%	17.5%	18.9%	25.6%	10.5%	16.3%	20.6%
> €100 mln	35.1%	2.5%	70.3%	20.5%	50.0%	9.3%	67.6%
Number of responses	77	40	37	39	38	43	34

Note: The sample was divided into subgroups based on the medians of AUM, age and headquarters.

Source: Our analysis

4. Results

This section examines our survey's results.

Table 3 indicates that our respondents have executed the B&B strategy extensively over the past five years, with 87% of the GPs having realised add-on acquisitions with at least one of their portfolio companies, and almost one-third of the GPs developing a B&B strategy with more than 75% of their portfolio companies. Interestingly, bigger GPs are more likely to use the B&B strategy, as M&A entails difficult post-integration activities that require dedicated human resources (Datta *et al.*, 1992), which are less available in smaller organisational structures.

Tab. 3: GPs developing a B&B strategy with their portfolio companies over the past five years

		AUM		Age		Headquarters	
%	%	Low	High	Young	Old	Italy	Abroad
0%	13.0%	17.5%	8.1%	20.5%	5.3%	18.6%	5.9%
25-50%	23.4%	32.5%	13.5%	23.1%	23.7%	23.3%	23.5%
50-75%	31.2%	27.5%	35.1%	25.6%	36.8%	30.2%	32.4%
>75%	32.5%	22.5%	43.2%	30.8%	34.2%	27.9%	38.2%
Number of responses	77	40	37	39	38	43	34

Note: This table indicates the percentage of GPs realising add-on acquisitions over the past five years with a certain weight of their portfolio companies. The sample was divided into subgroups based on the medians of AUM, age and headquarters.

Source: Our analysis

4.1 Strategic determinants of the B&B strategy

B&B involves several strategic decisions for PE investors. Before finalising a new investment, 95% of GPs analyse and consider, as an investment criterion, a company's potential to make additional acquisitions during the investment period, thereby supporting H1. Moreover, almost 30% of PE investors would acquire a new portfolio company only if it would serve as a platform for future add-ons adequately (Table 4).

Tab. 4: Capacity of being a platform as an investment criterion

		AUM		Age		Headquarters	
Categories	%	Low	High	Young	Old	Italy	Abroad
Important, but not mandatory	66.2%	62.5%	70.3%	61.5%	71.1%	62.8%	70.6%
Only companies with the potential for functioning as a platform are acquired	28.6%	32.5%	24.3%	28.2%	28.9%	27.9%	29.4%
Not important	5.2%	5.0%	5.4%	10.3%	0%	9.3%	0%
Number of responses	77	40	37	39	38	43	34

Note: This table indicates whether the possibility of future add-on executions of a new target company impacts a GP's investment strategy in terms of new potential portfolio companies. The sample was divided into subgroups based on the medians of AUM, age and headquarters.

Source: Our analysis

Table 5 indicates that during the platform's acquisition process, due diligence includes examining the potential for industry consolidation and identifying long lists of future possible add-on acquisitions.

Tab. 5: Timing of identification of add-on opportunities

		AUM		Age		Headquarters	
Categories	%	Low	High	Young	Old	Italy	Abroad
During the platform's holding period	19.7%	22.2%	16.7%	25.0%	14.7%	19.4%	20.0%
Before investing in a platform	80.3%	77.8%	83.3%	75.0%	85.3%	80.6%	80.0%
Number of responses	68	37	31	34	34	38	30

Note: This table indicates the timing of identification and evaluation of potential add-on opportunities for a new portfolio company. The sample was divided into subgroups based on the medians of AUM, age and headquarters.

Source: Our analysis

Realising synergies in a new combined entity after M&A requires time. In the case of PE investors, who are committed to relatively short holding periods, the later the add-on is executed during the platform's investment period, the more difficult it is to achieve operating synergies.

Table 6 indicates that PE investors seem willing to execute add-ons even during a later phase of their investment period on a platform, in an opportunistic way, thereby not supporting H2. However, even late add-ons might benefit PE investors through the combined entity's increased size (EBITDA growth), then from reaching higher valuations at exit. Table 7 supports this scenario, depicting how multiple arbitrage is viewed as a central goal for almost two-thirds of GPs, thereby supporting H3.

