



Preparing a Business for Sale—Part 1: Data Matters

Specific actions need to be taken to achieve a competitive process.

by Mark Working

Investment bankers provide a variety of services to businesses, but a banker's primary mission is to create a competitive market for an illiquid asset – the privately held business. Competition invariably brings out the best, and a competitive market is created when each relevant and capable buyer simultaneously

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has a complete understanding of the opportunity. But for a decision on price, there are no unknowns. This article is the first of a series of three essays, each delving into a critical area in which advance preparation can make a meaningful impact on the ability to create a market for a business.

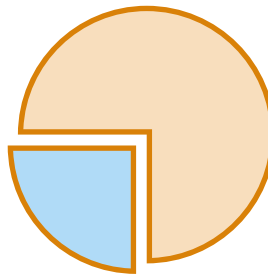
The banker's ideal outcome is conversion of a complex business entity into a virtual commodity. While this is rarely achieved, one can come close. It requires specific actions on the part of owners and managers to prepare the business for a competitive process. Three areas that stick out in our minds are the subjects of our series:

- **Data matters; its absence leaves only a story.** The existence of and accessibility of data on the detailed operational and financial mechanics of the business are necessary to quantify the company's business model and how it employs its capital and earns its return.
- **Understand the problem your company solves.** The size and growth curves for the market, the number and nature of the competitors, and how customers make buying decisions need to be understood and quantified in a manner that defines the environment in which the company competes; understanding precisely which problem the company solves thereby creates the framework for defining

Part I: Data Matters



Part II: Understand the Problem



Part III: Plot the Course



each of these items.

- **The future course must be plotted.**

There is a specific value proposition that underlies every business and customer buying decision. What is it? The roadmap for future success has to be specific such that the equation for return on capital employed is clear to the potential next owner.

PART 1: DATA MATTERS

To acquire or invest in a business, one must develop an in-depth understanding of how the business works. An accountant-prepared financial statement and good performance certainly

is a good start, but is insufficient to get the check written. Businesses are complex; a deep dive into the data is invariably required to tease out the complexities.

Externally audited or reviewed financials are recommended, not because they provide the nature of the information required, but rather they evidence the independent scrutiny of and the quality and reliability of the data and the underlying management systems.

Buyers seek a much more granular understanding of the underlying data, which will allow them to align financial revenues and costs alongside operating activity in order to reveal the economic contribution of each component of the business. Frequently, buyers want to deconstruct each revenue stream and cost activity into all of its component parts and analyze the relationships among them all. Owners of businesses often have a "gut" feel for the operating dynamics and may not grasp why all the analy-

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sis is necessary. Here are a few things over the years we've found upon detailed inquiry:

- Profit was driven by a few SKUs and customers, with much of the remainder of the customer/product portfolio detracting from core profits – which suggested implications for facilities, employees, and capital employed.
- Cycles over time showed patterns in SKU demand by customers that conflicted with inventory production, thereby leading to the conclusion that inventories (and, therefore, capital) could be meaningfully reduced.
- Analysis of variations in service and product volumes over time showed that the profit stream varied far less than the revenue stream, implying more resilience, and therefore less

risk, across business cycles.

Activity drives the financial numbers, so the collection of operating activity in terms of units of production and work activity to produce each unit is the basis of the economic analysis. It is sometimes easier to look backwards from the customer to trace what and how much each customer buys, what is paid for each unit, and the costs to produce each unit. In essence, buyers want to follow the human and material resources flow through the business to their ultimate end, with the costs and time of each stage clearly identified. The optimal depository of the data is a multivariate time-series relational database from which data can be extracted to address whichever revenue/cost/activity question is posed. When the data exists and is in reachable form, questions and answers can take on real time speed. The degree of responsiveness to questions by buyers is a critical factor influencing the ability to create competition.

A data collection and analysis culture must be established to assure consistent and accurate data. Everyone knows about “garbage in, garbage out” so the creation of a culture in which the leadership of the company cares about accurate data helps set standards. When operations and financial people work together to assure activity and financial data being connected, the basis for a good system is present. We have observed that when operations people are given the opportunity to obtain data on certain efficiency metrics they feel worthwhile, data collection is far easier to achieve.

The last piece is the physical system with the architecture that allows the data to be stored and accessed through software applications. Large businesses devote substantial resources to develop and maintain customized systems that capture and store data in formats that can be used in management decisions.

Our experience has been that most middle

market companies collect operating activity data and have sufficiently detailed general ledger accounts in their financial system such that the basis for analysis exists. Often the missing links are a “mapping” of the relationship of the operating activity and financial data, together with the tools to align the pertinent data in a manner that transforms it into useful and timely information for robust analysis and action.

In our view, business owners should take the time to inventory and critique their organization’s data collection efforts for conformance, with the end goal of having a flexible, accurate and comprehensive information system that assists management in decision-making and which allows flexibility in analysis of the business by a third party. The clarity that can be derived from robust systems leads the way to greater value, whether for use in a sale process or when used to make ongoing decisions. **ZS**



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ABOUT ZACHARY SCOTT

Zachary Scott is an investment banking and financial advisory firm founded in 1991 to serve the needs of privately held, middle-market companies. The firm offers a unique combination of in-depth knowledge of the capital markets and industry competitive dynamics, sophisticated analytical capabilities, and proven expertise in structuring and negotiating complex transactions. For more information on Zachary Scott, go to **ZacharyScott.com**.

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