

## Episode 3 Importance of Ops in ETA

Length of recording: 31 minutes

### Transcription notes

GB: Gautam Basu  
MJ: Mikko Järvinen

wo- an unfinished word  
(word) an uncertain passage in speech or an unrecognised speaker  
(-) an unrecognisable word  
(--) unrecognisable words  
[pause 10 s] a pause in speech of at least 10 seconds  
  
, . ? : a grammatically correct punctuation mark or a pause in speech of less than 10 seconds

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[intro music]

GB: The Operations Leadership Podcast with Gautam Basu provides insights for today's business leaders on creating value through operations improvement, process excellence, digital innovation, and organizational leadership.

The following is an interview with Mikko Järvinen. Mikko is the co-founder and partner of True North Search. An Entrepreneurship Through Acquisition accelerator based in Northern Europe. Mikko has a long background in the lower middle market, small medium enterprise segment, where he has served in multiple roles from a chief operation officer to a founder to various companies within health technology and digital marketing services consultancy. And in addition to this, he has coached and advised many entrepreneurs both early stage as well as the latter growth stage and now focusing on acquisition entrepreneurship. And in this interview Mikko will talk a little bit about the Entrepreneurship Through Acquisition model, and really the criticality of operations and specifically operations improvement as a critical factor for the success in Entrepreneurship Through Acquisition. Hope you enjoy.

[intro music ends]

GB: Hello, Mikko, and welcome to The Operations Leadership Podcast.

MJ: Thank you for the invitation, and happy to be here.

GB: Great. I understand, Mikko, that you are involved with a model called Entrepreneurship Through Acquisition or ETA. Could you tell us a little bit more about this ETA model?

MJ: That's right. Maybe I'll start off by introducing the model with the exact words that it was introduced to me a couple of years back. So, it's the best kept secret in the business community, and I think that's quite an accurate statement for it. What Entrepreneurship Through Acquisition is about, it's about getting into entrepreneurship through acquiring a business. So, alternative path to setting up a new business, setting up a start-up and building from there. And the model isn't actually very new. It was originally developed in Ivy League business school, in the US, mainly in Stanford by an individual named -

The model is actually quite simple. You have three key roles: you have analogy of horse race, so you have jockey, you have a horse, and you have a trainer. And in this analogy the jockey is the entrepreneur to be, the upcoming operator who's looking for a business to acquire. Horse, that actually the business that's gonna be acquired. And then you have trainer, which in this case is investor or - maybe we'll talk a bit about True North Search later - and accelerator that is supporting the jockey on this journey.

GB: It's interesting because you're saying that this model is quite different from the traditional start-up model in the sense that you're acquiring an established business. Can you tell us a little how what else kind of differs, in terms of success rates, start-up vs the ETA model?

MJ: One thing that differs is the returns with this model. The model has been actually quite successful throughout the, since the inception of early 1980s. And we've seen return rates closer to 30 % IRR.

GB: that's pretty high.

MJ: Yeah, it's pretty much outperforming alternative assets, of course it's outperforming the listed companies. It's kind of like interesting how those returns are heavily based also on the operator that is taking the company over. Maybe one way to look at that returns and comparison to start-ups is the thinking of the risk and also on the return on this side. If you look at start-ups, the two key reasons why start-ups fails, the most quoted ones, are timing and team. You can't really do much about timing. You're coming in with a technology, it might be right time to move forward with that, or it might the wrong time to move forward with that. With team, getting into a start-up is a bit of a risky proposition, so you might be struggling getting the competencies that you need to have in place and getting the people in with the right motivations.

These two things are completely different with the ETA model. Firstly, you're going in buying a well-established company that has a track record of profitability, pretty secure marketplace, and you start building from there. So you're kind of like, the

timing doesn't really matter. The company has been there for ten years, twenty years or so on.

GB: So this is an established business and has this kind of a track record.

MJ: Exactly.

GB: Are there any other kind of let's say criteria that need to be in place for this let's say target acquisition?

MJ: Yes, there is. Actually, there's quite tightly knit community around the ETA model, and well established criteria on what these jockeys are looking for when they're actually evaluating the horses for the businesses to buy. And of course you're looking at profitability. Number two is probably the industry. You're kind of like placing your bets in a way that's you're looking into growing industries, so you get kind of like a bit of a tail wind when you're growing with that one. And of course one criteria is recurring revenue. So, companies with business models where you have a large share of recurring revenue are something that are quite favored with this model.

GB: That makes sense. And I guess if you have a recurring revenue model that makes it more predictable in terms of cash flow and of course your sales.

