



The CEO Challenge for October 2009

How to Survive an Investor's Due Diligence

As we all know, this isn't a good time to raise capital for your company. But surprisingly, it may be a good time to sell. An August 2009 New York Times article (["As Deal-Making Returns, Midsize Companies Are Seen as Prime Targets"](#) by Brent Bowers) proclaimed "The United States is ripe for a boom in acquisitions of privately held companies."

Dennis J. Roberts, the chairman of the McLean Group, an investment bank in McLean, Va., estimates that 1.2 million U.S. mid-market businesses earn annual revenues of \$1 million to \$500 million. Collectively they earn nearly \$8.8 trillion and have a market value of \$4.4 trillion. (That's an average of \$7.33 million in revenue per company with an average market value of \$3.67 million.)

Roberts identifies four trends that will drive the surge:

1. Baby boomer burnout
2. Technology advances that drive market consolidation
3. Increased foreign appetite for U.S. companies
4. A buildup of cash at the nation's 4,000-8,000 private equity groups

The article is full of helpful recommendations for owners and executives who are preparing to sell or raise capital. Even if an exit isn't in the cards right now, Roberts recommends bringing in outside counsel to evaluate the company from an investor's perspective. Why? Because outside advice could help you improve your strategy and profitability, leading to a higher valuation if you later decide to take the next step.

Do you have comments, questions or feedback on this article? Please share your thoughts at <http://www.therevenuegame.com/ceochallenge/10/due-diligence/>.

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The monthly CEO Challenge is published by The Revenue Game, a revenue consultancy that helps clients generate predictable, profitable growth. To get in touch with us directly, please contact Jane Adamson, CEO, at (866) 356-8979 or janeadamson@therevenuegame.com.

CAN YOU SUSTAIN YOUR REVENUE AND PROFIT?

When they launch due diligence, a seasoned investor, organization or buyer is looking for one simple thing: Will this company make money in the future? They truly don't care whether it was profitable in the past. It's all about the future.

That's where many business owners or executives get into trouble. I've seen many CEOs and small business owners assume that since the company is profitable now, it will continue to be profitable in the future. And yet buyers and investors aren't making that assumption at all. In fact, they're doing just the opposite -- they're looking for evidence that the company CAN'T maintain and grow profitability.

For example, let's say your company's revenue and profit depends on a relatively small number of high-value accounts. An investor or buyer will assume that you'll lose some of those accounts, which can kill your valuation and/or the entire deal. What if your company has one or two star salespeople? An investor or buyer will assume that one or both of them jumps ship, leaving the company in a lurch.

You've just introduced a great new high-margin profit. Guess what? Investors will assume that you'll soon have competition and won't be able to maintain those margins. If your industry is generally weak in marketing, they'll assume that someone will improve in short order. If you're in a very hot economic market, they'll evaluate what happens when the market softens.

As you can see, buyers and investors need to be pessimistic because they're looking for the best investment opportunities -- companies that can survive their most rigorous analysis. Thus, your challenge during this due diligence process is to clearly demonstrate that your revenue and profit is sustainable and repeatable over the long term.

IS THERE A STRUCTURE AND PROCESS IN PLACE?

To show that your revenue and profits are repeatable and sustainable, your organization needs two components:

1. A clearly-defined long-term revenue strategy
2. The process and structure to create that reality.

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To really demonstrate these concepts, I've created a "Revenue Test" for this month's CEO Challenge. It's lighthearted, but these ideas are serious business. After all, buyers will take a very hard look at how your company generates revenue. You should do the same.

THE REVENUE TEST

- 1. Could everyone in your company AND your customers describe your brand in the same way?**
 - We don't have a defined brand
 - We have a defined brand but haven't communicated it well
 - Our clients wouldn't be able to describe our brand consistently
 - YES
- 2. Do you have a clearly defined niche you either dominate or have a written plan to dominate?**
 - We don't have a defined niche
 - We've defined one in theory
 - We have a defined niche but don't have plans to dominate it
 - YES
- 3. Could your employees identify the "problem you solve" for your customer niche?**
 - What do you mean?
 - There are many. Which ones do you want?
 - The sales team is clear on this. The rest of the company isn't.
 - YES
- 4. Is your company "messaging" consistent in all forms (website, written materials, answering the phone, verbal conversations)?**
 - Everything is different & changes regularly
 - Written communication is very consistent, but verbal isn't
 - We're consistent but change regularly
 - YES
- 5. Do you have a regular system for tracking customer feedback?**
 - We don't track feedback at all
 - We track informally
 - We track but don't share the data well
 - YES

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6. **Do you have a regular system for tracking future trends in your industry?**
 - We don't track future trends at all
 - We track informally
 - We track but don't share the data well
 - YES

7. **Does your company have a defined sales process with clear steps for both marketing and sales**
 - What would that look like
 - Somewhat
 - We have a sales process but it's not detailed
 - YES

8. **Is everyone in your organization clear about what promises you're making to your customers?**
 - The promises depend on circumstances
 - Promises change
 - The promises are department dependent
 - YES

9. **Have you had a strategic revenue plan in writing for each of the last 3 years?**
 - We've never had one in writing
 - We created one this year for the first time
 - We've created them but I don't know what happens to them
 - YES

10. **Have you achieved your company objectives for each of the past 3 years?**
 - We haven't had clear objectives
 - Occasionally
 - Usually
 - YES

11. **What metrics do you track?**
 - None
 - Top line and bottom line
 - Sales related metrics
 - Companywide key indicators, department indicators, and revenue indicators

12. **Do you track the ROI for every marketing initiative (e.g. ads, trade shows, mail campaigns, referral marketing, web marketing, lead generation programs)?**
 - We've never tracked ROI
 - Sometimes
 - Usually
 - YES

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13. Do your compensation plans align with the stated goals?
- I've never looked at it that way
 - No
 - Not exactly
 - YES
14. How many times have you changed focus over the past 3 years?
- Numerous
 - Several
 - 2
 - Never completely, only slight adjustments to market changes
15. Do all functional areas of the company participate in revenue discussions on a regular basis?
- No
 - Occasionally
 - Sometimes
 - YES

CONCLUSION

Give yourself 1 point for every (a) answer, 2 points for every (b) answer, 3 points for every (c) answer, and 4 points for every (d) answer.

Score	Recommendation
15-30	Don't try to sell.
31-45	Consider major changes to create a revenue focus in your organization.
46-59	Keep up the good work. With some small adjustments, a big win is in your sights.
60	Call us – we're ready to invest!

What do you think?

Please share your thoughts and experiences with us at the URL below!

<http://www.therevenuegame.com/ceochallenge/10/due-diligence/>



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