

# Unpacking the Elements of a Well-Structured Company



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Gábor Szendrői, from IMAP Hungary, outlines why owners of well-structured companies are not only better positioned to maximize the value of their company as an asset but will also have more options when deciding their future.

Based on our IMAP transaction experience, many smaller local companies unfortunately don't realize until it's too late, usually right before they sell, that a lack of operational structure decreases the company's value. Similarly, company founders or business owners who decide to retire and subsequently try to involve an independent executive in running the company, realize that too much knowledge of the company's operations is stored inside their own head. So much so, that it's impossible to pass onto someone who hasn't spent the same amount of time facing the same set of issues, in a similar position. In each of these cases, "the corporate structure" is missing.

## Determining What Constitutes a Structured Company

In terms of their level of operational structuring, companies can be categorized into 2 different types: poorly or under-structured companies and well-organized or well-structured companies.

Poorly structured companies are characterized by the fact that the company is organized solely around the

founder-owner-executive, who essentially acts as a one-man band. Their opinion is sought on everything and they are almost always the decision maker; having knowledge on everything and if an issue arises, they will be involved in the solution. Maintaining relationships with client decision makers, customers subsequently call them directly with questions.

The concept of a well-structured company is that the top manager only decides on the most important issues, whilst there is a structure below them, with the ability, skill and most importantly, power, to make key decisions within their own area of competence, including whether or not to request help from their superiors.

## Essential Characteristics of a Well-structured Company

We have developed the 6 key elements of a well-structured company, based on the *Family Firms and their Governance - Creating Tomorrow's Company from Today's* case study by Sir Adrian Cadbury, published by Egon Zehnder, on Cadbury, the UK-based chocolate company, as well as our practical experience working

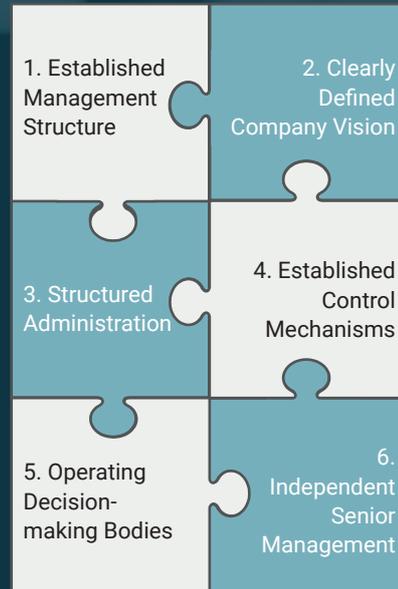
## ELEMENTS THAT DIFFERENTIATE AN UNDER-STRUCTURED COMPANY FROM A WELL-STRUCTURED ONE



Company organized around the founder-owner-executive with everything decided inside the owner's head



VS.



closely with hundreds of large local mid-sized companies.

### **1. Established Management Structure, i.e. Middle Management**

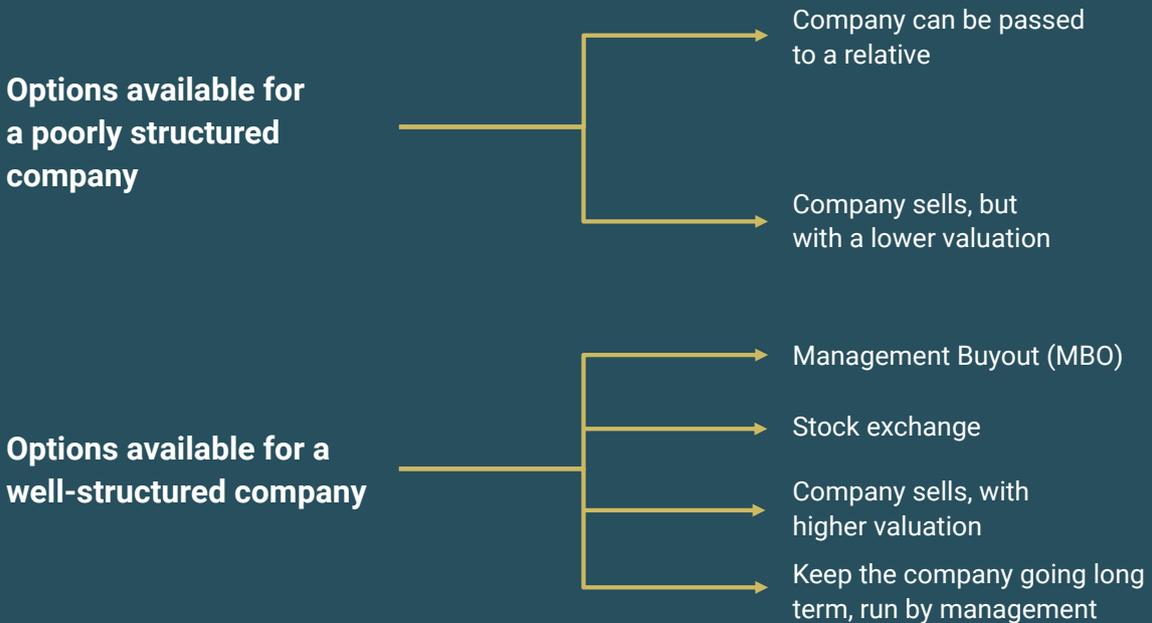
In many local medium-sized companies, the owner holds the most important customer relationships and also looks for new clients. Though there is some form of plant manager, the owner is still consulted, even for the tiniest details during the manufacturing process. Likewise, finances are handled by a family member, who often has no specialized education. There is no authorized executive team, looking to achieve optimum corporate performance, with the authority to make decisions, even in only a small, well-defined remit. Such leadership teams cost money; through analysis, we have shown that a full management team (4-5 people) in a local mid-sized company incurs a cost of at least EUR 1 million, including a CEO (depending on the jurisdiction). Therefore, this is a large cost saving, for someone not

incorporating this level of management structure into the company. However, this leads to two issues as a result: firstly, the current person/manager takes on much more work and responsibility necessary due to the lack of middle management, and secondly, whoever takes over the company would need to do the same or incur extensive additional costs by establishing their own middle management team.