MJ: Exactly, exactly. Also one perspective on that is that we are changing the management with this model. You're introducing new management, and with this high level of recurring revenue you're kind of like making that transition a bit easier. So there's not gonna be a quick impact on the revenues, whatever changes during that time. It's more occurring over the time. Of course the downside of recurring revenue is that growing that revenue might be a bit slower in a sense.

GB: How so?

MJ: I mean, you could go into industry where you have high level of switching costs. You have long contracts in that industry, contracts spanning over months or years, and winning those contracts might be a bit slower than in an industry that is running on a different type of revenue model.

GB: Right. You mentioned something interesting. I mean, of course the returns of this type of model, I think you mentioned 29, 30 % internal rate of return, which is a good gauge for investors in terms of picking investments. Why do you think that, what's the secret sauce behind this type of ETA? Why the high returns?

MJ: I would bring out actually three things. One we already discussed. You're looking at businesses that are well-established and enduringly profitable. Having an opportunity to grow forward. You're introducing investors that are smart that can

actually support the operator, but the key thing with this model is that you're introducing new management. And that is completely different maybe for at least for the listed businesses. Also if you will look at the other alternative investments, you might see more involvement in the board level, not actually in the operational management. And comparing to the startups, you might have trouble getting that talent into companies, you might be struggling to get experienced people who can actually leverage their skills on developing that business forward. With this model, the key is the operator, who can actually be there to drive that value.

GB: Okay. That's interesting, because this is a podcast of course on operations leadership.

MJ: Exactly.

GB: So this is a very relevant topic to to us. Could you elaborate a little, because obviously if you're getting such a high return, internal rate return, there must be some sort of value creating that this searcher or acquirer is doing. Can you elaborate a little bit on that aspect in terms of specifically around the value creation component, so to speak?

MJ: Yeah, sure. That's pretty much given for looking at those returns, what needs to happen, the company needs to become more valuable in the hands of the new jockey, in the hands of the new management. How that may work is that typically, the companies that are acquired are actually founder-managed companies. And you might have founders who are a bit on IRH, they might have the skills to grow that company, to improve that company from certain stage where they are. And they might just lack the motivation, so they're happy where the company is.

GB: Are these people are the let's say selling the company, are they typically of retirement age? Or how does that work?

MJ: Exactly. That's probably the number one reason for people who are selling these businesses. That's typically the focus. What you're looking for is companies that are maybe not having a succession plan in place. You might have companies where the children of the founder are not interested in taking that company forward, and maybe the founder hasn't just really thought of structured process on succession with the company.

GB: So that's quite an acute problem, especially where you have countries where there's aging population.

MJ: It's it, I mean it's the fastest aging continent, I would say. You could characterize that as a problem for pretty much all of the Western world.

GB: Yeah. Going back to the kind of the value that's created let's say after the acquisition is done, can you tell us a little bit about the let's say the levers of value creation and kind of distinguishing - I mean, how does operations actually fit in to the overall picture, if you compare that with maybe the capital structure or the multiple expansion? How does that actually fit into the picture operations?

MJ: Sure. Let's maybe start with what are the actual levers or opportunities for value creation with this model. So, you actually have only three or maybe four levers that you can use with this one. First one, that's kind of like I would say traditional private equity, the use of leverage, so as the companies that are being acquired are cash flow positive, they have the history of positive returns. Some leverage can be applied on this acquisition.

GB: By leverage you're talking about taking debt?

MJ: Exactly. Having maybe 50 % of debt, maybe even more on acquiring these companies. The second one, that's pretty clear. You buy with reasonable price and find ways to actually increase that price over time. We're looking at, typically these companies are valued by multiple of some earnings figure, so you might ways to actually increase that multiple. And with actually that formula, you'll also have the earning side. That's the realms of operations improvement.

GB: So basically the first two, one is the realm of the capital structure and essentially the component of de-leveraging to basically raise the equity value of the company through the course of the holding period. And the second one is around of course the multiple of the earnings, like you said. Is that a difference between multiple of let's say of profit EBIDTA, earnings before interest taxes. And the exit, so when you actually exit the thing, how is that one?

MJ: Exactly. So, you're looking at what is the multiple on that earnings figure on your entry, and what could that multiple be on the exit it.

GB: Got it.

MJ: And of course if you're able to - I mean, something that happens with this size of companies that we're focusing on, I think we didn't mention that but with this model you're typically looking at companies that are under the radar of traditional private equity entities. And what that means is that it's highly illiquid market, in a way, that the entrepreneurs might not have that much of opportunities to find buyers for their businesses. By doing this transaction, introducing the operator who would be growing the company, improving the company, you might be able to grow that company in a stage here it becomes maybe more attractive for traditional private equity.