Tab. 6: Timing of execution of add-on deals

		AUM		Age		Headquarters	
Categories	%	Low	High	Young	Old	Italy	Abroad
Only before the 3rd year of the platform's holding period	20.6%	24.3%	16.1%	20.6%	20.6%	21.1%	20.0%
Always during the platform's holding period	79.4%	75.7%	83.9%	79.4%	79.4%	78.9%	80.0%
Number of responses	68	37	31	34	34	38	30

Note: This table indicates the timing of identification and execution of add-on operations. The sample was divided into subgroups based on the medians of AUM, age and headquarters.

Source: Our analysis

Tab. 7: Main goals of the B&B strategy for GPs

Categories	Frequencies
New sales markets	76.6%
Product portfolio development	71.4%
Multiple arbitrage	64.9%
Creation of hubs of excellence	57.1%
Operating synergies	42.9%
Acquiring know-how	41.6%
Management synergies	31.2%
Financial synergies	14.3%
Sharing of best practices	11.7%
Number of responses	77

Note: This table indicates the main goals pursued by GPs by means of a B&B strategy.

Source: Our analysis

4.2 Add-ons' characteristics

In this section, we address some characteristics of add-on target companies and the B&B strategy's impact on industry consolidation and internationalisation. Tables 8, 9 and 10 indicate that add-ons are smaller firms that usually operate in the same industry. However, sizable GPs are more active in acquiring add-ons, which operate in a different business and in another country with respect to the platform, thereby supporting H4.

Tab. 8: Size of add-ons compared with platforms in terms of turnover

		AUM		Age		Headquarters	
Categories	%	Low	High	Young	Old	Italy	Abroad
Bigger than the platform	5.8%	7.9%	3.2%	11.4%	0.0%	5.1%	6.7%
Equal to the platform	7.2%	7.9%	6.5%	2.9%	11.8%	10.3%	3.3%
Smaller than the platform	87.0%	84.2%	90.3%	85.7%	88.2%	84.6%	90.0%
Number of responses	69	38	31	35	34	39	30

Note: This table indicates the size of add-ons compared with platforms in terms of turnover. The sample was divided into subgroups based on the medians of AUM, age and headquarters.

Source: Our analysis

Tab. 9: Add-ons' headquarters compared with platforms

		AUM		Age		Headquarters	
Categories	%	Low	High	Young	Old	Italy	Abroad
Same country	55.1%	60.5%	48.4%	51.4%	58.8%	61.5%	46.7%
Foreign country	44.9%	39.5%	51.6%	48.6%	41.2%	38.5%	53.3%
Number of responses	69	38	31	35	34	39	30

Note: This table indicates the country in which target companies of B&B strategies are located with respect to the country where platforms' headquarters are located. The sample was divided into subgroups based on the medians of AUM, age and headquarters.

Source: Our analysis

Tab. 10: Industry consolidation

		AUM		Age		Headquarters	
Categories	%	Low	High	Young	Old	Italy	Abroad
Diversification	21.7%	15.8%	29.0%	20.0%	23.5%	20.5%	23.3%
Horizontal M&As	56.5%	55.3%	58.1%	48.6%	64.7%	59.0%	53.3%
Vertical M&As (Suppliers)	10.1%	13.2%	6.5%	17.1%	2.9%	5.1%	16.7%
Vertical M&As (Clients)	11.6%	15.8%	6.5%	14.3%	8.8%	15.4%	6.7%
Number of responses	69	38	31	35	34	39	30

Note: This table reports the M&A strategy pursued by B&B activity. The sample was divided into subgroups based on the medians of AUM, age and headquarters.

Source: Our analysis

4.3 Deal technicalities

This section addresses the topic of deal structuring and negotiations, funding and pricing of add-on acquisitions.

Table 11 indicates that the platform acquires add-ons in a follow-on deal without merging different legal entities into a new group.

Tab. 11: Add-ons' ownership structure

		AUM		Age		Headquarters	
Categories	%	Low	High	Young	Old	Italy	Abroad
Acquisition made by platform	95.7%	94.7%	96.8%	97.1%	94.1%	94.9%	100.0%
Creation of a new group	4.3%	5.3%	3.2%	2.9%	5.9%	5.1%	0.0%
Number of responses	69	38	31	35	34	39	30

Note: This table investigates whether the 'acquirer' is the platform or a different entity that lies somewhere between the company and the private equity firm to create a group. The sample was divided into subgroups based on the medians of AUM, age and headquarters.

