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Working On – Not In – Your Business

A number of years ago, I met with Diana Duff, the owner of Major Machining, Inc. (MMI), a machine shop. She wanted out. I suspected that her severe case of "early onset burnout" was due to the departure of her three-person management team six months earlier. These employees had not just left the company, they had set up a competing machine shop funded by the many MMI customers they took with them.

MMI was in shambles — it had no value because its owner had ignored the most important Value Driver — key employees. Duff could — and should — have considered a variety of tools to motivate and keep the company's top employees.

What are Value Drivers? And why are they so important to you and your company? Value Drivers are the various characteristics of a business that professional buy-out experts believe drive business value upward and for which they are willing to pay top dollar. It is vital for you to know what these value drivers are if you want to successfully exit your business.

In Steps One and Two of The Seven Step Exit Planning Process™, you establish your Exit Objectives and determine the value of your business. Driving business value upward is a necessary step if, as is so often the case, you determine that the value of your company is not sufficient to satisfy your financial objective. During Step Three, you create the additional business value and cash flow necessary to help achieve your financial objectives.

To increase business value, you must target those same elements of a business that professional buy-out experts believe drive a business' value upward and for which they are willing to pay top dollar. These elements — characteristics that both help to reduce risk and improve return — are commonly referred to as "Value Drivers."

Value Drivers come in two varieties: generic (common to all industries) and industry specific. The generic Value Drivers are:

- A stable and motivated management team;
- Operating systems that improve sustainability of cash flows;
- Operating profit margins, at least as good as industry average;
- A solid, diversified customer base;
- Facility appearance consistent with asking price;
- A realistic growth strategy;
- Effective financial controls; and
- Good and improving cash flow.

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Your industry also has specific or unique Value Drivers. For example, if you have a distribution company, a potential purchaser would look at the strength of the manufacturers you represent, the number of inventory turns per year, and the level of technical expertise your sales force possess.

For MMI, a number of Value Driver tools and techniques could have been used to motivate and keep key people. These tools included:

- Stock option, purchase or bonus plans subject to forfeiture if the key employees left prematurely;
- Non-qualified deferred compensation plans — with vesting — to encourage key employees to stay;
- A richer benefit package; or
- A defined succession plan, which included the key employees.

All of these tools can be designed not only to motivate and keep your top people — an essential Value Driver itself — but to reward them based on their efforts and success in driving business value upward. Look at your own business. Do you have an incentive system that:

- Is substantial in the eyes of the key employee?
- Has written performance standards, the attainment of which by the key employee not only results in a bonus to the key employee, but also increases the value of the company?
- Is part of a defined, written plan, communicated to the key employee?

"Handcuffs" the key employee to the business by making it difficult for him to leave the business without forfeiting significant financial benefits?

As you can see from MMI's example, creating and fostering Value Drivers is crucial whether you simply wish to put more money in your pocket every year, or whether you want top dollar by selling your company.

It bears repeating that we believe you should concentrate on Value Drivers because that's what professional buyers may deem important and if they deem it important, it probably is. After all, they should have considerable experience in analyzing what increases a company's value.

How do you implement Value Drivers in your business?

- First, learn more about Value Drivers by contacting us.
- Talk to your advisory team members, especially your financial/insurance professional, your CPA, and perhaps business consultant or attorney.
- Stand above the fray at least one-half day per month. Look at your business through the eyes of someone interested in buying it. What do you see that would cause you to pay top dollar for your business? What would cause you to pay less for your business? When answering these questions look both at what your business is doing, as well as at what it is not. Viewing your business in this way is what we mean by working on your business, not just in it.

By increasing your knowledge, by working with capable advisors, and, most importantly, by thinking about what the business needs to become more valuable, you can work to put into place the elements necessary to drive the value of your business upward.

*Subsequent issues of **Sage Solutions** will discuss all aspects of Exit Planning.*