PRE-SALE POSITIONING

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The continuing dichotomy in the M&A world is one of haves and have-nots, but that split isn't defined by revenue or assets. Rather, it's a division between the highly courted and the wallflowers, the well-respected and the unknown. The result, for many or most business owners, is lost $millions when it's time to cash in on their sweat equity.

Megadeals, fat multiples and overnight success stories dominate the headlines, boardroom conversations and banter on the back nine. Those tales are the exceptions, however, the man-bites-dog stories that offer the prototypical definition of news.

The reality recognized by pretty much every M&A professional is that most business owners—yes, most—will fail to obtain a full return on their investment when they seek to sell their companies. Worse, that wound will usually be self-inflicted.

If your company is already in the sales pipeline, it's too late for you to be benefiting from the insights we offer here. Save your time and read something else. If you're considering an investment round or an exit/sale at some time in the next five years, pay attention.

The Company Is a Product

If the product development team was seeking funds for a product launch, the management team would want to know what the product is, who would buy it, why they would want it and what they would pay. The management team would want to know how the developers planned to sell the product, what marketing channels they would use and how they would measure returns. Until the product development people could provide reasonable answers to those questions, no sensible management team would agree to bring the product to market.

In a liquidity event, the company itself is the product, a product with specific features that offer more or less value to specific, identifiable buyers. As we describe in our *Think Like a Buyer* white paper, ownership teams can often identify specific groups of financial or strategic investors who are likely to pay the highest premiums for their organizations.

Perversely, owners embarking on the most momentous transaction of their lifetimes will frequently begin this journey with a less detailed road map than they would require for a single SKU. Advisors will be brought on board to guide the process, but these advisors will be brought in only after the ownership team has missed multiple opportunities that cannot be recaptured.

Almost invariably, this lack of forethought will cost the owners dearly, either by making a transaction unaffordable for them or by precluding any transaction at all. Ownership teams that apply a few commonsense concepts in advance of any sales process can generate stronger returns and greater certainty of a deal that closes.

The Payoff from Positioning

Here, we look at pre-sale positioning techniques that can ensure that the highest-premium buyers are increasingly aware of and interested in the business they might one day acquire. Pre-sale positioning efforts involve essentially three steps:

1. Identify the value most likely to attract the interest of acquirers.

2. Focus on increasing that value, while reducing emphasis on less attractive activities.
3. Raise the company's profile among likely acquirers or acquirer groups.

This relatively simple process can yield dramatic returns, both by improving the operating performance of the company and by increasing the number and quality of potential acquirers/investors. The net result should be an increase in the most powerful variable in business valuation: the earnings multiple.

The multiple, of course, is the total number of dollars an acquirer/investor would pay for each dollar of earnings. If buyers are paying a range of 3-6 times EBITDA for privately-held companies, a seller can double the value of his/her company by convincing a buyer to pay 6x instead of 3x. Assuming an EBITDA of $5 million, that increase would yield an additional $15 million for the sellers, without requiring a dime of added revenue, assets or profitability.

What would make a buyer pay a richer premium for a company? The buyer might be convinced that the company's risk profile is low, which would shift the risk/reward tradeoff. The buyer might believe that the company needs less investment after the close, which would translate into a lower aggregate capital investment. The buyer might recognize that other acquirers are interested in the company, which could drive an energetic bidding process.

This type of pricing variation is common in both business and consumer markets. Banks offer different interest rates to different customers, bonds with the same coupon will trade at different prices and brand name grooming aids will sell at a premium to store brands that contain the same active ingredients. Reputation and awareness can be as important as financial performance in driving acquirer interest and valuations.

The IPO world is filled with examples of the reputational benefits that can accrue to well-known and well-regarded companies. When a company comes to market with a highly over-subscribed offering, the strong demand for shares by the public is a reflection of the widespread positive valuation accorded by a large number of buyers. The process is essentially the same in the private M&A market, where a larger pool of potential buyers will tend to increase the ultimate market value of the company being sold.

Supply and demand, it turns out, is a powerful tool for building exit value.

Working Backwards From the Close

Pre-sale positioning programs work backward from the time of a deal to identify the steps most likely to increase the ultimate value of that transaction. Knowing the most likely path to success, the ownership team can implement a series of initiatives that move the company closer to its goal in a measured, cost-effective manner.