Source: Our analysis

In terms of funding, Table 12 indicates that the PE sponsor mostly finances the acquisitions' equity component through a capital increase in the platform company. Table 13 also reports that debt almost always is used, mainly leveraged bank debt. However, larger, foreign GPs use private credit funds as resources relatively more often.

Tab. 12: Funding of add-ons' equity component

		AUM		Age		Headquarters	
Categories	%	Low	High	Young	Old	Italy	Abroad
GPs' resources	59.4%	60.5%	58.1%	60.0%	58.8%	59.0%	60.0%
Platform resources	33.3%	31.6%	35.5%	34.3%	32.4%	33.3%	33.3%
Combination	7.2%	7.9%	6.5%	5.7%	8.8%	7.7%	6.7%
Number of responses	69	38	31	35	34	39	30

Note: This table indicates the funding options for the add-on acquisitions' equity component. The sample was divided into subgroups based on the medians of AUM, age and headquarters.

Source: Our analysis

Tab. 13: Use of debt component in add-ons

		AUM		Age		Headquarters	
Categories	%	Low	High	Young	Old	Italy	Abroad
Banks	81.2%	89.5%	71.0%	80.0%	82.4%	89.7%	70.0%
Private debt	5.8%	0.0%	12.9%	0.0%	11.8%	0.0%	13.3%
Both	11.6%	10.5%	12.9%	17.1%	5.9%	10.3%	13.3%
No	1.4%	0.0%	3.2%	2.9%	0.0%	0.0%	3.3%
Number of responses	69	38	31	35	34	39	30

Note: This table indicates whether B&B deals imply the use of debt. The sample was divided into subgroups based on the medians of AUM, age and headquarters.

Source: Our analysis

Furthermore, in terms of pricing (Tab. 14), no clear evidence supports H5, as GPs are not backing up the idea of behaving as strategic buyers on add-on acquisitions, i.e., paying more to anticipate future synergies.

Tab. 14: Add-ons' pricing strategy compared with non-B&B buyouts

		AUM		Age		Headquarters	
Categories	%	Low	High	Young	Old	Italy	Abroad
Strategic buyer	50.7%	42.1%	61.3%	57.1%	44.1%	48.7%	53.3%
Financial buyer	49.3%	57.9%	38.7%	42.9%	55.9%	51.3%	46.7%
Number of responses	69	38	31	35	34	39	30

Note: This table indicates PE firms' behaviour as buyers. The sample was divided into subgroups based on the medians of AUM, age and headquarters.

Source: Our analysis

4.4 Post-acquisition

This section analyses the main obstacles that arise after acquisitions have been made, i.e., changes implemented in the platform and add-ons to create value, and the B&B strategy's impact on holding periods.

Table 15 indicates that GPs have realised that integrating different organisations, corporate cultures and human resource management (HRM) is a major obstacle to deploying the B&B strategy effectively, as highlighted in the M&A literature (Steigenberger, 2017). New hirings often are viewed as necessary to ease the post-acquisition process (Table 16).

Tab. 15: Problems arising following a B&B strategy

Categories	Frequencies
Business organisation and HRM	63.2%
Corporate culture integration	44.1%
Deploying synergies	41.2%
Less attention paid to core business	33.8%
IT integration	22.1%
Top management commitment	20.6%
Customers' reactions	4.4%
Number of responses	68

Note: This table indicates the main issues that GPs face when deploying B&B strategies.

Source: Our analysis

Tab. 16: New hirings to ease post-acquisition integration

		AUM		Age		Headquarters	
Categories	%	Low	High	Young	Old	Italy	Abroad
Never	21.7%	23.7%	19.4%	25.7%	17.6%	28.2%	13.3%
Sometimes	68.1%	65.8%	71.0%	60.0%	76.5%	66.7%	70.0%
Always	10.1%	10.5%	9.7%	14.3%	5.9%	5.1%	16.&
Number of responses	69	38	31	35	34	39	30

Note: This table presents new hirings to ease post-acquisition integration. The sample was divided into subgroups based on the medians of AUM, age and headquarters.

Source: Our analysis

Only one-third of GPs asserted that the holding period for platforms activating a B&B strategy is longer than other portfolio companies that do not pursue inorganic growth strategies (Table 17). Thus, the investment period's length in a portfolio company is not dependent on a B&B strategy, thereby not supporting H6.

