The Biggest Obstacles to Selling a Recruitment Business

There is increased activity in the M&A market which is prompting recruitment owners to think about their plans for selling their business. Many people feel that the right time to sell will be in 2-3 years' time. This might be for a variety of reasons, including:

- Expectation that the market will improve over the coming years
- Expectation that the business will be more profitable by then
- A sense that the business isn't quite ready to be sold yet

The final point is the topic addressed in this paper – the biggest obstacles to selling a recruitment business. We will concentrate only on business-specific issues which owners can influence and we will make no reference to external factors such as market conditions.

It is rare that a business is ideally positioned for sale by chance, so value can be lost if suitable preparations are not made. In more extreme cases, a business might not be saleable at all. Set out below are what we consider to be the biggest obstacles:

Dependence upon the Owner

Perhaps the biggest challenge for a small business owner is ensuring that that the business isn't dependent upon him or her. Relinquishing control may feel unnatural or uncomfortable, but failure to do so will destroy value and will make a potential acquirer very nervous about the sustainability of the business.
Owners often claim to play a very limited day to day role in the business, but in reality their business could not survive without them. This reliance can take a number of forms:

- Key client relationships
- High billing
- Winning new business
- Hands-on management of staff

If one or more of these apply, the business will have a weakness which will impact on its value. Action needs to be taken to distance the owner from these key areas in the business by empowering the team through delegation and training. It would be entirely sensible for an owner to do this gradually and to monitor performance, recognising that this is a gradual process.

A good practical test for an owner is to assess the strength of the senior team and determine how impressive they would look to a potential acquirer. If there appear to be weaknesses, they should be addressed before commencing the sale process.

Non-Compliance

Whilst this might not apply to all businesses, any form of non-compliance may render a business unsaleable. Examples of potential areas of non-compliance include (but are not limited to):

- Agency Worker Regulations
- an umbrella company's use of travel and subsistence schemes

- candidate credentialing
- VAT legislation
- compliance with a regulatory body (eg the GLA)
- tax deductions for international contractors

An acquirer could be immediately scared off if their initial due diligence identifies that the business is not operating strictly within its relevant rules and regulatory framework.

Owner managed businesses are generally (but not always) less stringent in relation to compliance than larger, more structured competitors. In order to prepare a business for sale, professionalising operations and making procedures more corporate is a good discipline.

Although time consuming and painful, this process can truly add value to a business by making it suitable for acquisition by a corporate acquirer which requires certain standards to be met. Compliance will be reflected in the quality of the acquirer and the price they are willing to pay.

Range of Generalist Services

Remaining focused on a particular market is important; niche or specialist businesses are definitely more valuable than generalists. By way of extension, a business which operates in a wide range of markets without enjoying a strong position in any of them may make profit, but won't necessarily be an attractive acquisition target.

If a hypothetical business operated in the banking, nursing and driving markets, the chances of identifying a selection of acquirers which services each of the areas of operation is slim, whereas a business of the same size operating in any of those markets would be able to approach a selection of potential acquirers with which they would fit.

Trying to split a business and sell it in different parts is likely to destroy value and add significant complexity and cost.

Greatest value will be achieved by remaining focused on a single market or if diversifying into other markets, by ensuring that the selected markets are complementary and potential acquirers also operate in the same markets.

Unrealistic Valuation Expectations

Valuation is a crucial aspect of selling a business. If the owners have been advised that their business is worth say £2m whereas a more realistic valuation is £1.5m, it is unlikely that a satisfactory deal could be completed. The owners will feel disappointed with an offer of anything around £1.5m so a genuine acquirer will always struggle to complete a sensible acquisition.

There is no simple guideline on valuation as many factors can influence a business valuation, including external market conditions. Owners would be well advised not to be flattered by high valuations, but to ask for evidence of comparative deals to assess the reality of advice before setting their expectations and appointing advisors.

It is crucial to appreciate that debt will be deducted in arriving at the value of a recruitment business. Debt includes Factoring and Invoice Discounting borrowings and failure to take this into account when assessing value can lead to a nasty surprise.

Greed

It might be tempting to try to squeeze every last penny out of an acquirer, but that can kill a deal. An acquirer needs to know how they will make a return on their investment, so a business with increasing profits will be attractive. Vendors should ensure the acquirer can see immediate growth opportunities, ideally leaving both parties feeling that the deal is fair and well-priced. There are many areas of negotiation in a deal and pushing too hard on price is likely to result in tougher negotiations in other areas.

Bear in mind also that rarely is 100% of consideration paid on the day of completion, so if the spirit in which the deal has been negotiated and conducted is amicable, there is less prospect of having a battle to secure any deferred or earnout consideration than if the acquirer feels “beaten up” by the process.

As a final point we would recommend that anyone looking to sell their business appoints experienced professional advisors to help them navigate this complex area. Good advisors more than cover the cost of their fees in the value they deliver in the deal.

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