

PO BOX 655  
 1 EAST STATE ST  
 SHARON, PA 16146

(724) 346-0150

# The Business Value Manager

## EXIT PLANNING

### EXTERNAL THREATS: RECOGNIZE WHEN YOUR ABILITY TO COMPETE IS DECLINING

*Advice  
 for business  
 owners,  
 investors and  
 service providers  
 on how to build  
 value and wealth  
 through  
 investment in  
 closely held  
 companies.*

Executive Summary—Page 2

Creating operational and financial success in a private company has always been a challenge. In today's shrinking world, with growing international competition, continual technological change, and ever-growing regulations, factors outside your business threaten its existence more than ever. Therefore, it's critical for private company owners to recognize when their competitive advantages are declining and the effect of this trend on the survival of their business.

This edition of *The Business Value Manager* identifies external threats – those generally beyond the control of the private company owner – that present special challenges and risks to your success.

#### EXTERNAL THREATS

The following is a list of ten critical, external threats, one or more of which threaten almost every middle market company:

- **Consolidation** – the presence of continued industry consolidation that steadily rewards larger size and capabilities, economies of scale, broader product lines, or deeper management. Industries ranging from financial services to cement, distribution, waste management, and retail sales continually experience these pressures
- **Advertising power** – the continued growth of national franchises that possess huge marketing and advertising capabilities and advantages. For example, while Staples or Office Max may not have a better selection or lower prices than their

independent competitors, their national advertising gives them the ability to continually tell customers that they are better. Auto Zone, Pep Boys and Napa all follow the same process in auto parts.

- **Technological advantages** – the emergence of technological advances that make processes, services, or products easier and cheaper to deliver and, which in the process, diminish customers' current need for their private company supplier. Advances in furniture and building manufacturing versus custom construction, and in the manufacture and delivery of processed foods, create new choices for customers and more threats to private company owners with traditional construction or production methods.

- **Cost advantages** – the continued advancement in product offerings and product quality by lower cost competitors in lesser-developed countries. U.S. manufacturing continues its long-term decline as

international manufacturers produce improving products with cheaper labor. Software development, data processing and similar technical services are also out-

*"...while Staples or Office Max may not have a better selection or lower prices than their independent competitors, their national advertising gives them the ability to continually tell customers that they are better."*

*(Continued on page 2)*



(Continued from page 1)

sourced overseas, often at night, for use the following business day.

- **Bundling** – increasing growth in the practice of “bundling” by larger companies who include key components that are also produced by private companies into a broader product offering to achieve pricing and marketing advantages over their single product competitors. Microsoft’s efforts to do this with Internet search engines led to court challenges and prohibitions. Other global companies routinely do this in markets where they have a dominant position, such as General Electric in the railroad supply industry. Offering a broader array of linked products and services is also a standard strategy in the financial services industry.
- **Barriers to entry** - the presence of technological advancements that continually raise the capital, personnel, or compliance costs to compete effectively in an industry. UPS and Federal Express have pursued strategies in logistics and global package delivery that require world-class logistical expertise and billions in capital investment to compete. As a result, they now dominate this market. Similarly, much higher compliance costs and regulatory threats are forcing continual change in the way public accounting, investment banking and brokerage services are delivered, leaving smaller firms increasingly less able to compete in complex areas.
- **Channels to market** – the emergence of new and more effective channels to market that limit or eliminate the private company’s ability to both present and differentiate products and services. The growth of Lowe’s and Home Depot and their home center merchandising concepts have not only hurt other retailers. Many manufacturers who relied on specialty channels to take their product to market saw these routes disappear as consumers opted to buy through home centers. The policies of

“...the emergence of new and more effective channels to market limit or eliminate the private company’s ability to both present and differentiate products and services.”

the big box retailers to offer a more limited range of choices – one each in the low, medium and high price ranges – create added challenges for the independent to clearly distinguish the benefits of their offerings. Independent brewers have experienced similar difficulties. While they may have attractive and interesting products, the most popular taverns and restaurants typically have agreements with Budweiser, Miller, or Coors that limit the independents’ offerings through these outlets. Similarly, while an independent tool manufacturer may have a superior product or a lower cost, the private company can almost never compete successfully against the distribution systems of Black & Decker or Stanley. Their broad product lines are offered in almost every discount chain and they can add a product to that line at almost no incremental cost.

- **Distribution control** – the influence and presence of national companies in retail outlets to achieve optimum exposure. For example, Kraft, Kellogg’s, Frito Lay, Coke and Pepsi constantly monitor grocery and convenience stores to insure that they receive premium store shelf spacing and aisle end-caps for optimum exposure. Independents who generally have narrow product lines lack this reach or influence with the retail channel to customers.
- **Vendor screening** – the continual desire by large corporate partners whose source of supply or channel to market is private companies to have fewer vendors or distributors who possess greater capabilities. Many independents who produced components for the auto industry were forced to sell out or otherwise team up with larger suppliers to even get access to the major auto manufacturers. The major oil companies and brewers are forcing

“While private companies may be able to develop a narrow brand or build a brand in a limited geographic market, they typically lack the capital and expertise to extend it beyond that.”

## EXECUTIVE SUMMARY

Successfully harvesting private company wealth requires owners to understand their ability to compete. External threats continually emerge from larger companies.

For private company owners, the critical steps to success are:

- ◆ Recognize the threats your company will encounter.
- ◆ When possible, build competitive barriers to protect your space.
- ◆ When your competitive position begins to decline, get out before your value is destroyed.

