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Lessons from the Front Lines: Time for a Business Makeover

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Mistake 1: In today's economic crisis most companies are just looking to survive and rarely take advantage of tough times.

Mistake 2: They tend to hope for a quick turnaround and do little or nothing which is the worst possible scenario for survival and long term growth.

Mistake 3: With the IPO markets effectively closed for several years, they fail to recognize that an exit event is an excellent alternative for survival, provided the company is well prepared to pursue acquisition discussions.

An optimist is convinced that their small technology company will survive the current economic crisis. The realist understands that only those with proven business models and a willingness to shift tactics and strategies will be successful over the longer term.

As a 10-year veteran of M&A and former CEO of several mid-market companies with 35-plus years of experience in technology, I have definitely seen the best and worst of times in our industry. For the most part I have always aggressively pursued growth yet have had to regularly temper my approach in order to successfully weather tough economic conditions. There are several fundamental principles that are essential survival strategies in difficult times:

- Achieve and sustain a positive cash flow position. Cash is King.
- Become more aggressive in sales and marketing, and I do not mean by cutting prices.
- Be prepared and proactive in M&A discussions, rather than be caught off guard and missing the window of opportunity.

Be Proactive – Be Aggressive

In order to improve cash flow many firms have little choice but to trim expenses. The initial reaction is to make a very painful decision and downsize an organization through layoffs and a reduction in workforce through attrition. Downsizing in itself will not ensure survival, as that only addresses the cost side of the business and does very little for top line production.

Adopting a more proactive, aggressive strategy is crucial to surviving, but the organization also needs to consider the ramifications of being ready for the eventual turnaround and more importantly ensuring the continued growth and long success of the business. Management, and especially SMB executives, need to carefully consider the implications of cutting your revenue producing engine and may wish to try and take advantage of market turmoil by becoming more aggressive in sales and marketing, especially when others around you are downsizing marketing programs.

You need to balance being quietly confident on future prospects for growth with being brutally honest and cut anything that isn't working. With that said, I do subscribe to the theory that "stopping spending on sales and marketing to save money is like stopping a clock to save time"; it just doesn't work.

There are several options organizations should evaluate in reducing direct sales expenses: such as substituting highly leveraged incentive plans for base salaries; or potentially turning your R&D team and support staff into revenue producing consultants and onsite advocates for your products; or job sharing by redeploying your top technical staff as consultative sales representatives.

CEOs must make better use of limited resource by becoming more customer focused. Fine tune your competitive message and by communicating a more compelling customer ROI, as well as using new tactical programs to increase market visibility as opposed to just cutting costs and taking a wait and see attitude. If you are committed to downsizing, look at more cost effective alternatives that allow you to expand rather than contract your efforts by outsourcing some of the tactical programs.

In today's global market, outsourcing either all or part of your sales and support initiatives can dramatically reduce your ongoing operating costs by 40 percent to 60 percent, while simultaneously expanding your market reach. Depending on the complexity of your application, the majority of the selling process could be outsourced. Prospecting, lead generation, lead qualification, appointment setting and closing strategic accounts could be outsourced. Typical applications include: telemarketing, telesales, new product introductions, filling seats at seminars, lead qualification, appointment setting and response to commercial ads or trade show follow-up. You should be able to get better bang for your buck by negotiating lower rates based on either a flat rate per hour or a combination of an hourly rate plus commission based on results.

Effective business leaders use the lean times as an agent of change: to improve processes, sharpen product focus, upgrade the team (having the right person in the right seat on the bus), and ultimately increase future prospects of thriving. One must also emphasize building and maintaining relationships with customers, partners, employees and suppliers.

Be Prepared to Engage in Partnering Discussions

With a downturn in the economy and the need to preserve cash, a good number of firms often reduce R&D expenditures, effectively delaying or canceling the development and delivery of the next generation of product. These same firms still have to address the urgent need to stay ahead of competitors and the technology curve, which in turn drives the critical need for acquisitions that helps expedite time to market and raise competitive barriers.

While cash rich, forward-looking companies also look to reduce costs, they recognize that their acquisition dollars go a lot further in tough times, and are not adverse to acquiring companies that strategically advance their position for growth. Most of the deals they look at are closely tied to their strategic plans to create new markets, capture market share or build added product differentiation.

Another interesting fact is that many software companies spend far more on acquisitions than they do on new product research and development. Companies like Cisco and Computer Associates are better known for buying technology, market share and customers rather than building new products, or entering a new market segment. These companies may reduce the number of deals they do in any particular period, but they still remain very active buyers.

While it's tough for software executives to think about an exit event when struggling to keep the business afloat, CEOs must maintain an acute awareness of what deals are getting done in their market. Which competitors are being acquired at what valuation multiples. Understand that if market consolidation is occurring, it could leave your company behind with no strategic buyer in sight willing to pay reasonable deal premiums. In a consolidating market you want to be one of the first companies to be acquired where higher deal values are realized and you have a larger buyer pool competing to acquire your business.

Another important byproduct of entering into acquisition discussions with potential buyers sooner rather than later is that you will gain some valuable insights into their future product and market strategies, and their build-buy-partner model of doing business. This value-added knowledge can often lead to a better understanding of their road map and corporate priority for addressing functional product gaps, core competencies or need for a more cost-effective and timely entry to other vertical or geographic sectors. While M&A negotiations may not immediately occur, you will obtain priceless feedback on your business and the areas management could focus on improving to increase deal consideration and ultimately shareholder value/return.

Make no mistake, this is a buyer's market. There are lot of opportunities to acquire distressed, underfunded and underperforming companies, which tend to be businesses that require substantial investment to turnaround or leverage. Companies with good performance in these difficult times can and do attract more attention than “fire sale” situations. You can always say no and walk away from offers with some degree of confidence buyers will be back with improved offers.

With market consolidation occurring in every sector it doesn’t makes sense to wait for the next M&A boom to consider an exit. CEOs need to anticipate, prepare and actively engage in partnering discussions. All strategic buyers focus on mitigating deal risk, and are quite willing to pay some premium for companies they know extremely well, based on existing relationships and deep understanding of the target companies' business.

Surviving or Thriving in Tough Times

There is a major difference between surviving and thriving.

- Survivors hope and pray for better days while thriving firms view current conditions as an opportunity to affect long-term change that will support growth.
- Survivors rely on cost and price cutting measures while thriving firms not only reduce costs, but also improve the process, gain new efficiencies and improve product focus.
- Survivors look at the short-term cash crunch while thriving firms consider the long term objectives of strengthening the business, advancing its competitive market position, and gaining greater market share.

Even in tough economic times, thriving firms are more likely to receive quality attention from buyers and a market premium for their business, while survivors will probably either close their doors or be gobbled up in a bankruptcy sale.

Over the last ten years Marshall Warwaruk has specialized in helping small, privately held software companies maximize shareholder value through strategic investments, merger, acquisitions and strategic alliances. He has represented both buyers and sellers, guiding them through the planning and execution process of deal making. Marshall has also been a speaker at numerous industry conferences, and has written and published countless articles providing valuable insights into M&A market trends, negotiations and strategic deal making in the IT software and services industry.

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