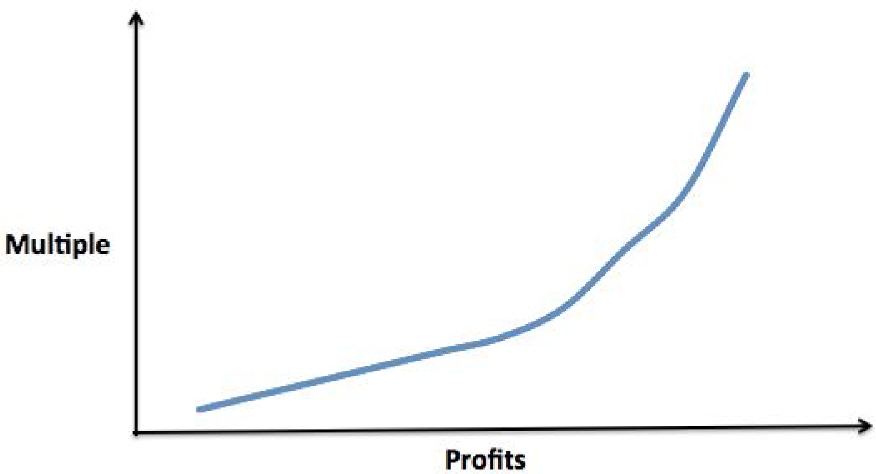
Maximising the Value of a Recruitment Business

At some stage all business owners wonder about value. Some are focused on this from a very early stage, whilst the majority just run and build their business, assuming that this will automatically build value. This however is not always the case and this White Paper aims to give guidance on how owners can maximise the value of their business.

Recruitment businesses are valued based on a multiple of profits, with adjustments made for cash, debt and working capital. Valuation methodology has been addressed earlier in this series and I do not intend to repeat it here; I will mostly focus on the factors which adjust the multiple.

In general terms, size matters and larger businesses are more valuable than their smaller counterparts. This is primarily due to risk and the fact that a larger business is more resilient to the loss of a key client or a senior team member than a small business. **Valuation correlates inversely with risk**.



However, two businesses with the same profit figure will not necessarily have the same valuation. Some examples:

Company A	Company B
Healthy spread of clients	Largest client represents 70% of the business
Strong team of billers	One superstar biller, several under-performers
Steady profit growth	Declining profits

So what can an owner do to maximise the value of their business?

There are a wide range of aspects of any business which can impact valuation, both in a positive and a negative sense. I address below many common factors, but this should not be regarded as an exhaustive list. Every business has its own unique set of circumstances.

1. Brand / Specialism

A specialist business will be more valuable than a generalist. Having expertise in your field, being a known name within that particular discipline and building awareness of your brand within your market will raise your profile with clients, candidates and potential employees. This becomes a virtuous circle, making it easier to build the business. Acquirers will value that specialism and will see logic in becoming a recognised player in new market which may be complementary to their existing business or may have scope for an international rollout. A business operating across several different markets with no particular specialism simply doesn't offer an acquirer the same opportunity.

2. Client Spread

A healthy client spread with no over-reliance on any individual clients is crucial. If a large client offers more opportunity it can be hard to resist, especially in the early stages of building a business. I am not necessarily suggesting that business should be turned away, but owners must be aware of the impact of over-reliance. Not only does it impact on valuation but it places the business itself in a position of risk and could give that client undue levels of influence in negotiations.

3. Pricing

Markets are competitive and margin pressure is a common theme, particularly where RPOs are involved. To demonstrate the quality and sustainability of your business it is important to be able to show that your services are valued and that you can maintain strong margins. Commoditised, low margin businesses have limited value. Equally, a business which is charging significantly higher margins than its peers will be regarded as unsustainable, despite generating good profits in the short term.

4. Compliance

Whilst running a compliant business may not necessarily enhance value, running a non-compliant business would definitely destroy value. Compliance covers a variety of areas and will vary from business to business, but may include matters such as:

- Tax – all areas including VAT, PAYE and international considerations if appropriate
- AWR
- Pensions
- Use of Umbrella / payroll solutions
- Candidate referencing and vetting
- Meeting specific client requirements

5. Second Tier Management

When owners sell their business, acquirers are usually keen to know that the remaining team is capable of continuing to run the business on a day to day basis, although this can vary depending on the structure of the acquirer. Nevertheless, value is preserved in a business if there is continuity of management who are hungry to drive the business forward. Ideally more than one key person, both in terms of billing and management, would be present to mitigate risk.

6. No Dependence upon Owners

Following on from the point about the quality of second tier management, a business which is dependent upon the owners has limited value. The most common manifestation of this is owners who remain active billers and hold key client relationships. Acquirers regard this as highly risky as the elimination of a personal relationship with a client could lead to a loss of business. Owners should do everything possible to make themselves redundant on a day to day basis.

7. Delivered Profits

Having an established profits record is appealing. It is not unusual for owners of private companies to legitimately minimise tax liabilities by managing their profit levels, but this can impact on valuation. It can be hard to convince an acquirer that profits have been understated, so it will help a sale to show delivered profits, even if this means paying tax.

8. Profit Trend

It is crucial to be able to demonstrate increasing profits. This may require an element of planning. If a timescale is agreed for looking to sell a business, the profit trend can to some extend be managed to ensure that a graph has a nice, steady upwards trend and scope for that pattern to continue. Acquirers want to know that they are not buying at the top of the market, both in macro terms of the wider economy and in micro terms related to the specific business. Don't fall into the trap though of claiming that the business is poised for substantial growth the year following sale – acquirers hear that too often and you might be told to come back when those profits have been delivered.

9. International Expansion

This is by no means a pre-requisite, but demonstrating that the business is scalable by establishing a profitable overseas office will add value and will demonstrate the capability of management. If an acquirer can see that the business can be established one overseas location, they will sense that there is a wider expansion opportunity. A word of caution though – international expansion is not for everyone and can prove very costly and distracting, so ensure you have a well-researched strategy and sufficient knowledge before embarking on such a strategy.

10. Choose the Right Advisors

When the time comes to sell, having credible advisors with sector experience will pay dividends. You will need corporate finance, legal and tax advice and each of these advisors should bring considerably more value to the deal than their costs. Advice will include:

- Timing a transaction
- Who to approach
- Who not to approach
- Deal structuring
- Suitable legal protections
- Minimising exposure to claims following the sale
- Maximising tax benefits

A business which addresses most if not all of these areas is likely to prove an attractive acquisition target and should as a result be able to command a health valuation in relation to its peers.

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