## Five Critical Strategic Questions Private Company Owners Should Annually Ask

1. What key product, service, process, technology or intellectual property do we have that others cannot easily duplicate?
2. What cost advantages do we possess that competitors cannot easily match?
3. What customer knowledge or contacts do we possess that competitors could not easily acquire?
4. What market niche or space do we occupy that is unattractive to competitors or would be difficult for them to enter?
5. What license, patent or similar regulatory barrier do we possess that should protect our market position for the foreseeable future?

(Continued from page 2)

the same consolidation in their private company distribution channels.

- **Branding** – the growing importance of brands to attract and retain customers and the need for huge annual expenditures to build and maintain the brand identity and quality. Global food and consumer products companies routinely make multi-million dollar investments to introduce a new brand and recognize that continual annual reinvestments are essential to maintain broad product awareness and appeal. While private companies may be able to develop a narrow brand or build a brand in a limited geographic market, they typically lack the capital and expertise to extend it beyond that.

*“ Most private companies tend to focus less on introducing and promoting their product or service to customers and typically fail to recognize the significant expertise required for success in these activities.”*

vate company’s ability to create or maintain barriers to competitors begins to decline, owners must brutally assess their future prospects. Too often, entrepreneurs think with their hearts rather than their minds and pursue strategies that are no longer viable. Or they choose to delay, do nothing and hope challenges will go away.

Constant change in business practices and conditions is a certainty and those who fail to recognize this will eventually perish, with most or all of their private company wealth sacrificed in the process. When the external threats that have been described create circumstances that no longer allow your independent company to compete, you should seek exit strategies to protect your wealth and then seek alternative investments that offer safer, more liquid returns.

Should this daunting list of challenges mean every private company owner should put their company up for sale and get out? Actually, many will eventually have to. And some should begin the process immediately to preserve the wealth they have created in their company before it is further diminished by these forces. For others, the key is to recognize when these forces will seriously erode your returns so that you can plan your exit before this occurs.

**BUILD YOUR STRATEGIC ADVANTAGES**

Stronger private companies, including those with better management or unique circumstances, will survive and even thrive, in spite of these forces. The key, in most cases, is **differentiation**. This entails creating or maintaining strategic advantages or other barriers that enable you to compete more effectively than larger players in the market. Such advantages include possessing specialized knowledge of customer needs or capabilities to fulfill those needs, the benefits of a unique location, or cost advantages from lower overhead.

Creation of barriers to entry is a key strategy in differentiation. Whether it’s a process or technology that is difficult to replicate, a regulatory barrier such as a patent or a license, or a unique image or brand, the secret is to create and maintain separation from your competition that enables you to maintain your market presence, customers, and pricing. Every private company owner should continually ask, “What is it that we have or do that is most difficult or unique, and which prevents others from capturing our market?”

**ANNUAL STRATEGIC PLANNING IS A MUST**

Private company owners must continually monitor their competitive position. This should be done through annual strategic planning where they assess their company’s differentiation and ability to compete in the long-term. When the pri-

**FIRST STEPS**

To manage your business as an investment and take control of your life:

- Retain qualified valuation advisors to lead the process.
- Identify and prioritize your personal and financial goals.
- Quantify
  - Your company’s return
  - Your company’s risk
  - Your company’s worth
  - Your company’s return on investment

**RESULT:**

Armed with the information, you can devise the best strategy to achieve your business, personal and financial goals.

Index of Recent Issues of *THE BUSINESS VALUE MANAGER*

- “Succession Blues”
- “Six Keys to Private Company Payoff”
- “Why 10% of a Private Company is Worth Less Than 10%”
- “Is Your Company Building Wealth?—12 Value Metrics”
- “Is Your Shareholder Agreement a Time Bomb?”
- “Transfer Wealth at Discounted Values”
- “SPECIAL REPORT: Sarbanes Oxley”
- “Protecting Your Private Company Wealth from the Government”
- “Critical Issues Every Private Company Owner Must Address”

To order back copies, please contact us at [csurano@smithevanscarrier.com](mailto:csurano@smithevanscarrier.com)

***Reproduction is prohibited without permission.***

## EVANS AND ASSOCIATES

VALUATION ADVISORY SERVICES

P.O. Box 655  
One East State Street  
Sharon, PA 16146

Phone: 724-346-0150

Fax: 724-342-4510

fevans@evansandassociates.net



Frank C. Evans  
ASA, CBA, CPA/ABV  
fevans@evansandassociates.net

Visit us on the Web!  
[www.evansandassociates.net](http://www.evansandassociates.net)

### Our Mission

Evans and Associates is a leading provider of strategic valuation advisory services. We maximize wealth and profits for individuals and corporations.

When your circumstances require measurement or management of business value, our focused approach provides solutions.

Our team's expertise in competitive analysis, finance and accounting, merger and acquisition, risk analysis and value creation forms the basis for our opinions and advice.

Typical engagements for Evans and Associates include specialized valuation consultation for the purpose of gift or estate planning, merger and acquisition, shareholder value enhancement and litigation support.

#### Evans and Associates Partner Credentials Include:

Accredited Senior Appraiser  
Certified Business Appraiser  
Certified Public Accountant Accredited in Business Valuation

### Personal Attention Backed by a Network of National Resources

Evans and Associates is a specialized valuation advisory firm small enough to provide the personal attention you want, but deep enough to possess the broad range of service expertise you may need. Our membership in the American Business Appraisers (ABA) national network— we were the founding affiliate member—provides resources and advice from other nationally known valuation experts. Our ABA affiliation enables us to effectively execute virtually any valuation or merger and acquisition assignment.

