



Preparing a Business for Sale—Part II: Understand the Problem

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

by David 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 has a complete understanding of the opportunity. But for a decision on price, there are no unknowns. This article is the second in 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.

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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:

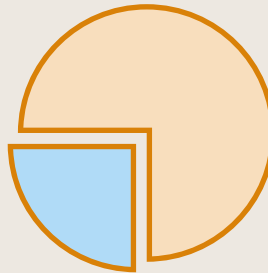
- **Data matters; its absence leaves only a story.** The existence of and accessibility of data on the detailed operational and financial mechanics of the business are necessary to quantify the company’s business model and how it employs its capital and earns its return.

- **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

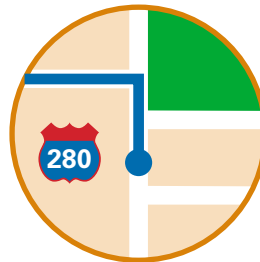
Part I: Data Matters



Part II: Understand the Problem



Part III: Plot the Course



precisely which problem the company solves thereby creates the framework for defining 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 2: UNDERSTAND THE PROBLEM

Part I of this series outlined the necessity of developing robust data systems inside the business being brought to market, for the purposes of proving the economic concept of the business. These systems, in essence, provide an internal perspective into what makes the business valuable. But a complete internal perspective only makes up half of the overall picture; the external perspective, or a solid understanding of the environment in which the business exists, is an equally crucial component to building a complete buyer thesis. If “a rising tide lifts all boats,” then both the boat and the tide must be thoroughly explained.

Our experience is that the middle-market business owner, by necessity, influences the operations of the enterprise in numerous capacities, most notably from an internal perspective, trying to adjust to a constantly changing exter-

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nal environment. To continue the metaphor, the boat’s captain can’t change the tide, so he doesn’t work to predict it.

Well-documented systems and data collection can address “what” and “how” the business operates, but not “why?,” which gives perspective as to the future prospects of the business. Especially for businesses with complex business models, or in industries with seemingly obvious risk issues, buyers can be “scared away” from an investment before taking the time to investigate whether their intuition is correct. At the very least, extended periods of time will be required

to allow adequate investigation. While an owner cannot force a buyer to share his own conclusions on the market, he can clearly illuminate a certain perspective.

There is a near-infinite amount of information that could be used in discussing a business environment, so we help our clients narrow the scope with three lines of questioning, each with a static and dynamic component:

1. **What customer problem does your company compete to solve? Or: what is your market?**
2. **How large is your market? How large will it be?**
3. **What is your market share? What will your market share be?**

Addressing the core question, “What problem does my company solve?” defines the open questions of “who are my potential customers?” and “who are my competitors?”. Customers are not always direct customers, but end users of the value chain. Competitors are not always those similar businesses, but other businesses and channels that attempt to solve the same end-user problem. As an example, a customer problem to be solved is “getting to work in time for a staff meeting.” Cars, buses, light

rail transit, taxis, bicycles, and van pools are all competing mechanisms to solve the customers’ problems, each with a specific set of cost, convenience, and dependability attributes.

Another competitor could be video conferencing, which attempts to solve the problem in a totally different manner. Customers are not just the people who use these methods, but all the people who have this same problem, and may even be without a current solution. Too often we see companies struggle to define exactly what the market encompasses, or who they consider their competitors—they allow a specific set of products or a certain class of customers to define a narrower view of the opportunity (or ignore a major source of competitive risk) than is warranted. By defining the specific need that the company’s products and services address, and the “market” as the group of customers who are in need of the service (even if they leave the problem unsolved or solve it through a different style of products or services), and the “competition” as anyone else who seeks to provide a solution to the same problem—then the answers to the questions of market size, market share, competitive dynamics, and market potential crystallize out

of that structure. The more the overall picture of a business environment “ticks and ties,” the more likely it will lead to a valuable conversation in the sale process.

Quantifying the market, market share, and competitive attributes can be difficult for already busy managers, and requires a specific kind of research to provide a firm framework for the issue. Much like some businesses engage a “sell-side Quality of Earnings Report” from an independent entity, it might make sense to address this issue by engaging an additional resource (ranging from a dedicated internal resource, to a local university research team, to an external market research consulting firm).

We believe that the continual assessment of the business environment is important for the strategic direction of any operating company, not just those preparing for a sale. The earlier an organization can begin efforts to regularly collect data along their value chain, and allocate internal or external resources to interpreting the data for strategic use, the better prepared they will be to pivot those insights into tangible value in management decisions, as well as when a sale process begins. **ZS**



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