M&A For Staffing Services:
Building Business Value Prior to Selling

By Steve Sorrentino, President, MergeQuest

It's a fact of our economic environment that every business will ultimately be sold or cease to exist. According to Arie deGeus, who wrote *The Living Company* [1] a study conducted in conjunction with the Harvard Business School and Royal Dutch Shell, the following were notable findings in his study:

- The average life expectancy of a Fortune 500 company was 40-50 years;
- One-third of the Fortune 500 companies in 1970 had vanished by 1983;
- The average life expectancy of all firms, regardless of size, is 12.5 years.

With the foregoing statistics in mind, business owners must decide whether to let their business run its course, or whether to prepare for the inevitable sale of the business. Whether it's motivated by professional burn-out, or perhaps a planned exit strategy that leads to retirement, thinking long and hard about the future sale of your business, along with how to maximize the value received for your business, is time well spent.

Understanding "Value"

Perhaps the most appropriate place to start in understanding the concept of value is: first understanding what a potential buyer would value. Potential buyers may view your company as a strategic acquisition that will help them bolster a particular service, or perhaps help them obtain new clients, or broaden market coverage to a new geography or perhaps gain human capital talent. Though buyers may view value somewhat differently, there is at least one viewpoint they all share: every buyer is looking for *predictability and certainty*. Business owners are well advised to bear in mind that things that a prospective buyer may see during an evaluation of a company that create uncertainty and hinder predictability - *will reduce value*. In preparing your business for any ownership transition, *your central objective is to reduce perceived uncertainty and improve predictability for prospective buyers.*

Knowing this, let's consider some of the areas that can create uncertainty and cloud predictability for a prospective buyer:

- **Financial Performance.** Does your company have a consistent and profitable track record of both revenue and profitability growth? Your financial performance over the last three to five years is where most buyers start their analysis. The buyer is looking at past results, predicting future results based on the past, and paying you today for that future stream of cash. The key is that *consistency* increases value.

- **Customer Connections.** Do you have longstanding, stable relationships with a fairly diverse customer base – without reliance on one or a few key customers? Do you offer services or have proprietary operating methodologies that make it difficult for your competitors to woo your customers? The more you can demonstrate strength, stability and consistency with your customers, the more a buyer will place a value on your business.

- **Industry and Market Position.** Bear in mind that the long-term forecast for your industry influences value. Some industries are in disfavor, while others are enjoying record growth. In today's Staffing Industry M&A environment, all staffing sectors appear to be back in favor and on a growth curve. It's also beneficial to understand that if your business has a very small market share in a market dominated by giants, make certain that you have other competitive strengths going for you such as innovative services, proprietary business process methodologies, strong delivery and unparalleled customer service quality. I mean, nothing beats the a large competitor like strong customer service quality. Dancing with elephants can be tricky, especially when the elephant is leading. To a buyer, this spells *risk*.

- **Human Capital.** Have you attracted and developed a talented team of managers and employees? Have your employees been successful at implementing change? Astute buyers know that employees are critical to realizing future value, especially in a service business. In almost all cases now, the human capital is at least as important as other value components to a potential buyer. A strong management team, complemented by talented and loyal team members, adds tremendous value.

- **Clear long and short-term strategy.** Have you developed a strategy for how your business will be successful in the future? Do you have a written business plan? According to business sale statistics, privately owned companies that have a written business plan that cover financial, marketing, operational and succession planning realize greater value in the long run. In short, *document your plans*. Ask yourself, "can I clearly explain why my business is successful now, and how it will continue to be successful in the future? A prospective buyer will want to hear a clear answer to this question.

How to Start Building Value - *Now*

I have put together a list of key steps a business owner can take now to begin to enhance shareholder value – before going to the negotiating table:

- **Demonstrated Performance and Financial Reporting.** Clearly one of the key things any buyer will want to see is historical financial performance that shows growth in both revenues and profits. In the Staffing Industry, many buyers will want to see strong, consistent gross profit margins as well – this tells them how well you manage your service pricing, along with how well you manage the cost of your temp employees and other payroll related costs. And don't discount a buyer's review of your SG&A overhead costs, as with any industry experiencing margin pressure, how well you manage your other overhead determines the quality of your bottom line (net) earnings.

  Also, one final note on financial reporting: audits by a reputable accounting firm are a worthwhile investment. Reliable financial information during the years leading up to a sale will verify your company's track record and eliminate uncertainty for the buyer.

- **Protect Your Customer Connection.** Without customers there is no business. This old adage is something important to a buyer. Loyal customers truly enhance the value of a business to most buyers. Make certain that you understand how you are performing for customers. Conduct a survey of your customers and see what you can do to improve customer connection. Make certain customers understand the value you offer. If not, start some marketing efforts to explain the value. Finally, be sure to conduct a customer revenue analysis to assess the contribution each makes relative to your total revenues. Those that command over say 20% of your total revenues can spell *risk* to a potential buyer. Buyers want to see good customer diversity, which means that you are not reliant on one or a few top customers.

- **Plan for Growth.** A key driver of any business valuation is the expected growth rate for revenue, profitability, and ultimately, cash flow. Avoiding investing in the business in anticipation of a sale is not a good strategy. An astute buyer takes into consideration the dollars necessary to fix, upgrade or improve any aspect of the business that has been neglected. The lack of investment may hurt your business revenues, margins, service quality, while placing the business at a competitive disadvantage with customers.

- **Develop a Team That Can Grow Your Business.** Investing in developing strong managers and capable employees is critical to building shareholder value. Evaluate the strengths and weaknesses of each functional area and each manager. If you have significant weaknesses, correct them. Training may be needed. If so, do it. You may have to face the difficult issue of replacing a manager (or other team member). If you don't, the new owner will. If the new owner does it, it will cost him money and this will, in effect, be factored into the value calculation. Review your employee team, stay close and "re-recruit" your best players, let them know they are valued. The key is to strengthen the team, and eliminate any uncertainty that a prospective buyer may have about the long-term viability, loyalty and commitment of your key players followed by the balance of team members.

  Returning for a moment to the author of *The Living Company*, Mr. Arie deGeus, he insightfully notes the following: "companies lose value and die because their managers focus on the economic activity of producing goods or services and forget that their organization's true nature is that of a community of humans." [1]

Staying Focused With a Plan

As noted in the beginning of my article, organization's will, eventually, face the inevitable: they will cease to exist or they will be sold. With this view in mind, it seems to make sense to prepare for the future sale of your business, *today*. And while it may be common sense to run a business with a focus on the above components of what contributes to good business value, it's hard in our everyday lives to stay focused on these things. For many business owners, staying focused means running the business. In many cases, the owner is the key manager who is developing and maintaining customers, providing the firm's services and overseeing the administrative functions of the business. So it's not an easy task to stay focused on key business value-building activities.

What's needed, in my view, is a plan. My advice is to take the time to sit and concentrate on writing a simple plan that will help you stay focused on the necessary things that will help you prepare for the inevitable day when you say to yourself, "you know, I think it's time to think about selling my business." And when that day comes, you can say with confidence that you're prepared to enjoy the true fruits of your labor.

[1] Arie deGeus, *The Living Company*, (Longview Publishing, 1997), pp 1-2.

Steve Sorrentino is the founder and President of MergeQuest, a trusted and experienced M&A Advisory & Brokerage Services firm serving the Staffing Services industries. Steve can be reached at (781) 334-7184, or by email at sjsorrentino@mergequest.com, (website: www.mergequest.com)