Tab. 17: Holding period of portfolio companies using B&B compared with those not using B&B

		AUM		Age		Headquarters	
Categories	%	Low	High	Young	Old	Italy	Abroad
Similar	66.2%	59.5%	74.2%	67.6%	64.7%	71.1%	60.0%
Longer	33.8%	40.5%	25.8%	32.4%	35.3%	28.9%	40.0%
Number of responses	68	37	31	34	34	38	30

Note: This table presents the holding periods of portfolio companies using B&B compared with those that do not. The sample was divided into subgroups based on the medians of AUM, age and headquarters.

Source: Our analysis

4.5 B&B strategy assessment

Table 18 reports that for almost two out of three GPs, the B&B strategy always meets desired goals, and no one is totally sceptical about its effects, coherently with the wide market diffusion.

Tab. 18: Self-assessment about achievement of desired B&B goals

		AUM		Age		Headquarters	
Categories	%	Low	High	Young	Old	Italy	Abroad
Never	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Sometimes	35.3%	29.7%	41.9%	32.4%	38.2%	23.7%	50.0%
Always	64.7%	70.3%	58.1%	67.6%	61.8%	76.3%	50.0%
Number of responses	68	37	31	34	34	38	30

Note: This table reports a self-assessment of the GP about the achievement of B&B strategy goals. The sample was divided into subgroups based on the medians of AUM, age and headquarters.

Source: Our analysis

5. Discussion and conclusions

5.1 Discussion of the findings

Industry data have indicated that PE investors' interest in the B&B strategy (i.e., pushing inorganic growth by making additional acquisitions with a platform company) has been growing steadily. This strategy poses several implications for GPs, LPs, entrepreneurs and other PE industry stakeholders, and also impacts the M&A market.

Altogether, 87% of GPs claim they have made additional acquisitions with at least one of their portfolio companies over the past five years, thereby confirming PE investors' strong commitment to this strategy.

PE investors conduct a thorough ex ante strategic evaluation before embarking on a B&B strategy: As early as the due diligence period of a new investment, the degree of fragmentation in the industry in which the potential target operates is investigated, and long lists of future potential acquisitions are analysed. The potential to function as a platform is an investment criterion that GPs analyse thoroughly before investing in a new portfolio company, thereby supporting H1 and aligning with Hammer *et al.* (2022) that PE investors pay a premium EV/sales multiple for platform deals.

The source of value creation in a PE-backed B&B strategy is a crucial and debated topic: The M&A literature has demonstrated that post-merger integration and the realisation of synergies is a difficult and long process (Angwin and Meadows, 2015; Steigenberger, 2017) that seems at odds with PE investors' relatively short holding periods with their portfolio companies. Can PE investors realise post-merger integration in a shorter period thanks to their set of internal skills and expertise? Moreover, our findings indicated that a huge majority of PE investors make additional acquisitions late in their investment period in a platform, thereby not supporting H2. PE investors then would have even less time to deploy synergies in the new combined entity. Indeed, Hammer *et al.* (2021) demonstrated that late acquisitions might be detrimental to acquirers' performance. Also, interviewees reported that the holding periods of platform companies that make additional acquisitions are similar to those that do not, which does not support H6.

Taken together, this indicates that PE investors employ inorganic growth strategies mainly to create a new combined entity with a higher combined value than the sum of its parts, leveraging higher valuations typical of bigger firms at exit, with less emphasis on having enough time to deploy operating synergies fully. Thus, the B&B strategy's main value creation lever is multiple arbitrage, i.e., buying at a lower EBITDA multiple than the realised multiple at exit, thereby supporting H3. Small companies generally are cheaper than large companies because they have fewer potential buyers. Examining this finding from GPs' managerial perspective, additional acquisitions are viewed as an effective way to use their dry powder to contribute to portfolio companies' growth, as they require committing a fixed amount of resources (add-ons' acquisition prices), rather than investing less-predictable cash flows to pursue internal organic growth paths. Furthermore, more space is created for more exit routes and, consequently, more competition among bidders, thereby driving up valuations.

