Grow or Sell Your Information Technology Company

A Crossroads Decision

By Dave Kauppi, President, MidMarket Capital, Inc

Thinking of taking your information technology company to the next level with a major marketing campaign or by hiring additional sales resources? These are decisions that can impact your company's future. It might be time to consider the alternative of selling your business.

We are often approached by software company or information technology business owners at a crossroads of taking the company to the next level. The decision in most cases is whether they should bring on the one or two hot shot sales people or channel development people necessary to bring the company sales to a level that will allow the company to reach critical mass. For a smaller company with sales below $5 million this can be a critical decision.

For frame of reference, prior to embarking on my merger and acquisition advisor career, I spent my prior 20 years in various sales capacities in primarily information technology and computer industry related companies from bag carrying salesman to district, regional, to national sales manager and finally Chief Marketing Officer. So when I look at a company, it is from the sales and marketing perspective first and foremost. I am sure that if I had a public accounting background, I would look at my clients through those lenses.

So with that backdrop, let's look at what might be a typical situation. The software company is doing $7.5 million in sales, has a good group of loyal customers, produces a nice income for its owner or owners, and has a lot more potential for sales growth in the opinion of the owner. Some light bulb has been lit that suggests that they need to step this up to the next level after relying on word of mouth and the passion and energy of the owner to get to this stage.

I have spoken with more than 50, primarily technology based companies over the years that have faced this exact situation and can count on one hand the ones that had a successful outcome. The natural inclination is to bite the bullet and bring on that expensive resource and hope your staff can keep up with the big influx of orders. The reality is that in most cases the execution was a very expensive failure. Below are several factors that you should consider when you are at this crossroads:

1. The 80 20 rule of salesmen. You know this one. 80% of sales are produced by 20% of the salespeople. If you are only hiring one or two, the likelihood is that you will not get a top performer.
2. The president of the company and decision maker has no sales background so the odds of him making the right hiring decision are greatly diminished. He will

not understand how to properly set milestones, judge progress, evaluate performance objectively, or coach the new hire.

3. To hire a good salesman that can handle a complex sale requires a base salary and a draw for at least 6 months that puts him in a better economic condition than he was in on his last job. So you are probably looking at $150,000 annual run rate for a decent candidate.
4. If you have not had a formalized sales effort before, you are probably lacking the sales infrastructure that your new hire is used to. Proper contact management systems, customer and prospect databases, developed collateral materials and sales presentations, sales cycle timeframes and critical milestones and developed competition feature benefit matrixes will need to be developed.
5. Current customers are most likely the early adapters, risk takers, pioneers, etc. and are not afraid of making the buying decision with a small more risky company. These early adaptors, however, are not viewed as good references for the more conservative majority that needs the security of a big company backing their product selection decision.
6. Your new hire is most likely someone that came from a bigger information technology company and may be comfortable performing in an established sales department. It is the rare salesman that can transform from that environment to developing the environment while trying to meet a sales quota. Throw on top of that the objection that he has never had to deal with before, the small company risk factor, and the odds of success diminish. Finally, this transformation from a core group of early adapters to now selling to the conservative majority elongates the sales cycle by 25% to as much as double his prior experience. If you don't fire him first, he will probably quit when his draw runs out.

With all this going against the business owner, most of them go ahead and make the hire and then I hear something like this, "Yes, we brought on a sales guy two years ago who said he had all the industry contacts and in nine months after he hadn't sold a thing and cost us a lot of money, we fired him. That really hurt the company and we have just now recovered. We won't do that again."

What are the alternatives? Certainly strategic alliances, channel partnerships, value added resellers are options, but again the success rate for these arrangements are suspect without the sales background in the executive suite. A lower risk approach is to outsource your VP of Sales or Chief Marketing Officer function. There are a number of highly experienced and talented free lancers that you can hire on a consulting basis that can help you establish a sales and marketing infrastructure and guide you through the staffing process. That may be the best way to go.

An option that one of our clients chose when faced with the six points to consider from above was to sell his company. This is a very difficult decision for an entrepreneur who by nature is very optimistic about the future and feels like he can clear any hurdle. This client had no sales background but was a very smart subject matter expert with an outstanding background as a former consultant with a Big 5 accounting firm. He did not make the hiring mistake, but instead went the outsourcing of VP of Sales function as step 1. When their firm wanted to make the transition from the early adapters to the conservative majority, the sales cycle slowed to a crawl. Meanwhile their technology advantage was being eroded by a well funded venture backed competitor that had struck an alliance with a big vendor.

They engaged our firm to find them a buyer, but then we encountered the valuation gap. Our business seller thought his company was worth a great deal and that he should be paid with cash at close for all the future potential his product could deliver. The buyer, on the other hand, wanted to pay based on a trailing twelve months historical perspective and if anything was paid for potential, that would be in the form of an earn out based on post acquisition sales performance.

With a well structured earn out agreement and the right buyer, our client will reach his transaction value goals. His earn out is based on future sales, but his effective sales force has been increased from one (himself) to 27 reps. His install base has been increased from 14 to 800. Every one of the buyer's current customers is a candidate for this product. The small company risk has been removed going from a little known start-up with $3.5 million in revenues to a well known industry player, publicly traded stock with a market cap of $2.5 billion.

He avoided the big cash drain that a bad sales person hiring decision would have created and he sold his company before a competitor dominated the market and made his technology irrelevant and of minimal value.

My professional contacts sometimes tease me and suggest that I think every company should be sold. That may be a slight exaggeration, but in many instances, a company sale is the best route. When a information technology business owner is faced with that crossroads decision of bringing on a significant sales resource that will be faced with a complex sale and the executive suite does not have the sales background, a company sale may be the best outcome.

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