



Business Development Ideas to Help You:

- ◀ Make \$1,000,000 to \$5,000,000 Every Year
- ◀ Dominate a Market/Eliminate Competition
- ◀ Triple the Value of Your Business



Two Main Risk Factors Deflate Your Business Value...and Can Even Make It Unsellable At Any Price

Innovation and Marketing increase business valuation by reducing risk and increasing the buyer's expectancy of future profits. Business *builders* always must remember what business *buyers* want to buy:

Business buyers want to purchase a system for making money that they perceive has a high probability of making an ever increasing amount of money for them in the future.

There are two main **value depressors** that affect business buyer's perception of risk and thus their confidence in the probability of your business making money for them in the future. These two value depressors are:

Lack of Transferability and Excessive Concentration

Risk Factor One: Lack of Transferability

Buyers have to make the assessment that your business will work for them. They need to understand how the company will continue operating under their control after the current ownership departs. The key to this is systematization, especially in four areas:

New Product Development. There needs to be an organized system to develop new products and services that is not dependent on the business owner's individual creativity. Occasionally we see technology firms that are headed by a brilliant engineer. Unfortunately, since the owner is the technical genius, a business sale is hobbled and the business value decreased because of the lack of transferability of new product development. Innovation must be (and absolutely can be) systematized to avoid this trap.

Product or Service Manufacturing and Delivery. A business can not be dependent on the physical efforts of the owners to make and deliver its products and services.

There must be an expandable system in place. We see this challenge when a business has been built by a “craftsman,” who has his hands in the middle of the manufacturing process. Only he really knows how to put the products together. In a professional service business, this can be a problem as well, when the service provider is the “expert,” and is the only one capable of delivering the service at a high level of proficiency. The secret to beating this problem is effective marketing, as really all it takes is additional profits to fund the management and productive teams required to deliver an expanded level of products and services.

Marketing. In many businesses, there is little in the way of a marketing system. Often what passes for marketing is based on the relationships of the owners. Country club membership, service club participation and relationship marketing are fine as far as they go, but their weakness is their lack of transferability to new ownership. Business value is optimized when the marketing programs are designed as a “profit faucet” that can be turned on or off at will by current and new ownership.

Sales. Closing new sales can not be reliant on you or on a sales superstar. If it is, the lack of transferability will severely handicap the sale of your company and severely reduce its market price. A selling system has to be in place that gives a new owner confidence that as new selling opportunities arise after the closing that the company can convert them to closed business. Sales tools must be developed that are so strong that an average salesperson, a service technician, a receptionist or even a website can convert qualified prospects into customers.

Risk Factor Two: Excessive Concentration

Closely linked to the issue of Lack of Transferability is the issue of Excessive Concentration. Business buyers are extremely sensitive to this risk factor. When they feel a business is over-concentrated, they either not buy, reduce the price they are willing to pay, or make payment of the price contingent on the future performance of the business in the area of concentration. There are four areas of concentration risk:

You. The more the operating success of the business is tied to your skill, effort and connections, the less sellable and the less valuable it is.

Key Employees. The more the operating success of the business is tied to the skill, effort and connections of a key employee, the less sellable and the less valuable it is. This obviously poses a bit of a business design problem, because if you are not doing the work personally, someone has to do it, right? The keys are to develop operating systems, to not allow too much power to get concentrated in any one employee, and to provide strong incentive programs for key employees to stay with the business...both while you own it and after you sell.

Case in point: Recently I met with the owner of an equipment sales company. Three years before, the business had a \$1,000,000 a year net profit and gotten a business valuation from a general business broker of \$4,000,000 (the valuation was grossly flawed, but that’s another story). The broker advised that the business would be worth a lot more if the owner, who was doing all the selling, would hire a salesman and transfer all the accounts to a salesman. The business owner followed the advice and gave all his accounts to one salesman. When the would-be seller showed up to talk to me, he proudly described how he had increased the value of the company by this strategy and that it should now be worth at least \$6,000,000 like the business broker had predicted. He now had one salesman who controlled all the accounts and had been doing all the sales for the company for the last 24 months. The salesman took the lion’s share of the profits in commissions. The business owner now was making \$75,000 a year.

Hmmm. What do you think? Did this approach increase the value and salability of the business? In my opinion, the owner had given his business away to the salesman and it was now essentially worthless. I suggested the seller return to the original broker with the brilliant strategy and let him try to get the \$6,000,000. It may not surprise you to learn that the broker was no longer in business either.

Vendors. Don't allow your business to become "captive" to a single provider of component parts.

Case in point: One time we were asked to sell a manufacturing company. The owner had received a 15,000,000 dollar valuation estimate from a national M&A firm that holds seminars to sell expensive "valuations." After analyzing the company, I told the owner the valuation was seriously in error because it overlooked vendor concentration. The company was not going to sell for anywhere near \$15,000,000 and would likely be very difficult to sell at all because his main product had been designed around a special, one-of-a-kind display screen produced by only one small foreign company with annual revenues estimated at about \$3,000,000.

The owner scoffed at my assessment of the risk. His display maker would never let him down. I declined the assignment and strongly suggested the owner develop alternate suppliers...even if it meant re-designing his product. When I called to follow up only two months later, he was out of business and bankrupt. Seems the sure thing, nothing to worry about, totally reliable foreign manufacturer had closed up shop. With no other source for a critical component the local manufacturing company was killed.

Customers. Customer concentration is a major risk factor considered by business buyers. When you begin to get more than 10% of your business coming from one customer, business buyers start paying attention. Over 25% and they get concerned. Over 50% and the salability and value of your business are seriously jeopardized. 75% or more and you are in real trouble. This can be a real dilemma for a business owner. On the one hand, when you have big customers willing to send increasing amounts of business your way, it's hard not to accept the orders. On the other hand, the more your business is capitalized, staffed and organized to support one or two key customers, the more risky your situation.

Keeping a book of business balanced and keeping big customers honest and committed to doing business with you because of your unique capabilities (there's that innovation thing again) is a never ending challenge. **But it's one you have to face if you want to sell your company for top dollar someday.**

Case in point: We were selling a manufacturing services company. 65% of its business and 75% of its profits came from a particular manufacturing process it provided to one customer...and these percentages were growing. Nonetheless, the selling company had some unique capabilities and growth prospects and the seller was confident that the main customer would never leave. We had several buyers and a bidding war going on. Excellent all-cash offers were on the table. In the middle of negotiations, the main customer announced it was going to bring the process in-house. Ouch. The deals vaporized.

We ultimately succeeded in selling the company to a new buyer, but unfortunately the price and terms were nowhere near the original deals, as you can imagine. For your business to sell for top dollar, you must manage customer concentration carefully! Ongoing Innovation and Marketing are critical to this process.

Let's close with a reminder about what business buyers want to buy:

Business buyers want to purchase a system for making money that they perceive has a high probability of making an ever increasing amount of money for them in the future.

This Value Building Strategy was brought to you by...

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