Add-ons are smaller firms and usually are active in the same industry as platforms; therefore, a B&B strategy is akin to a horizontal M&A strategy. However, bigger GPs can realise more diversification and create cross-border M&As, as they are more likely than the platform to acquire add-ons that are active in different industries and located in another country, thereby supporting H4. Finally, the interviewees did not seem to confirm that PE investors pay more for add-on deals, i.e., behave like a strategic buyer, thereby supporting H5. However, as reported in the previous section, this question requires considering respondents' incentives to be overly positive.

5.2 Research limitations

In this study, we assumed that the PE investors provided faithful answers. Upon contacting PE firms, we assured them that their responses would be aggregated and anonymised so that they could not be identified in our analyses. Therefore, the incentive to report overly positive or otherwise inaccurate responses arguably was low because doing so would not have benefitted any one individual firm directly. However, we acknowledge that some PE investors could have responded in an overly positive way to some questions in the hopes that the PE industry would be cast in a more positive light overall. We were unable to evaluate answers independently, but we can discuss where we think any incentives and behaviours could have affected our results.

We did not expect questions about GPs' strategic decisions or add-on companies' characteristics to elicit any biases, as this was not information that affects GPs' reputations or signals relevant information to their stakeholders, particularly LPs.

The questions that we believe that PE investors could have been incentivised to be overly positive about concern pricing and the difficulties found in realising a B&B strategy, as well as their self-assessments on achievement of their desired goals.

To the extent that such investors want their LPs to believe that they do not function as strategic buyers who are willing to pay more for these types of deals, we can assume that the question on pricing could be biased. However, as Gompers *et al.* (2016) highlighted, to the extent that PE investors want to be known for being able to grow their investments (and create jobs), instead of using merely financial engineering or multiple arbitrage, we also believe that there could be incentives to disclose their ability to generate positive returns by means of an industrial combination, even though the initial acquisition price was high.

Instead, questions regarding issues that GPs face in deploying the add-on strategy and the ability to reach established goals may be answered less truthfully because PE sponsors might be incentivised to overstate their results to present the company in a positive light.

Overall, the answers provided, which were consistent with preliminary empirical findings described in the theoretical framework, do not give us solid reasons to believe that GPs had strong incentives to be biased.

5.3 Managerial implications and future research

Generally, PE investors' behaviour as 'serial acquirers' poses several managerial implications and is highly interesting for policymakers. It helps create more structured and resilient firms, particularly when grouping SMEs together, with a better capacity for attracting skilled human capital. The highly incentivising financial packages offered to management at portfolio firms enable PE investors to attract very skilled executives who otherwise would not view these companies as attractive. However, they also might increase the risk of anti-competitive behaviour across the economy. Indeed, a recent US regulation requires antitrust agencies to consider entire series of acquisitions, rather than individual deals. A fruitful avenue of future research might be to examine the actual capacity of new PE-backed combined entities to gain a higher market share and bargaining power, which are elements influenced by size (Moatti *et al.*, 2015), and to act as a price-maker and improve EBITDA margins, which Hammer *et al.* (2021) did not find.

Future research also should try to decompose platforms and add-ons' organic and inorganic growth to shed light on PE-backed portfolio companies' real economic impact, as well as their effects on labour productivity and wages. Researchers should consider longer observational periods to observe platform companies' various exit channels and their post-exit (long-term) performance.

Hammer *et al.* (2017) found that add-on acquisitions increase the probability of exiting through secondary buyouts, as the secondary buyer frequently exploits the portfolio firm's unused inorganic growth potential.

This would imply that the primary buyout's PE investor, who realised a B&B strategy, did not fully deploy operating synergies, either because it approached the end of its fund lifetime or because it had an incentive to exit quickly to realise performance. The primary buyout's GP would need a longer holding period to realise the full add-on potential. As the PE industry over the past few years has experienced a sharp rise in GP-led secondary operations (i.e., when a GP sells one or more portfolio companies from a fund it already manages to a so-called continuation fund, managed by themselves, thereby extending the holding period on some portfolio companies), an interesting future research avenue would be to study whether transferred companies have activated a B&B strategy and thus the rationale of the deal for GPs would be to have more time to deploy operating synergies and boost value creation.

More attention also should be directed toward platform companies' internal organisation by investigating whether and how it is modified by PE investors to support the execution of a B&B strategy. Relational dynamics among PE investors and entrepreneurs who remain in the shareholding structure offer another fruitful research direction. These inquiries should use case-based data focussed on changes that PE investors implement at an organisational level.

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