We cover a number of these analysis and assessment techniques in our *Think Like a Buyer* white paper. In that piece, we show how owners can increase the value of their companies dramatically—while also strengthening ongoing performance—by identifying the factors that would make their companies most attractive to buyers. We also considered some of the ways ownership groups could identify the type of buyer, or specific buyer, who would be most likely to offer the greatest premium for their business.

Here, we add a number of internal considerations that focus on what the ownership team hopes to obtain from a transaction. It's important to identify goals and timelines for a potential liquidity event, addressing such key questions as:

- What is the reason for this liquidity event?
- What alternative forms of liquidity event would be considered?
- What variables might make one option preferable to another?
- What is the intended timeline for a transaction?
- Would the transaction include the entire company or just some portion of it?
- If the transaction would be fractional, what would be retained and why?
- Will the ownership team continue working with the company after a transaction and, if so, for how much time?
- Will the management team continue working with the company after a transaction?
- What personal/family issues add nuance or challenges to the plan?
- What issues or stumbling blocks could derail the process?
- What resources are available already to help move the process forward?
- What non-financial issues loom large for us and will these issues (loyalty, legacy, engagement, family) require that we give up some of our financial returns?

The answers to these and other questions help create the framework for a positioning program that fulfils the goals of the ownership group. Unless the ownership group has a vision for the type of transaction that will be pursued, there is no way to know if the positioning effort can meet those goals. As an example, an ownership team that will seek to sell only a portion of its business might focus its positioning effort on that segment, while reducing its promotion of units that won't be sold. Similarly, a team that wants to stay with the firm after a liquidity event might wish to emphasize the team's specific impact on corporate success.

Market Assessment

Next, the team should consider market conditions and competitive issues that can influence the value of their company. Where might the company have an edge with buyers and what types of markets might highlight that edge the most? What factors—cash flow, intellectual property, market share, etc.—are most likely to influence the specific valuation assigned to the company?

To identify the issues that must be addressed, the ownership team can conduct a market analysis that includes key competitors, recent sales of analog businesses, private equity investment preferences and other data. This type of analysis can identify what worked and what failed in other transactions. Some questions to consider include:

- What types of transactions are most common for similarly situated companies, both inside and out of our industry?
- What other companies are analogs for ours, regardless of industry, and how do different analogs get valued differently?
- What are the benefits or shortcomings of different transaction types?
- How do transaction/value patterns mesh or conflict with the ownership group's goals?
- What has differentiated successful transactions from the also-rans?
- What megatrends might accelerate or delay a liquidity event?
- What competitors are most likely to be seeking a liquidity event?
- What benchmarks are used by potential buyers to determine value in our industry and how does our performance measure up?

Knowing what has worked for other firms can help the management team refine its own approach to value maximization. Many resources, including M&A advisors, can provide insights into factors that might be most relevant for a specific company.

Corporate Analysis

In order to maximize value in a transaction, the ownership team should identify the key factors that drive the company's unique value and build on those strengths. Among the questions that should be considered:

- Where is the company making most of its money?
- Where is the greatest growth potential for sales and earnings?
- What intellectual property or other assets create a moat that protects the company?
- What competitors offer the greatest or least threat to growth?
- What departments or functions need to be adjusted in order to succeed?
- What do customers believe to be the value of working with the company?
- What drives customer loyalty and retention?
- Where is management spending money and time that could be spent better elsewhere?
- What waste of time or dollars are we putting up with, even though we know we shouldn't, that a new owner would not tolerate?

The answers to these questions will drive management's focus to the corporate strengths most likely to influence valuations in a transaction. It's important to note that these corporate strengths will usually be strengths that are important to customers, as well.

For example, a company with superior account retention might earn a premium price as an acquisition target, but the factors behind the account retention should also draw the type of customers the company—and an acquirer—seeks. If the company's product quality is no different from that of competitors, promotion of product quality is not likely to draw positive interest from either commercial customers or potential investors.

One critically valuable resource for identifying corporate value is the customer audit. Customers make the final decision on sales, of course, and the reasons behind their purchases, retention, pricing tolerance and other choices can provide important indicators for value that an investor/buyer would recognize. We employ the Quadrant Five methodology to identify the true value drivers for companies, although readers might identify other processes that also seek insights in this area.