### **2. Clearly Defined Company Vision**

Many local companies lack a clearly defined company strategy. There is no well thought out 2-3-year business plan which management follows, formally defined projects, project descriptions for selected projects or project postmortems at closure. As such, many things are done ad-hoc, driven by current events and with little formalization. This may be perfectly in line with the operating model used by companies with old business habits; however, this practice is not conducive to businesses looking to sell.

WHAT ARE THE MAIN BENEFITS OF A WELL-STRUCTURED COMPANY?



**3. Structured Administration**

For many of our clients, we see that financial administration only means complying with accounting laws, i.e. there are no control systems, or management reports. In many cases, financial audit processes are endlessly simplified providing legal compliance only and do not serve to ensure that the owner is confident that his or her company is operating properly. This practice only works as long as all the other details are carefully stored in the business owner’s executive head and if no serious due diligence has been carried out. However, it is unsustainable the moment the ownership and management roles are separated, and the company goes up for sale. In this case, we often see that practices that do not comply with the latest legislation are discovered and the budget, energy and time required to implement a structured administration is not always available.

**4. Established Control Mechanisms**

Very few domestic medium and large companies have processes in place for systematic business risk analysis. Hardly any systematically follow their competitors, analyzing the concentration of their customer portfolio or their suppliers. Likewise, only a

small number systematically use different methods of financial risk management.

**5. Operating Decision-making Bodies**

There is hardly any domestic medium or large enterprise that we know of, that has some form of corporate governance - whereby the owner is supported by a consultative body, a supervisory board or a board of directors. Where we have found this to be the case, the owner greatly appreciates having an external party involved in making decisions, ensuring that the opinions, experience and knowledge of others further contribute to the success of their business.

**6. Independent Senior Management**

The most significant indicator of a company being well-structured, is its successful appointment of a long-term independent executive, who runs the company under independent management. According to the puzzle (on p.9), the 6 levels are interconnected; however, we believe that there is also a timetable for structuring that is determined by order. In our experience, no independent executive can be appointed nor function, unless the first 5 elements have been adequately resolved.

## IMAP CREATING VALUE

### THE VALUE OF WELL-STRUCTURED COMPANIES

Choosing the right independent senior manager takes time and money and there isn't a recipe for success. That being said, we have observed some best practices in this space. While entrepreneurs don't necessarily like talking to advisors, this is a point in time for the company, when we would highly recommend they do so, not only in order to identify the best candidates, but also to integrate them successfully into the company's operations. While this isn't a service normally provided by investment banks such as ourselves, we recently cooperated with one of our clients in such a process. The client needed a CEO and we just so happened to know a good CEO who was looking for a new role, so we recommended him. The company owner, together with the new CEO, retained an HR consultant who, in the space of 3 months, worked with them on the integration process. This onboarding effort was essential and ensured the CEO remains with the company today.

Obviously, one of the reasons why entrepreneurs dislike the idea of recruiting a CEO is that it increases operating costs. However, if the entrepreneur doesn't receive a market-like compensation package, i.e. the compensation is in the form of entrepreneurial dividend, yet part of this is considered a salary for the role, then rather than seeing this as an additional cost, it should be seen as merely paying someone else.

#### The Value of a Well-structured Company for Business Owners

We see two main values, which are, of course, related but relevant in different life situations of well-structured companies. On the one hand, based on our own transaction experiences and those of our IMAP partners, we see that higher company valuations can be achieved in such cases. This is important not only for those looking to sell their company, but also for business owners seeking to maximize the value of their company as an asset.

If a business owner decides to sell, it is without a doubt, much easier to sell a well-structured company. Such companies will appeal to a much wider range of investors and when faced with competition, are more likely to achieve a better valuation.

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On the other hand, it provides owners significantly more options when it comes to deciding the future of their company. In our experience, owners of poorly structured companies have only 2 options for transferring their business; either selling it cheaply or trying to pass it onto their children/relatives, which will either succeed, or potentially fail.

However, for well-structured companies, there are several options for transferring the business. It can be transferred in a managed manner to a descendant who either enters into a management position or manages the company under independent management. In the case of a company with established management, the management buy-out (MBO) option opens; that is, existing management is in many cases able to buy companies from the owner using a variety of financing alternatives. In 2019, IMAP Hungary managed 2 MBO projects in Hungary. For larger companies, a well-established structure is the key to getting listed, which can be an interesting option, that allows for a partial exit for a business owner.

In conclusion, it is our experience, that if a business owner decides to sell, it is without a doubt, much easier to sell a well-structured company. Such companies will appeal to a much wider range of investors and when faced with competition, are more likely to achieve a better valuation, compared to a poorly structured company. ■

