Identifying Your Company's Value Drivers

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Preparing your company for sale takes work, but the effort might mean millions in your pocket, and will help you sleep at night - Morgan Smyth, Sep 28, 2011

Baby-boomers own most of the privately held businesses in Canada, but the cohort is reaching the age of retirement and starting to evaluate its options. When they first began their entrepreneurial careers, their plans looked like this:

- ✓ create a company
- ✓ grow it to a substantial size
- ✓ sell it for an outlandish sum of money
- ✓ finally get to enjoy life and travel the world

A great plan, in theory. But those of us who have tried to execute on it know differently. Every step in this journey is a challenge. And the reward at the end? All I can say is, don't bank on it!

Why is it so hard? Part of the reason lies in the prevailing market conditions when the time comes for you to sell your business. However, the majority of the causes can be traced back to our own decisions.

First, look at the market conditions. The laws of supply and demand influence the success of the goods or services we sell, and they apply equally to the sale of a company. Ask yourself, "How many buyers are looking to purchase company like mine and how many other companies like mine are up for sale?"

In Canada, there are roughly 1.2million privately owned small-to-medium businesses. Of those, 71% (or 852,000 companies) plan to transition their ownership over the next 10 years, according to the Canadian Federation of Independent Business. And, 41% (492,000) expect to change hands over the next five years. That is significant competition!

So there is an abundance of supply, but what about demand? Statistics Canada predicts that 75% of all these businesses will simply go out of business because they cannot find a suitable buyer. So, of the 852,000 who thought they would sell, only 213,000 will.

Before you assume you'll be among the lucky 213,000, here's another taste of reality – according to Business Valuation Resources, fewer than 1% of these companies will get their asking price. This works out to only 2,000 happy entrepreneurs over the next ten years.

So how do you get your company into this magic 2,000 club?

Many owners think they can simply stage their company as some homeowners do with their houses. Unfortunately, a basic due diligence by any prospective buyer will quickly peel this layer off. Once the concealed issues are exposed, and the owner's credibility is ruined, the deal is dead.

To prepare your company properly for sale, you really have to start three-to-five years in advance. It takes at least this long for most companies to implement the changes required.

What are these changes?

Attitude - Have the right attitude towards your company. Most owners enmesh themselves in their companies so much that, if they ever did sell them, they have to go along with the sale. They're so involved with the day-to-day operations that it really could not function without them. By making sure you stay out of the weeds, you avoid any possibility of extending the number of years you have to work (for the new owner), and you increase the price of the sale.

Separate yourself emotionally from your business. Passion is great, but the emotional shroud it places over you distorts your objective reasoning, resulting in bad decisions. Stop thinking of your company as your baby; start thinking of it as just another asset for sale. In fact, keep this asset on the block at all times, ready to sell on a moment's notice when the right offer comes along.

Where's the Beef?

Value Drivers - You have always strived to get top dollar for your products and services. Why not do the same with your company? Determine what parts of your business truly drive up its value and concentrate on maximizing them. What are these value drivers and where are they? Look hard enough and you should be able to identify approximately forty *business drivers* (internal) and nine *market drivers* (external) that determine the attractiveness of your company to others. Here are some examples:

Business Drivers	Market Drivers
Company Overview	Growth
Financial	Revenue Streams
Sales & Marketing	Market Share
Operations	Barriers to Entry
Customer Satisfaction	Product Differentiation
Senior Management	Brand Power
Innovation	Competitors
Human Resources	Margins
Legal	Customer Composition

Measure - Once you have identified these value drives, the next step is to measure them. For example, "On a scale of 1 to 10, how are we doing with our quote-to-close ratio?" Do this to all of them.

Compare - Compare your findings to what are normal for your particular industry. There are databases that have most of the information you require. I use one that has thousands of companies' metrics. Within these, there are typically 20 to 100 companies about the same size and in the same business as you.

Once completed, you have a much better understanding of how your firm is doing relative to your competitors. In which areas are your drivers excelling? Which need improving? How do you use this information? Get all of your poor performing drivers up into the "excelling" category. How do you do this?

Plan - Say your goal is to sell your company for $20M in five years. How to you get there? Set yearly objectives that track towards this five-year goal. Implement a proven methodology, such as Balanced Scorecard, to ensure your objectives harmonize with each other, as opposed to conflict. Once you have done this, you are ready for execution.

Structure & Process – While owners hate these words, they actually have some very good structures and processes in place. Take the accounting department. Sound structure and processes ensure that bills are paid on time, invoicing is timely and accurate, and most of all, employees get their paycheques.

Apply the same concepts to the other aspects of your business - Sales, Marketing, HR, Design, Production, etc. Implementing a structure and process like Balanced Scorecard for your planning purposes is an excellent start.

You can manage only what you can measure

Monitor - Now that you have started collecting your value measurements; and implemented your structures and processes; it is time to track their performance. Implement a software package that will capture this data and display it on your screen in the form of a dashboard.

It shows you how the company is performing from a 30,000 foot level and lets you to drill down and analyse each driver at its most granular level. That way, you will continually see any issues cropping up and deal with them immediately.

Notice too, you are no longer mired in the actual activities; rather you are now truly managing.

Quality - A person once said to me, “I’m too poor to buy cheap things.” Buyers pay more for quality products because they are less expensive in the end. The same is true with your company.

Conduct satisfaction interviews with a representative sample of customers, employees and suppliers. They are all serious stakeholders. You want objective, candid feedback, so use a third-party to collect it because they know how. The same goes for your structures, processes, procedures, your management team, etc. Have a professional, independent quality audit team evaluate them. Just as you have financial auditors come in annually, invite these quality auditors in on the same frequency. It will be a very rewarding experience.

There are some excellent tools available to help you get started. Please check out www.nqi.ca and www.nist.gov/baldrige. This latter link takes you to the Malcolm Baldrige site which offers an excellent quality blueprint and quality performance checklist downloadable free. *Quality* can never be over-stated. Make it an integral part of every decision you make.

Summary

Buyers pay more when the risk is low. By completing all these tasks, you have taken most of the risk right out – no skeletons, no surprises, no unknowns. The extra bonus is that you have extricated yourself from it as well, both emotionally and operationally. There is no need for you enter into the dreaded ‘earn-out’ option with the buyer because your newly renovated company can now function surprisingly well without you, and you can prove it.

By tracking your value drivers, you have implemented an excellent continuous due diligence process, resulting in your entire company being completely transparent. The charts and data you have accumulated over the past few years provide confirming evidence of the firm’s continuous improvement.

By managing these value drivers, you have created a well-oiled, smooth-running organization that can react immediately to both internal and external variables, and your company is now ready for sale at top dollar.