# How to Maximize Your Valuation

Think about the Long Term on the Impact of Day-To-Day Decisions

In managing their company, business owners should not focus solely on the day-to-day operations, but should always consider the long-term strategic impact of today's decisions on the future value of the company. Thus when analyzing any business decision, one must consider issues beyond the scope of the company's immediate financial performance, and remain cognizant of the implications the decision will have on the valuation of the company upon exiting.

Issues to Consider When Making Business Decisions:

**Customer Concentration**

Small to medium sized businesses ("SMBs") typically derive the majority of their revenues from a limited number of customers. Although these customers generally comprise highly profitable, long-standing relationships that are key to the success of the company, owners should not become complacent. The loss of one of these key customers could financially cripple a company. Although owners should pay special attention and even give preferential terms to retain their key customers, they should also proactively develop relationships with new customers.

Customer concentration often becomes a point of contention when valuing SMBs. Many acquirers, especially financial buyers, shy away from companies that derive a majority of their revenues from a handful of select customers. The loss of one of these important customers may result in the acquired company posting drastically lower revenue and profit figures. Due to this risk, acquirers will generally apply valuation discounts to companies with a high degree of customer concentration. Although some strategic acquirers may hold a company in a higher regard if it possesses a strong relationship with a particular client, this is the exception rather than the rule.

**Strong Partnerships**

Finding suppliers who can serve as the "one-stop shop" solution for companies has grown in popularity over the years, however, companies should still develop and maintain key strategic relationships with other suppliers involved in similar or complementary products and/or services. Developing a broad partnership network may play an important role in the success of your company. For example, the bidding process for a large contract may require skills and staff that your company does not possess. In this case, your company's only chance to place a competitive bid would be to leverage your partnership network to assist in delivering the project. Conversely, your industry partners may require your help on their projects, thus producing an inflow of business.


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A partner network may be even more crucial during your exit process, as a partner could become your acquirer. There are a number of reasons this scenario could occur. First, the relationship may be so crucial to a partner's operations that they may fear that a change in ownership will result in a shift in your business focus and disrupt the nature of their relationship with you. Second, partners providing similar product and/or services may be looking to expand.

The acquisition of your company could expedite increasing their customer base, capacity, and revenue growth. Lastly, partners with complementary products or services may develop an interest in your company which could enable their in-house operations to service a larger percentage of their customers' needs.

**Develop a Strong Management Team / Successor**

Some business owners in the SMB space control every aspect of their day-to-day operations. If the owner plans to exit the company, this autocratic structure might become problematic. Although strategic acquirers should have no problems with this issue (because of their existing industry skills), financial buyers may find this management structure to be problematic if the current owner's exit causes paralysis at the company. Thus, a manager of equal or greater capabilities will need to be brought in to run the acquired business. The executive search process will prolong the acquisition, and could potentially kill the deal.

The risk in bringing in new management may be too great of a deterrent for financial buyers as the new managers will not have the same breadth of knowledge of the company's specific market niche, geographic atmosphere, and current client relationships as the previous owner. In order to avoid this problem, companies should develop some form of management team, so that all members are capable of running the firm's operations.

**Long-Term Real Estate Leases**

A long-term lease generally presents advantageous financial terms over a short-term lease and locks a company into specific locale for a greater period of time. Long-term leases are especially advantageous to a company if the property is situated in a location conducive to business. Although these benefits usually lead companies to sign long-term leases, owners should be aware that a long-term lease could have a negative impact upon valuation. Both strategic and financial buyers generally prefer to acquire companies that do not have long-term leases and are easily relocatable, because:

- Acquirers who have operating units in close geographic proximity may want to "tuck-in" the acquisition (meaning that the employees and equipment of the acquired company are moved into the acquirer's facilities).

- Acquirers might want to use the acquired company as a platform to expand into a new product, service, or geographic market. This agenda usually entails a plan to grow the acquired company into a larger entity, and a larger facility would be required to accommodate growth.


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Leases that lock in an acquisition target for a substantial period of time can be a deal breaker, or at a minimum devalue your company. If any of the two scenarios that are detailed in this paragraph occur, the company's current leases represent an unnecessary post-acquisition expense to the potential acquirer. It must be noted that this commentary regarding real estate leases is only applicable to companies which do not require them to remain at the same locale to maintain current financial performance levels.

**Diversity of Customer Base**

Some companies cater to a particular industry. While this strategy enables a company to specialize in products and/or services related to one industry, and gives them a competitive advantage in winning contracts, it also forces the company to take on risk due to a lack of diversity. If the industry suffers a cyclical downturn, the company specializing in the industry usually falters as their customers place fewer orders. Although unavoidable in certain situations, companies should not specialize in serving just one industry. If a company believes in the merits of industry specialization, it should attempt to diversify its product and service offerings to include another industry which is counter cyclical to their other industry.

Companies specializing in work within a single industry represent an interesting situation for an acquirer. Specialization may be valued at a premium by acquirers who also specialize in the same area, or are looking to enter this market. However, more often than not, acquirers view the target company's products and/or service offerings as limited and reduce the valuation appropriately.

**Conclusion**

This article has highlighted some of the general issues that should be considered in maximizing the value of your company. These topics are in no way inclusive of all factors that an acquirer will inspect; every transaction is unique and dozens of variables could be used to calculate a company's value. Keeping these issues in mind can help owners to analyze how each decision they make today will affect their business valuation in the future.

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