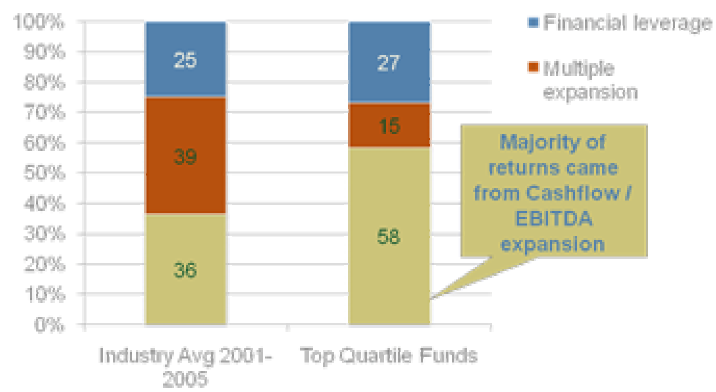
Positioning Your Client for Sale in 2009

by Steve Sarracino, Serent Capital

In the lower middle market, entrepreneurial and family-owned companies need better advice than ever given the current economic environment. Whether they are seeking a capital provider in 2009 or in ten years, taking the appropriate steps now can both improve the value of the company independently and make it more attractive for a private equity investor. Most of these steps can be informed by adopting the mindset of a private equity investor.

Top private equity firms have tended to pull the operations lever harder than lower performing funds. In the chart below, Private Equity Analyst conducted a survey of US Institutional Investors, and found that top private equity firms drove the majority of their returns from operating improvements.

Given leverage is no longer freely available, and you can no longer necessarily count on a robust exit market - - private equity firms will focus even more on operational improvements. What you can do is to help your clients look at their businesses through the same objective lens that private equity uses.



Deficiencies are now opportunities. Framing the problem correctly is critical. As you are preparing your client for sale, it is important to point out the flaws, or low hanging fruit so they can be addressed and fixed, or at least understood so they can be framed properly. Perhaps your client is under-investing in its sales force, or doesn't have the right incentives in place for its sales people. There might not be time to implement a new sales strategy, but at least you can discuss with a potential buyer what the business *could* do if it had the right sales strategy. If you can identify the deficiencies early on, they can be turned into potential upside, which the private equity firm can incorporate into their investment case.

Besides sales, other common examples for small business are marketing, management, procurement, accounting, and reporting. Does your client know its gross margins for all its service/product lines and how much of the SG&A would you apply to each? How profitable are its top customers?

Borrow the best practices PE firms use to find and create value. Why re-create the wheel when you can help your client create value by using the best value drivers for private equity? There are four primary ways private equity investors create value after buying a business: 1) operating improvements, 2) talent management 3) governance and 4) long term strategy.

Operating Improvements. Revenue is often the biggest lever any owner can pull because it has unlimited upside versus cost cutting for which you can only go so far. Hence, the first place to focus is revenue, even though it is often overlooked. Revenue can be broken down to price x volume. Is your client pricing its products/services optimally? Has your client tested it elasticity of pricing? Are there ways to implement two tier pricing to price differently to different segments? On volume, for many small businesses, sales and marketing is under-optimized. How do they generate leads and how are the sales people (either internal or channel partners) spending their time? Have they segmented the market appropriately? Have they used low cost marketing strategies or tried working with third party sales channels?

Talent Management. Does your client have the proper management team in place to support the next two or three years of growth? If their current head of finance is really a controller, do they need a bona fide CFO? Sometimes making an investment to fill the gap three years out, rather than to fill current needs can pay dividends for your clients.

Governance. Encourage your client to form a board of directors or at least an advisory board. It can be a tremendous help to an entrepreneur to have a group of peers they can go to for advice. Make sure your client pays its board – even if the fee is nominal, we have found that if consideration is paid, board members tend to be more responsive to the entrepreneurs needs.

Long term Strategy. Finally, work with them on their long term strategy. After closing a transaction, we typically start by building on the objective diligence that was conducted prior to close. We quantify opportunities for upside capture which is critical to do objectively with full visibility of the board and key advisors. Develop a 100-day plan to realize the opportunities from the objective assessment and help them set key performance indicators to manage the business on a go forward basis. The 100 day plan becomes the springboard for three and five year objectives.

There is no magic involved in driving value for a business. As a key adviser (a banker, broker, lawyer, accountant, consultant, realtor), you can help you client implement best practices to position them to maximize value.

About Serent Capital. Serent Capital (www.serentcapital.com) is a private equity firm focused on small growth buyouts of services businesses. We have $250MM of committed capital under management. Serent's thesis is rooted in a fundamental belief and enthusiasm for helping companies drive intrinsic improvements to their operating value (EBITDA), primarily through revenue growth. Our team of professionals strives to be involved, value-added investors, capable of providing significant operational and strategic support to its portfolio company CEOs on the most critical issues that they face as their companies scale.

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