Mergers & Acquisitions: Some Strategies for Improving the Value of Your Business

management solution

by Brooke Hollis

What Drives Value?

To improve your company's value, it is important to understand buyers and influence their thinking. As noted in the last issue, acquisition valuation in staffing and other service businesses is largely driven by the buyer's comfort that an acquisition will generate sufficient cash to yield a reasonable rate of return. That said, there are many other items to consider – some that owners can control and some they cannot.

This short article can only touch on a few areas, but hopefully it will give owners some initial value improvement strategies to consider.

CONTROLLING THE BUYER'S PERCEPTION OF RISK

In the staffing business, perceived comfort or discomfort regarding risks begins with the people, but includes a variety of factors.

People Issues

Most buyers are concerned that business performance will suffer post-transaction. Even if owners stay, buyers worry about reduced motivation, etc. Further, the other human capital assets of the business walk out the door at the end of the day.

To help assure a shorter transition and better price, owners should consider establishing a Chief Operating Officer (COO) or other management positions to take over day-to-day responsibilities and decrease the dependency on the owner for the successful operation of the company. Other items to consider include:

- A well-thought-through transition plan, highlighting what would be positive for the staff
- A clearly understandable reason for selling
- Some period of continued involvement, retained equity, a partial earn-out, etc., to reduce perceived risk
- Employees, not 1099s
- Reasonably enforceable non-competes with key individuals
- Compensation systems that properly align performance and pay.

Organizational, Legal and Recordkeeping Issues

Proper documentation of a variety of items improves the comfort level of buyers. For example:

- CPA-reviewed and, preferably, audited financial statements
- Detailed records on unusual or one-time expenses
- Minimal, easily tracked personal perks
- Well-documented information for any potential legal, past financial or other problem areas with expected impact and potential solutions
- Excellent insurance policies and records
- A corporate form that facilitates an asset sale (e.g. Subchapter S Corporation or Limited Liability Corporation (LLC)).

Customer and Business Mix Issues

Some preferred characteristics:

- Limited customer concentration
- Long history and good relationships with clients
- Customers with potential for growth and cross-selling
- Strong vendor status (Tier 1/Preferred/National etc)
- Few clients with vendor management and off-shore outsourcing
- Desirable niches and specialties
- Limited customers in commoditized, cyclical or declining industries
- If mixed staffing/perm, limited perm is preferable except for specialty-retained search businesses.

FINANCIAL RESULTS

The key driver of value is the cash generated by the business. Some things to look at in your business include:

- Gross Margin and Adjusted EBITDA levels should compare favorably with the public companies
- Growing overall revenues – but not at the expense of the above
- Number of offices and relative costs and contributions to profits
- Pricing and incentives for sales force; recruiters should assure higher gross margin
- Accounts Receivable (A/R) collections history and current Days Sales Outstanding (DSO)
- Realistic Selling, General and Administrative (SG&A) expenses.

FUTURE OPPORTUNITIES

While a "hot" market is helpful, not every seller will be the perfect geographic or cultural fit. This can be addressed if your team approaches enough buyers to improve the odds. At the same time, building a strong picture of the future opportunities for growth in business and profits for your company can help enhance value. Consider the following:

- Your growth rate in revenue, gross margin and bottom line, compared to peers
- Opportunities to improve the above, plus potential services, features, etc.
- Whether your segments of the industry are growing, and if you could credibly add lines of business that are growing
- What steps have been taken to protect your market position from competitors
- Number and location of offices and potential impact on growth
- Your market penetration and reputation, and how to prove this
- Specific ways in which additional capital, management, infrastructure and relationships of a larger partner or acquirer would be used to further growth.

Even if the business has seen some difficulty, or is coming off a downward cycle, if the owner has taken the appropriate turn-around steps, and the numbers support this, the negative impact on value can be lessened. Retaining equity, or having an earn-out or upside type formula can give the buyer confidence that this trend is going to continue.

CONCLUSION

Owners seeking to increase the value of their firms need to plan, monitor, keep good records, and take actions to correct areas noted above on a regular basis. To the extent owners do not have the time to do this well in advance, a Mergers and Acquisitions (M&A) advisory team can help identify and prioritize those items that can be changed prior to, or parallel with, the marketing process. By taking these steps, in conjunction with the positioning and competition created by your advisors, owners can significantly improve the chances of an improved value for their company.

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