

Should I Shrink or Grow My Company?

By Ed McCormick, SCORE

Most businesses today feel like they're stuck – shrinking revenue, compressed margins or simply an inability to increase sales. These are all signs of mature industries. The owner is faced with some critical decisions, especially if they plan to exit the business in the next few years.

Over 40% of all small to mid-size businesses are owned by “baby-boomers” and many of these individuals are, or will be, considering retirement in the next two to three years. Now is the time to think about an Exit Strategy. Maintaining the status-quo isn't a strategy. Therefore, you have two choices – shrink the business, try to improve profitability on static or lower sales volume or grow the business...easier said than done. But it is possible. Let's look at both options.

Shrink Strategy

The most common approach to improving earnings is “shrinking” the business or cutting back on expenses. It may also involve the elimination of unprofitable product-service segments, allowing one to concentrate on those areas that represent the highest profit potential.

Cutting expenses may improve earnings so long as revenue remains constant or you shed unprofitable sales segments. In either case, the business may not present itself favorably to the market. While this strategy may free up cash that translates to bottom line profits, buyers may view this situation as a company in retreat and offer prices far below asking price.

Some shrinking strategies lead to growth. For example, a company that is successful at reducing its variable costs (costs that only occur when a sale is made – materials, production, delivery etc.) may find itself in a position of becoming a “low cost producer.” This means that you are able to reduce price without sacrificing margin. Being the low cost producer means that you can still make money at a price where the competitors begin losing money. With proper marketing, this company could be positioned to grow at the expense of their competitors. Buyers would view this situation very favorably and may pay a premium price due to the likelihood of future growth.

Growth Strategy

Growing a mature business isn't easy but there are proven strategies that can be successfully employed and it may ultimately increase the value of your company.

Growth strategies can be internal or external. It begins with a commitment from the top and the selection and execution of the appropriate strategy. Samples of internal growth strategies for mature industries include:

- **Product – Service Line Extension**
- **Value Based Pricing Strategies**
- **Marketing Innovation**
- **Experiential Innovation**

External growth strategies might include:

- **Merger – Acquisition** (line extension strategy)

- **Joint Venture**
- **Strategic Partnerships**

All new strategies take time and commitment but many do not require a great deal of expense. To improve the sale-able value of the company, you will need to have the strategy take traction such that a growing financial trend can be seen by a buyer. This timeframe might be as long as three years and as little as 6 to 8 months.

Buyers, as well as lenders, will require that the strategic turnaround is real. Therefore, buyers and lenders will insist that the new strategy can show several months of increasing trends. Lenders have specific loan underwriting guidelines, when it comes to business sales. These may require the new growth strategy be in place long enough to demonstrate two successive years of “cash flow available to repay the buyer’s proposed acquisition loan” (typically 70% to 80% of the price agreed upon). This requirement alone could force you to hold on to the business for another year beyond your plan. The upside, however; is the premium price you’ll realize when you sell!