

Mergers & Acquisitions

March 2004

The Dealmaker's Journal

F R O M T H E F I E L D

Exit Pay-Offs for the Entrepreneur

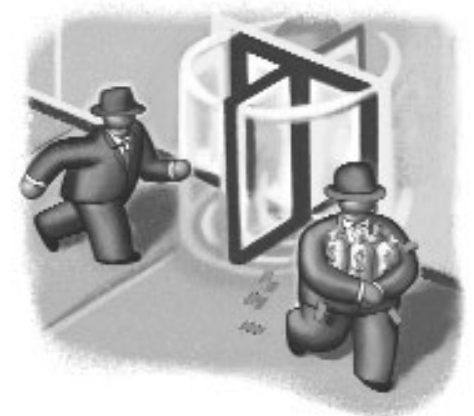
Mergers and acquisitions as a discipline are strongly focused on making deals. Money is made when transactions close. A lot of talent and time is spent on maximizing the value of a company when a deal is imminent. But any seller who waits until deal time to maximize value, is heavily dependent on the circumstances of the moment and may be leaving considerable amounts of money on the table. By contrast, the dealmaker that prepares for the ultimate sale well in advance not only can increase the ultimate value of the company and substantially boost the proceeds but maximize the prospects of getting the deal done.



By Guest Writer
Mary Adams



A wise seller can pick the optimal buyer and get the best price by running the company for an eventual sale.



In effect, up-front preparation utilizes ongoing development of the company as the key factor in a rewarding exit strategy.

How then does a seller create realizable value? Start with the strategic reasons that companies are making acquisitions in your field and related industries. These “value drivers” offer a good idea of the kinds of trends and opportunities that are influencing the industry. Then develop a plan that will make your company more attractive to the most likely future acquirers.

This is essentially an exercise in strategic planning. Ideally, the projected exit should be a subset of a complete strategic plan and should follow three basic steps:

- Development of a thorough briefing package on your industry and your company.
- Formulation of a plan that matches the company’s skills with the industry’s opportunities.
- Execution and follow-up in a disciplined way.

Strategic Value Drivers In Acquisitions

Before you can build value attractive to an acquirer, you must understand the buyer’s perspective. Most acquisitions are undertaken because the acquiring company sees one or more strategic advantages that can be obtained by buying another business. These advantages or value drivers vary from industry to industry. They also change over time in specific industries because of evolving product life cycles and external developments that affect the industry. Generic categories of strategic value drivers include:

Broader product lines — The buyer adds complementary products to increase revenues. This is a common strategy for both product and service companies.

Expanding the technology base — The buyer adds technology skills or intellectual property that enhances or complements the company’s current base.

Adding markets and distribution channels — The acquirer obtains channels it doesn’t currently serve. Companies that start out with a vertical strategy can add new industry expertise by widening its distribution capabilities. Vertical expertise, network, and infrastructure are all valuable vehicles for differentiation in many industries and may be worth gaining through acquisition.

Increasing the customer base — The buyer adds a company that is similar in product offerings or in its business model yet focuses on a different customer segment. This strategy is enhanced if the target company has a good reputation or strong brand. It also can expand the acquirer’s geographic coverage.

Creating economies of scale — The combined company can offer a more efficient use of physical assets or overhead — a critical need in consolidating industries.

Extending internal skills — The buyer can add new capabilities such as consulting or service offerings, international management skills, or various types of management and business skills. These skills can be offered as independent revenue producers or enhance a company’s competitive edge.

Many acquirers hope to leverage several value drivers in a single deal. Software company **BEA Systems Inc.**, for example, has regularly used acquisitions as a strategic tool to bring in new skills, new technology, and, sometimes, new customers. BEA has developed expertise for integrating and delivering these newly acquired technologies in their complete product offering for Internet-enabled business.



A different dynamic is occurring in the commercial printing industry. The advent of the Internet and the difficult economy of recent years have sharply reduced printing revenues. Because printing is very capital intensive, managers don't have a lot of flexibility in the face of the revenue declines. In printing, acquisitions are driven by the need to generate more volume against a fixed cost base, and consolidating deals have been abundant. New customers or markets — but not additional assets — will continue to be critical value factors that drive acquisitions in this industry over the next few years.

When you factor the perspective of potential buyers into the development of your company's strategy, you take your strategic planning process to a new and very productive level. You will learn a lot from a new dimension and the lessons probably will influence many more aspects of your business than just the exit strategy.

