



Making Exit Readiness Part of Your Company's DNA Will Grow Your Business

By Andy Thorson

www.ShareVault.com

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Preparing your company to withstand the scrutiny of a potential buyer places an incredible demand on you and your resources. The rigors of the due diligence process can grind business to a halt. This standstill can affect a potential investor or buyer's perception of value.

Being prepared for an exit, which means having all due diligence materials current, organized and available for review in a virtual data room, should be done long before an exit is even anticipated. Having a well prepared exit plan not only ensures a smooth transition, but also has value that reaches far beyond the exit process itself.

When your company is well-prepared for the exit process it means that everything a buyer will want to scrutinize—contracts, employee records, customer agreements, compliance documentation, HR and IP issues, etc.—is accurate, up-to-date, and organized in a way that makes it easy to review. If anything arises during preparation that would be a red flag to a potential buyer, then it should be a red flag for your company. Implementing a regular process of updating these materials provides valuable feedback on the execution of your business strategy.

Exit readiness is really about the creation, organization, and maintenance of data which will not only be reviewed by a potential buyer, but is critical to you while you grow your business.

Often, when an exit is not on your company's radar, certain documentation can fall through the cracks or become dated which can be devastating. If a buyer wouldn't want to inherit your company's liabilities then why would you want to retain them? If being prepared for an exit is part of your company's DNA, then not only will you avoid scrambling for data during due diligence, but you'll have data in place to inform you of your company's health, expose weaknesses and liabilities, and grow your company and increase value.

The Exit Plan

What does it mean to be prepared for an exit? Part of the process is having a realistic expectation of when an exit will make the most sense for your company. The timing of an exit will vary based on the acceptance and adoption of company products in the marketplace. An exit is generally most valuable at an inflection point where it becomes possible to coherently demonstrate the value of your organization and strong prospects for increased or continued growth to a potential buyer.

Ask yourself what the major metrics are that drive value in your enterprise. Who are your potential exit targets? Are they financial investors, strategic investors, public markets or another group? Those different targets will have different value parameters and different ways of evaluating your company. That said, in general, they will likely be interested in the same type of data, so it's important to have it in place. This information, while being essential to a potential buyer, also contributes to your company's growth by creating a feedback loop that helps you understand how your strategies are working, what kind of revenue they are creating, the costs they are precipitating, and whether or not your strategies are meeting your targets.

The Importance of Information Integrity

It should go without saying that the data you maintain within your company must be accurate, but during the day-to-day running of your business, while you're focusing on reaching out to new customers and increasing market share, the maintenance and organization of good documentation can often fall by the wayside. It's important to remember that data created inside your business helps you gauge how your business is functioning. Whether this data is specific to financials, customer response, or employee performance, if it is not accurate, you can't assess how your business is running.

The integrity of the data that you use is just as important as the data you would present to a potential buyer. When a buyer examines your company it will be done with a microscope. Today's buyers are increasingly sophisticated when performing due diligence. They bring in an army of people—accountants, consultants, internal auditors, lawyers, regulatory specialists—whose lives revolve around their single area of expertise, and they'll want to see organized and accurate information.

Gaps or inaccuracies in your data reflect poorly on your organization, misinforms buyers, erodes confidence and almost always result in a reduction in value. If that's true for a buyer, it should be true for you.

Making the accuracy, maintenance and organization of comprehensive data part of your company's DNA from its establishment will help you avoid real obstacles and increase your company's growth and value.

Six Areas of Your Company to Examine as if You Were a Buyer

Regulatory Compliance

We all love to hate regulatory compliance, but noncompliance can be a costly deal killer. Regulation is on the rise. If your business is not regulated today, chances are it will be soon. The U.S. government is constantly increasing resources available to regulators. Whether it's the health care industry, where regulation attempts to control costs and ensure that government money is being properly spent, or the software industry, where consumer privacy issues are a growing concern, regulation is proliferating. As a business owner you can't reduce regulation, all you can do is understand that it's the current environment, it's increasing, and that compliance failures can significantly increase the cost of growing your business. On the other hand, compliance that is well done can reduce the cost of doing business.

If your compliance program is well run, when it comes time to sell your business or let someone look inside your business during the due diligence process, you will be ready. Buyers need to have confidence that the compliance practices they are inheriting are not a liability. When a buyer purchases a business, almost any compliance issue allows a regulator to look anywhere into the purchaser's operations. What was a small regulatory compliance problem for your organization can be so magnified for a purchaser that it surpasses the value of the potential acquisition. Even a minute regulatory issue at your company can be a deal killer because it isn't worth the risk for a large organization.

Compliance is just good business. When compliance is made a company priority, documents and data necessary for an audit are in order. This allows you to get through an audit process without the horrifying prospect of having to completely shut down your business.

Intellectual Property

Today almost all businesses have some form of intellectual property that needs to be protected. IP actions are expensive. The minimum cost of going through IP litigation today is in the neighborhood of \$3 million dollars, win or lose. When selling your business your IP ownership will be closely scrutinized during the due diligence process and any issues that arise can impact your value and a deal.