GB: So is this basically the small medium enterprise, lower middle market type of enterprise? Can you give a kind of a value of what range of companies, in terms of enterprise value?

MJ: Exactly. The value of the companies varies from market to market, but what we're seeing in Europe for example, we might start as low as half a million in EBITDA, which translate to maybe up to five million in terms of enterprise value.

GB: At the bottom?

MJ: Yeah, yeah. Some markets, maybe US markets, we're seeing a bit more larger companies. I guess private equities are maybe moving or focusing a bit larger companies, so we have a different type of opportunity gap that you can focus on.

GB: So from an operations perspective, typically if you have a company of that size, the process is the systems and the overall operations are typically less mature. In a way there could be more room for operations improvement. So, going back to the discussion around value creation, you were talking that there's the capital structure, there's the multiples, (-) [16:07] in the multiples, entry and exit. But then there's this whole operations improvement that is providing this lever. Can you elaborate a bit on that?

MJ: Exactly. So, operation improvements, which can be I think the ultimate measure would be earnings or free cash flow, if you want to look also at the working capital side of things. That's pretty much the core of the operations improvement side in the ETA model. And I think you hit it on the nail, these companies are stereotypically founder-run, there are a lot of opportunities that you can actually build on. Maybe a couple of examples. These are more from the US market, they are public information, so sharing some of those. One example is basically price increases. This is actually quite simple thing to get started. There is actually quite successful investor, Matt Estep with Bosworth Capital, who's focusing solely on companies that have opportunity for price increase with the ETA model. Some examples are residential elevator component manufacturer that he's been looking into. And essentially you might have just an opportunity to - this company doesn't have really direct competitors, none direct competitor, how he's doing this is he's trying to actually buy some of the components that the target company or the company to be acquired is producing. And he hasn't been able to do that. So that means that there's probably a good bargaining power with that company and moving forward from there.

GB: So that's almost like a lack of vertical integration in the value chain, in a sense. Or let's say some sort of integration in the value chain.

MJ: Yeah, you could say that. But essentially, it's just realizing that there is the opportunity to do that price increase, but it hasn't been just touched. Maybe the previous owner just doesn't want to do the effort of renegotiating those prices and

being happy where he's at the moment. So that's maybe one example. Maybe a couple of more interesting examples are what you can do on the revenue increase side.

One example is OnRamp Access, which was acquired by Lucas Braun a few years back. That's a data center operations, and that starting point, I think he had two salespeople there, and one of them quit on day one after acquisition. So, basically building the whole salesforce again for that company, and building it a bit more smarter than previously. One realization for him was the question that is this a product that is being bought or is this a product that is being sold. With data centers, usually the customer is already struggling with limited capacity or something like that, so it's definitely a product that is being bought. So, introducing tools like inbound marketing, creating content, making your customers aware that you are here and basically luring them in through different conversion goals, and building the customer relationship from there. He was quite successful actually pushing down the marketing expenses, customer acquisition expenses for this one.

But that's basically just one example that maybe the previous ownership wasn't really focused on battling, and the new entrepreneur was able to introduce improvement just essentially by implementing existing technology at that time.

GB: That's a good example of the kind of the revenue growth, top line sales, pushing that up higher. Can you do the same with for example the, really looking at the bottom line of profitability, things like sourcing, or production efficiency, logistics maybe, rationalizing some logistic service providers or distribution? Does that work in this model as well?

MJ: Exactly. I mean, it works perfectly. Maybe coming back to the role of the operator also in here, so it's also a lot about what kind of skills and competencies the operator can bring in. What is the jockey - if he has great experience on those kinds of improvements, that's where he will be focusing on. That's probably also the focus on what he will be acquiring with this one.

GB: You mentioned the operator, and of course the theme of this podcast is operations leadership. So, I understood that once this jockey or this searcher acquires, he or she basically transitions to the chief executive officer, the CEO role. What is your view on the leadership component? And especially the leadership component as referring to the operation side? Whether it's top line revenue growth or the reduction in the operating cost structure. How do you see leadership as a component, specific to drive some some of these changes, how do you see that?

MJ: Maybe two perspectives on that. One thing is that, we discussed that already previously, so it's a question of introducing new, more maybe motivated, more driven, better-skilled management for some of these companies. But maybe also other perspective you could say is the kind of like the role of the new manager who's

taking over that company. Maybe something that is noteworthy is that when we're looking at these smaller companies, starting from half a million EBIDTA, you might have organizations where you start with maybe ten people working on that one, maybe twenty people, thirty people. And that's going to be very hands-on work. The CEO, the operator taking over that business will be transitioning between doer and manager. So maybe one perspective that is new to people who take this path, coming maybe from corporate world, is that the buck stops with you in this model. You're the one who's kind of like taking the full responsibility of this company, and there is actually nobody else you can delegate lot of this stuff. You're the one who's carrying that company forward and responsible for implementing all those improvements.