Internal characteristics of your company obviously will influence the acquirer's final valuation. These factors are related to fundamental business management, strong cash flow, and clean books and records. While they obviously are necessary to closing a deal, they must be augmented by significant value drivers to motivate the buyer to pay a premium price.

Briefing Package: Check Assumptions at the Door

Value building, as with all good strategic planning exercises, should start with a review of a company's external environment, including its industry and its competition. Building long-term realizable value requires an especially thorough examination, which can be very hard to do. Most managers know their businesses well. They work with customers every day. But they don't think they need to take the time to write up "obvious" information about their industry. Big mistake!

I learned the hard way in my first strategic planning engagement, when I was an internal consultant at a company where I had worked for eight years. I came into the assignment with a long list of unwritten assumptions that I had formed about the industry and my company's position in the field. Many of my assumptions were influenced or reinforced by the company's management.

But a month into the project, when I obtained some



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data to shore up a presentation, I realized that I had made a mistake. The data told a different story than I expected. Fortunately, it was not too late to make a difference so I did more homework. I learned a lot more about the structure of our industry and where we fit in, and what I learned surprised me. In the end, the new facts helped us break through our prejudices and develop innovative solutions for the company. The point: Before making decisions, spend time gathering fresh information so decisions are not based on possibly misguided assumptions.

To get the process started and to keep it on track, a single individual should be placed in charge and given two main responsibilities:

- Ensuring that good, fresh information is gathered and disseminated to participants in the process.
- Serving as an advocate for the process to ensure that the job gets done in a disciplined way.

Written information should be obtained from articles and industry research. A complete picture of the company should be gathered from internal management and financial reports. Written sources should be supplemented by interviews with customers, employees, and external partners such as suppliers or distributors.

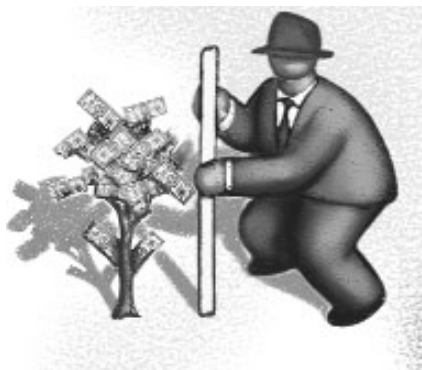
The information you gather will be the raw material for developing a plan for value creation. The analysis can be done by individual staff members or by groups. The important thing is to get high-quality information to the planning table.

Strategic Value Drivers In Your Industry

As you begin to study your industry, you will need to look at both industry trends and the strategies of competing companies in handling them. Some of the questions that need answers include:

- Why are your customers presently buying from you?
- What are the customers' sourcing alternatives, including direct competitors, internal competition within the customer company, inaction or not buying at all, and innovative alternate solutions?

- How will customers' needs change?
- What alternatives will customers have tomorrow?
- What is happening in related markets to influence buying patterns?
- What will the market look like tomorrow?
- What will other players be looking for in executing acquisitions?



The goal of the analysis is to identify high-value intersections between your strengths as a company and what the market will need in the future.

this process include:

- Where does the company fit in our industry today?
- What unique strengths do we have?
- What are our current weaknesses?
- Do we, or could we, fill a gap in the market value drivers of potential buyers?
- How should we change for tomorrow?
- What value will we be able to offer other players in our industry?
- Which companies would need or want to acquire us to get that value?

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For both hard goods companies and those with pure service-related offerings, it is important to look at both “product” and “knowledge” in defining strengths. For example, many of the large computer hardware companies are realizing that their future success is tied to customer solutions.

Having the best computers will not be enough. They also must have the software and implementation skills to create value for their customers.

The biggest example of this trend was the **International Business Machines Corp.** acquisition of **PwC Consulting**. IBM already had a large consulting business but felt it needed to expand through the acquisition of a large and well-established consulting firm that could offer added size and additional skills, as well as a large customer base that was built through PwC's roots in the accounting industry.

When you look at your own company, incorporate the knowledge and abilities your employees share. It is often helpful to actually map experience and skills as part of the value analysis.

In this exercise, create a table of skills that your company requires to meet needs of current and future customers, as well as a potential acquisition partner. Then rate your current skills levels. This graphical layout will show you quickly where you need to improve.

Another classic tool for analyzing your company is a SWOT analysis, which summarizes overall Strengths and Weaknesses as well as the Opportunities and Threats presented by your environment. These analyses help identify areas of opportunities for the company going forward.

The critical conclusion to this process is in the last two questions about the future. Doing your homework through the earlier points should help you develop a vision of future trends and value drivers in the industry.