1 Regulatory Compliance

2 Intellectual Property

3 Human Resource Liabilities

4 Contracts and Liabilities

5 Financial History: Projections and Reality

6 Operations, Markets and Customers



It's critical that you've completed all your filings. A provisional filing is not enough—a full patent is required. As your IP develops it's crucial that you continue to file to accommodate the addition of new innovations so that they are also protected. Finally, ensure that all your employees have signed assignment agreements. In small organizations there's often a level of camaraderie and collegiality that can make assignment agreements seem unnecessary, but they are essential. Make these forms a part of your culture, have employees sign them the minute they come on board, and your IP will be better protected.

Buyers will not knowingly take on IP risk. It's too expensive to deal with and it drives down value. By ensuring that your IP is protected you not only make yourself more attractive to a buyer, but you avoid unnecessary internal headaches.

Human Resource Liabilities

Human Resources can be a minefield of potential litigation risk. When a buyer evaluates your company they'll scrutinize your employee records to ensure that when they acquire your company they're not inheriting potential litigation risk. They'll want to know if there are any cases of discrimination, equal employment opportunity, sexual harassment, or any of the other issues on the long list of potential HR problems.

The most important asset most companies have is their employees. Keeping up-to-date employee records as you build your business both develops that base of assets, but also protects you when problems arise. One of the most challenging problems a company can face is an HR problem. Good documentation is your most powerful defensive weapon.

When looking at employee records, don't overlook job descriptions. In smaller companies, where everyone knows one another and the value they bring to the table, accurate job descriptions can sometimes be overlooked. Every role in the company should be described as well as the people you'd like to hire in the future. One of the first things the finance department of a buying company will look at when evaluating your company is how they can reduce costs without adversely affecting the productivity of the company. Personnel, as one of the highest expenses for any company, will be scrutinized first.

It's important to make sure that when a potential buyer evaluates your company it's clear to them what each one of your employees does and why they are there. The more confident a buyer is in the returns they're going to get from your employees the more likely it is that the sale will go smoothly.

Contracts and Liabilities

Everyone you deal with—bankers, vendors, customers, etc.—has a contractual arrangement with you. When a potential buyer is evaluating your company they'll want to understand in intimate detail what those agreements mean. It's important to understand the limitations and liabilities inherent in every contract you sign.

One of the potential ramifications of not fully understanding the intricacies of the contracts you've entered into is being locked up in escrow for years while contractual issues get ironed out. Don't ever make the mistake of assuming that a contract is fully in your best interest. Take the time to understand your contracts and never enter into agreements based solely on a handshake.

Financial History: Projections and Reality

When a buyer looks at your financial data they want to see conservative numbers that are backed by verifiable facts. Conservative financial data and projections can never hurt. A good practice is to present your numbers just as a public company would. Ask yourself if your company could survive a public audit, because when a potential buyer enters into the due diligence process that's essentially what they'll be doing. Using GAAP (Generally Accepted Accounting Principles) should be standard practice. Most buyers, if they find your numbers are not compliant with GAAP, will demand that that data is recreated so that it is. Going back three or more years to do that, depending on the rigor of the purchaser, is a very painful and costly process and is best avoided.

Finally, don't ignore cash flow numbers. Accurate cash flow data will not only impress prospective buyers, but it also gives you something to look at on a daily, weekly, or quarterly basis that will help you evaluate how your business is doing and alert you to change strategies when the company is not performing to expectations.

Operations, Markets and Customers

Knowing your operations, markets and customers intimately is important, but you also need to be able to demonstrate this knowledge to a potential buyer. Robust data around your customer base and the markets that you operate in allows you to leverage that information as you build your business. Current and accurate data allows a purchaser to understand your markets and customers as well as you do. This kind of practice lets the purchaser know that your company and its team of people and the product it represents are competent and valuable.

Make Exit Readiness Part of Your Company's DNA

The deal process should never have the effect of hobbling your business. Be ready in advance and have the necessary data in place that a buyer will be interested in and that you will be using operationally on a daily basis. Remember, you may go through the scrutiny of due diligence on multiple occasions. It shouldn't be destructive to value or growth. Instead, the due diligence process should improve your company, even if it doesn't result in an exit.

Good quality data, housed in a central repository, is key to creating a climate for a successful exit, but it should also be viewed as a tool to help achieve ongoing growth and value.

Make exit preparation part of your company's DNA. It will help you grow your business and in the event of an exit, it will ensure a smooth transition and optimum value.

About Andy Thorson

Andy Thorson is the former Corporate Vice President of Business Development at Varian Medical Systems. Thorson is Senior Executive with 25 years of experience in merchant banking, private equity advisory, medical device/capital equipment, financial management, business development, heavy industry and start-ups. He has extensive experience in Asian and European markets. Thorson has an MBA from the University of Chicago and an AB in International Relations from Stanford University.

About ShareVault

ShareVault™ is the industry leader in supplying intuitive, innovative virtual data rooms that provide a simple, secure way to share sensitive documents with third parties during the due diligence process. The on-demand platform is an innovative cloud computing solution that enables its customers to manage critical time-sensitive and document-centric processes faster and more intuitively. ShareVault™ offers the highest degree of security and reliability combined with unparalleled speed, ease of use and functionality. Backed by the experience of billions of dollars in successful deal transactions, along with industry-leading customer support, ShareVault™ can be a critical tool in accelerating deal transaction times and increasing deal success rates.

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