FINANCIAL POST

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Shutter or sell? How SMBs should deal with non-core operations

Brad Cherniak | April 10, 2015 2:06 PM ET

Scott Olson/Getty Images files *Smaller, privately held businesses tend to have unique characteristics and limitations that make selling non-core operations trickier and riskier than for large corporations.*

Lately, reading the financial press, you see it all the time, large corporations parcelling off parts of their business holdings that are no longer core — or no longer in vogue with their major investors. Conglomerates are out, focus is in. Pure plays, or at least strategically focused plays, are more highly valued than hodge-podges of different businesses.

It is common for private, medium-sized companies, like their larger brethren, to have lines of business, divisions or subsidiaries that are non-core.

These pieces may have come into existence for a plethora of reasons, including: An experiment by the business owner, dabbling with an intriguing idea or opportunity because they have the spare time and resources; part of an acquisition; an opportunity that arose at the behest of a core client and was taken on to keep their good favour.

Such divisions can also become non-core through a change in corporate strategy; resource constraints (including cash, management attention, or even physical space); changes in market conditions or technology; or the loss of key employees.

Do smaller private companies have the same opportunity as large corporations to trim down opportunistically? And what are the unique risks and opportunities for them? This comes down to whether the non-core operation can be sold for fair value without risking the core business. If not, it should either be maintained or shut down.

Following are some of the major considerations that will determine which is the case:

Shared resources Resources such as staff and equipment are a critical consideration for a smaller business considering selling a non-core division. Large corporations tend to have much deeper benches and can more easily reassign personnel without putting the core at risk. You'll need to decide whether you are willing to do without the staff dedicated to the non-core business in your core business.

However, if you are serious about divesting the non-core business as a going concern with its own real growth potential, and not assets sold for liquidation value, you will need to assemble at least the nucleus of a dedicated team, with sufficient critical operating resources exclusively devoted to that business.

It is possible to sell the business with a contract to continue to provide the buyer with services such as finance, purchasing, IT, customer service and others, for a set fee.

If that is the case, you will need good accounting and financial systems to make the proper allotments in order to manage this properly, and not confuse the financial results of your core business. You will also need to convince the buyer you have the capability and desire to make providing those services a priority, and not just doing them when and if your staff has the time.

Outsourcing takes commitment, organization and process-dedication on the part of the provider, and shouldn't be offered lightly.

Realizable value Will the effort of packaging and selling the non-core operation be worth it?

Business valuations ranked by company size are not linear — larger companies tend to enjoy significantly higher multiples of sales or EBITDA.

As well, there are many more buyers for medium- and large-sized business, while few for small businesses. This is particularly the case with those that do not have a track record as a stand-alone business, or a full, established management team.

In other words, breaking off a chunk of a small business may just be too small, falling off the edge of the valuation curve, and making it infeasible to sell at a sensible value.

A good mergers and acquisitions adviser can help you figure this out by doing a transactional assessment vs. a theoretical valuation, which can be two very different things for a small- to mid-sized business owner.

The bottom line is, smaller, privately held businesses tend to have unique characteristics and limitations that make selling non-core operations trickier and riskier than for large corporations, and business owners are well-advised to be aware of them.

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