GB: So there's probably a big kind of let's say change agent also. I mean, if you do have a lean, small team, you must be able to leverage your leadership skills to kind of move the needle on these operational improvements.

MJ: Exactly. What we see a lot of times, it's kind of like king and pawns type of organizations with these ones.

GB: [laugh] Right.

MJ: You have maybe a - somebody refers to it as entrepreneurial leadership, but you kind of like might start with an organization, which is kind of like built around the personality of the founder, of the entrepreneur. And that has to change when this transition happens, because that guys is not going to be around anymore. That might mean a quite big change in these type of companies, in terms of employees and so on.

GB: Sure, interesting. So, you're a partner of this entity calles True North Search.

MJ: Yes.

GB: Can you tell us a little bit about what True North Search does?

MJ: Happy to do that. The reason for existence of True North Search is that we're here to accelerate this ETA process, essentially supporting individuals that decide to take this path. And how we run this is that we quite carefully vet, train, also support entrepreneur operator or future entrepreneurs. We like to call them entrepreneur operators in residence.

GB: Oh, so you call the entrepreneur operators in residence.

MJ: Yes we do, yes we do. And we are there to support them throughout the various stages of firstly preparing for their search, searching for a company to acquire - these individuals might go through hundreds of opportunities before they find the



right one - and also supporting them in the acquisition stage but also post-acquisition. Running that company and maybe supporting them through the exit, if they're willing to sell that company at some point.

GB: Now do you, when you look at a company and you're valuating a company, do you also take into account for example where the company could let's say improve from an operational standpoint and take that into consideration during the negotiation, even in the valuation? Is there kind of a process or subprocess that you kind of look at and say, okay, here's the current operation of the company based on the post-acquisition, the new CEO will take over, and based on his or her skillset that they can bring X, Y and Z from an operational perspective? Do you do that kind of thing?

MJ: Yes. With this model, the entrepreneur operator is quite heavily involved with evaluating the opportunities and running the due diligence. And what I like with this model is then you have a kind of like built-in setup, where you're not only objective evaluating that opportunity but also having a look where you can put your skills as the future CEO, as the future EOIR. That is the part of the process, so when evaluating those targets, we have the criteria of the enduringly profitable companies, is there a component of recurring revenue, is the company profitable, what kind of capital expenses that company carries. But there's also the evaluation criterion, what are the actual value creation opportunities post-acquisition. So, there needs to be a story of how this company becomes more valuable in the hands of the new EOIR.

GB: Interesting. If people want to, are more interested in True North Search, in getting in touch with you, how can they do that?

MJ: Yes. So, how the process is run is that firstly, you get more information from the True North Search website, [truenorthsearch.io](http://truenorthsearch.io) and you find the contact information there. We're running once, twice a year cohorts of future EOIRs. How the process goes from their side is that the EOIRs apply on our website, there is the selection process after that, and after that they start a nine-week training program with us.

GB: This EOIR is - ?

MJ: Entrepreneur operator in residence, exactly. So these are the individuals who are embarking on this process. And that nine-week program is actually kind of like covering all the major aspects that you need to have in order to increase your chances to succeed with this. We cover things like search strategies, how you actually do your search, we go through financing, deal-structuring with this model, but also the operations improvement side. So, getting some ideas also on that side before embarking for the search. After this nine-week program, that's when they settle. So, we're providing them with tools, company databases, process, coaching,

mentoring, for the search duration. Having maybe a bit of a more eyes to look at the deal, look at the opportunity, and help them forward with that one.

At the moment, we are working with eight entrepreneur operators in residence, so these individuals are searching for a company to acquire in Finland, UK, Estonia, Denmark and Norway, at this stage. As we're recording this podcast, two of our EOIRs have been in process of searching for closer to a year, now, and six of them have just started this process.

GB: Sounds exciting. So, this is great, this new model, Entrepreneurship Through Acquisition, so I definitely want to thank you for your time, Mikko.

MJ: Thank you.

GB: I look forward to seeing the success of the ETA model in Northern Europe, and thanks again.

MJ: Thank you, thank you for this.

[outro music]

GB: That's it for this week's Operations Leadership Podcast, we hope you enjoyed it, and until next time.

[outro music ends]