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The Ultimate Challenge

Maximizing Private Company Value

By Mary Adams and Michael Oleksak

Shareholder value is an oft-cited metric that casts too long a shadow on management of public companies. Most private company owners, in contrast, rarely focus on shareholder value as a management metric despite the direct link that exists between their personal net worth and the value of their companies. In fact, the owners of most private companies don't worry about their valuation until they are ready to sell due to sickness, weariness or a simple desire to play more golf. At that point, it is too late to make any significant changes that will affect the value.

Far-sighted owners of private companies don't wait to let the market set the value of their company, they manage the process. Trek Consulting LLC has worked with many such owners, many of them "baby boomers" who realize that thinking about the value of their companies is not only a good management practice but also an exercise that can provide direct benefits to their families. For them, value maximization is their *ultimate challenge.*

Trek developed an approach to value maximization for one of our first clients, a man named Ernie. He had built a service company over the course of 15 years when he was approached to sell. The sale to a third party acquirer fell through for a number of reasons but it opened Ernie's eyes to the possibility of there being lasting corporate value in the company he had built. He wanted to build the company and close a successful, valuable sale. Through Trek's work with the company, they actually doubled their revenues within 18 months and Ernie successfully sold the company a few years later.

What worked for Ernie and continues to work for many other companies? The starting point is to look at a company from the perspective of a buyer. What will influence the acquirer's decision to buy and at what price? Trek breaks it down into four sets of factors: strategic, internal, management, and external. After you understand the influences on the company's prospects and valuation, it is usually pretty clear what can be done to improve the value.

Strategic: *Why would someone buy this business?*

Even for financial buyers, strategic value drivers are critical in their decision about whether or not to buy a company. No one wants to buy a company that does not have favorable prospects for the future and opportunities for the buyer. It may be a customer list, product offering, service model, distribution channel or geographical market.

For example, the commercial printing industry is facing an extraordinarily challenging time due to seismic shifts in the use of electronic vs. printed documents, new digital printing technologies, and changing customer needs. Despite an outlook for continued growth of 2% to 4% per year for printed pages, many companies have gone out of business. Many of the commercial printers Trek knows are looking to create a competitive advantage that will help them survive this tumultuous market. Thinking about how their company might be positioned as an attractive acquisition candidate is a great way to hone in an appropriate strategy. Short-run, fast turnaround, print-on-demand specializing on schools and hospitals is an example of a market niche. The search for a competitive advantage has also led a number of printers to open conversations with complementary companies, which could eventually end up as merger talks.

Internal: *How does the company look from the outside?*

Many private businesses are not accustomed to outside scrutiny. With the exception of their accountant and sometimes their banker, company owners do not have to explain themselves. While there is little motivation to worry about outside scrutiny when an entrepreneur is building a business, if the company wants to attract a buyer some day, there is plenty of reason to consider how it looks from the outside.

From facility and equipment maintenance to financial and management reporting, there is almost always room for improvement. Trek worked with a company that had strong, decade-plus relationships with its customers. But when we asked for historical customer data, we got five spreadsheets for five years that all used a different format. The owners understood that the reports were an important value enhancement and standardized their spreadsheet presentations.

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Another Trek client in the technology research and analysis business had been unsuccessful in raising sub debt financing. Potential lenders were impressed with its financial results, but they could not understand the business model; since the company worked with cutting edge technologies, how could the lenders ensure that they didn't get caught when a technology lost its market zip? The owner, who was a very smart man and the author of a half dozen books said to us that his company was like his baby and, to him, "my baby is beautiful." But he couldn't explain it in a way that made lenders comfortable. After spending time with them, we came up with a great explanation of their business model which showed that the company had a very logical set of service offerings that followed the life cycle of new technologies and that the company had repeated this model over a dozen times. Not only did they get the financing commitments, they also used this explanation to sell the company to EDS a couple years later.

Management: *Is management a value enhancement?*

Management is a complicated issue from a value perspective. Strong management is a value enhancer. But if the managers are also the owners, a buyer will be concerned about whether the company can survive and thrive without them.

We have a client that is the CEO of the company he founded 25 years ago. When we first met him, he still represented his company at almost all industry functions. He was the point person with key clients, and he was still very important to the sales process. The CEO wants to sell his company in a few years, but he knows that too much of the value is still directly tied to his roles, relationships and knowledge. He has been working to involve more of his people in what he does and delegating where he can. Such delegation of authority will help him create more stand-alone value in the company. Having reliable backup will also save him from the problem faced by another CEO we know: his work with a failed sale of his company last year almost killed the company, because no one was watching the day-to-day operations while he was engaged in merger negotiations.

External: *What market trends could affect the company's valuation?*

All companies are affected by the ups and downs of the economy and the M&A market. It may seem obvious, but if you plan for value, then you will also be watching the market and be ready when the market conditions are right. One of our clients sold a web design and development company near the peak of the market in late 2000. They were ready at the right place and the right time. Today, that team is back and focusing on a new business model appropriate to the very much changed market for their services. Our bet is that they will catch the next wave as well.

Another client was riding very high in a regulatory consulting company related to the medical device industry. They missed their chance and were surprised by the downturn in their market that was caused by reduced enforcement by the Bush administration. They ended up selling for considerably less when one of the owners got cancer and they decided to sell during this downturn.

Other external factors that can influence valuations at any moment in time include technology shifts, exchange rates, industry capacity, demographic trends and economic cycles. While a company cannot influence external factors, it can and should watch them carefully and do everything they can to stay on the winning side.

Thinking about value is new to many entrepreneurs that have built their businesses over decades. Increasing value requires new discipline, new information and a fresh approach. But it is also a high return activity, giving the entrepreneur a chance to not only build but also cash in on the value of their many years of work. For them, it is worth taking the time to think about the strategic, internal, management and external factors that will influence the value of their company.

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