Customer audit and assessment are important as a means to identify and address *perception of risk.* Acquirers will project the future revenue and profitability of a company and condense all the numbers into a stream of discounted cash flows. However, the acquirer might discount the discount if it appears that stream has above-average risks of not coming to pass. When a seller identifies and capitalizes on the underlying drivers of customer loyalty, price inelasticity and collaboration, the case can be made that risk has been reduced and enterprise value has increased.

Spread the Word

As the process of discovery unfolds, the ownership team has identified its checklist for value maximization, addressing answers to these core questions:

- What type of transaction would we want/accept?
- What would make us most valuable and to whom?
- How are other companies valued and how can we compare more favorably to them?
- What is the core value that creates the foundation for our customer relationships?

With these questions answered, the ownership team is in a position to focus on the values, messages and audiences that are most likely to drive profitable growth today and a strong valuation down the road. From here, it's a simple step to raise the company's profile among potential buyers.

This doesn't require any direct conversations with acquisition partners. In fact, it is best if the company's positioning is implemented independent of any overt sales process. The corporation's goal is to encourage interest by ensuring that its most important messages reach its most coveted audience well in advance of any potential transactions.

Begin by developing the messages that highlight the strengths acquirers will reward in a transaction. What messages would increase awareness and interest in the positive differentiators? Which messages would undermine that interest? Consider how to present these messages in both ongoing commercial communications and in special reports or updates about the business or industry.

Don't rely solely on external communications or executive-level interaction. Deliver the key value messages consistently through employee communication, vendor outreach, customer meetings, advertising and marketing programs and other means.

Repeat the messages until members of the management team are sick of them. Most listeners need to hear something two, three or 500 times before they become aware of it. The management team will tire of the repetition long before the message is absorbed by the targeted audience. Never assume that a message has been received simply because it has been delivered. Repetition is critical. Repetition is critical. Repetition is critical.

Develop a timetable to ensure enough repetition that the messages sink in over time. Over time, connect the company firmly to the values that would drive transaction value. While doing so, reduce focus on any messages that would drive little or no interest and value.

Focus these messages within the groups that could provide the highest-value acquirers. If the most likely acquirer would be within the company's home industry, more active participation in trade groups, trade media/publicity programs or speaking engagements could be highly effective. If the most likely acquirer is a financial buyer, find ways to communicate to these groups through case studies, topic-specific conferences or professional associations.

As noted, it's also important to identify topics to be avoided in marketing communication. These might include areas in which the company does not have a competitive edge or another competitor is viewed as the leader. They might include points of pride for the management team that do not translate into market value to either A-List customers or potential acquirers.

Nothing dies on the internet, so these communications will create the public, permanent record that investors will review when the time comes for a liquidity event. The more they see a long-term investment in the areas that matter to them, the more likely they are to be aggressive in their pursuit of the "product" being offered.

Finally, it's important to use time to one's advantage in any pre-sale positioning program. Reputations are built over a period of years, possibly decades, so an owner should begin the positioning program well in advance of any transaction.

The same communication rules apply here as in sales. A salesman might call a customer four or five times before the customer remembers his name or pitch. Similarly, it is likely to take multiple touch points over an extended period before the core messages sink in with the intended audience. In fact, it might be impossible to change reputation or build profile quickly enough to maximize interest even when massive amounts of dollars and time are invested.

Time equals money here. The ownership team can gain much stronger returns by investing a relatively small amount of time and dollars to build awareness and reputation over the long term than by spending heavily to change perceptions on a deadline. Even more important, pre-sale positioning can drive improvements in operating performance in the years leading up to a transaction, delivering both stronger cash flows today and ultimate enterprise value down the road.

Win/Win. And win.

Michael Rosenbaum is founder and president of Quadrant Five, a unique methodology for customer-driven performance improvement. Through more than a quarter century as an advisor to C-Suite executives, and as president of a $35-million consulting firm, Rosenbaum identified the patterns that lead to success and failure at hundreds of companies. The result of his experience is Quadrant Five, a methodology that is both conceptually simple and sophisticated in its implementation. Beginning as a newspaper reporter, Rosenbaum developed a specialization in business journalism and earned an MBA on his way to a 25-year consulting career. Rosenbaum's most recent book, *Six Tires, No Plan,* examines the career path of a self-made billionaire whose approach to business is a strong match to the Quadrant Five process. In addition, Rosenbaum has authored four other books and is an active member of YPO/WPO, AM&AA, MMA and MBBI.