An interesting example of changing value drivers can be seen in the web design and development industry. In the early stages of this industry, good graphic design and programming skills were the critical skills needed to establish a business. Web design companies grew at lightning speed to “build” the Internet for Corporate America.

But just as fast, many of them disappeared. Customer bases contracted because of the economic downturn and many players failed to recognize the need to create new value for their surviving customers. Packaged software had simplified the development side and experienced marketers had learned the language of the Internet. Web design and development is not as much an industry now as it is a skills base incorporated in myriad industries ranging from advertising and marketing and portal design to business process automation. Survivors in this market found ways to add new value in one of the industry segments that has adopted the web design and development skills base.

As you examine your own industry, circle back to identifying value drivers. Translate your view of the future into the language of potential acquirers. What are they going to need to compete? How can they use acquisitions to improve their positions?

The Seller's Strategic Position

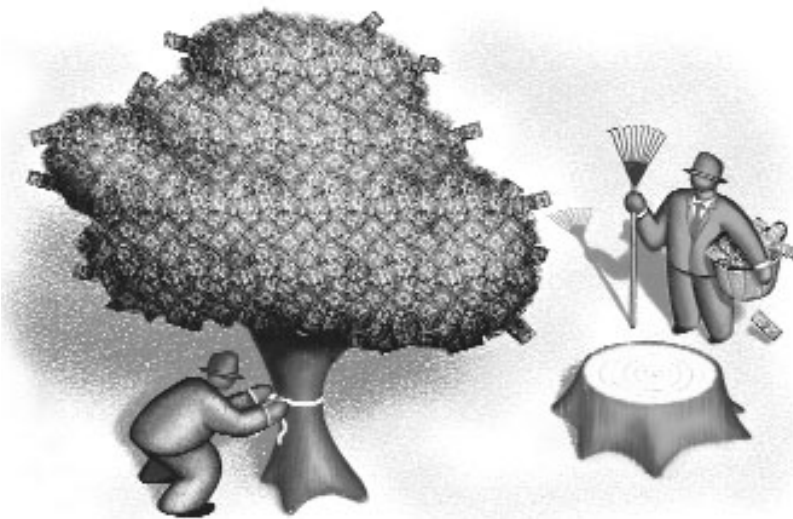
Once you understand the world outside, you are ready to turn your examination inward. Just as with the industry analysis, it is important to be methodical. Cutting corners and making statements off the top of your head will not lead to innovative thinking. Some of the questions that you need to ask yourselves, as a group, during

A Plan to Build Value

Your research will set the base for the development and execution of a strategy to build value. If you already have a planning process in place, use it. If not, design a series of discussions to develop your strategy, identify the right goals, and determine the specific steps to achieve them. The general sequence of planning meetings should be as follows:

- Reviewing the information and analysis in your briefing package. Try to develop a consensus about future opportunities and risks.
- Looking at the big picture, or what we call “dreaming.” This involves looking forward without limitations and asking, “If anything were possible, where would we like to be as a company in three to five years?”
- Getting practical and coming up with reasonable goals and specific steps to reach them. These should include target dates and naming a responsible person to run the process.
- Finally, writing it all down, with specific actions and a timetable for periodic follow-ups.

Don't leave the planning stage until you have a consensus on the timing and structure of a follow-up process. Change is to be expected. Make sure there is a commitment to update the critical information and to monitor progress against the action plans.



While characteristics of your company are necessary to closing a deal, they must be augmented by significant value drivers to motivate the buyer to pay a premium price.

Get to Work!

Armed with a set of specific action steps, get cracking. Your preparation will ensure that you know a good opportunity when it arises. It will also give you the knowledge base to be proactive and create opportunities on your own. Finally, the data you collect will make a deal go faster. The information base will enable you to articulate the

sources of value in a transaction and provide a starting point for formal presentations to your board or potential acquirers.

Stay flexible. Review and revisit your strategy. Update your read of the market. If the company, technology, competitors, or market trends don't develop as expected, don't be afraid to adjust your plans. Updates are also important in developing an organizational knowledge of potential partners or acquirers in your industry.

It is often said that luck happens to the prepared. When you develop and execute a value-building strategy, you are indeed prepared to “to let luck happen” and maximize the value you receive for your company. ■

Mary Adams is the founder of Trek Consulting LLC, Winchester, Mass., which helps entrepreneurs develop strategies for facing challenges of growth, change, and succession.

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fresh information. smarter decisions. great results.