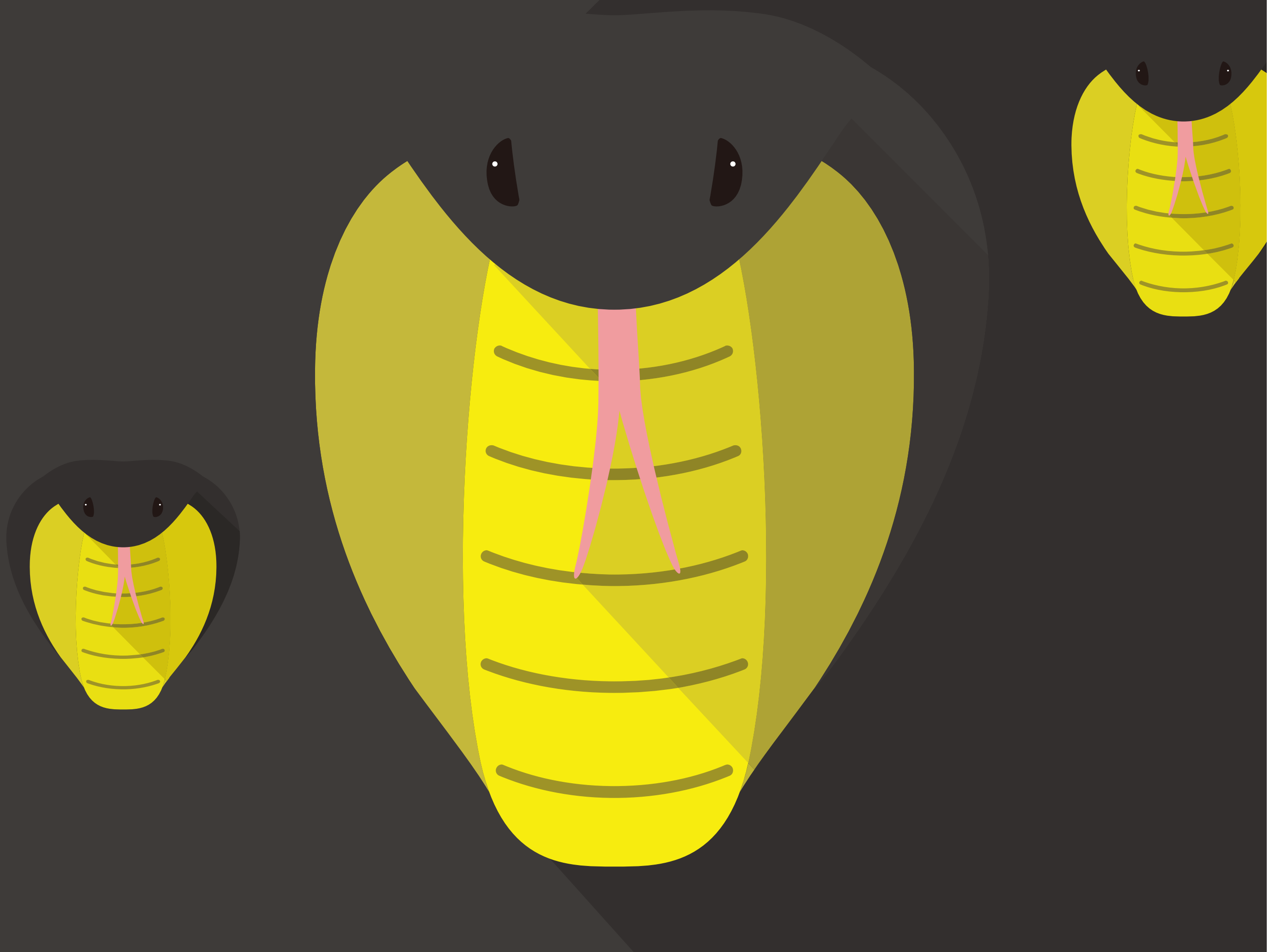
BUILDING A ROBUST BUSINESS



HOW TO MANAGE AND EMBRACE UNCERTAINTY

Article by David Kandziora
THREE SIXTY CAPITAL PARTNERS

The mythological Hydra can be considered anti-fragile: each time you cut off one of its heads, two grow back. When attacked, it only gets stronger. So, how does one bring out one's inner Hydra and remain sustainable in the face of uncertainty?

PROGRESS IN ENVIRONMENTAL SUSTAINABILITY HAS been both well founded and highly topical in recent times. Many businesses however neglect to consider sustainability from a robustness point of view. Is the business model so fragile that it will fail at the first hurdle, or is it structured in a way to cope with or even thrive on change? Sustainability is about maintaining structure and retaining value in the business which makes it attractive to clients, competitors and investors. Only once a business truly understands the ecology of corporate survival and embraces managing uncertainty can it start to be considered sustainable.

The inevitability of change is often unseen until it is too late. Corporate behemoths like Kodak and Nokia were deemed unstoppable in the decades they were dominant, only to become consigned to an interesting Wikipedia footnote or business school case study. The Dow Jones Industrial Average (DJIA), an index of the 30 largest stocks in the United States since 1896, has seen cotton, rubber, sugar and tobacco stocks taken over by consumer goods, pharmaceuticals and technology stocks. The median length of time today's DJIA30 companies have been included in the index is only 21 years, suggesting a rapid pace of chance.

While resilience (recovering from failure) is an important virtue, robustness (resisting failure) should be sought out in the first instance. The holy grail is to be considered anti-fragile, where a business can thrive on uncertainty. This is why Silicon Valley often views failing quickly as a blessing in disguise, as it gives you the opportunity to innovate faster.

Businesses should regularly review and critique their business models, assess changes in the market and acknowledge what is and what is not working for the firm. This process, which can be something as simple as a SWOT analysis, should identify key gaps in the business model and seek to remedy them with more robust alternatives. For example:

- An identified lack of presence in emerging products, markets or technology can either be built up internally or acquired externally. When Apple realised Power by Proxi had superior wireless charging technology to them, the best way it could reach its objective was not to aggressively compete, but to acquire the business, intellectual property and knowledgeable staff and get on with delivering on its own objective of making phones.
- Inadequate or undocumented supply contracts, employment contracts or intellectual property leave a firm vulnerable, inflexible and unprepared for change.
- Improving transparency. Clean tidy accounts that omit personal expenses and intercompany arrangements will give a more accurate representation of true profitability of the company. This will deliver more accurate numbers and allow more informed decisions to be made.
- Supply chain transparency can also be an advantage. For example, Patagonia actively decided to keep an eye on its manufacturers and distributors to reduce any negative social and environmental impacts the company may have.
- A lack of investment in key infrastructure can be an accident waiting to happen. Don't wait for a cataclysmic failure before, for example, investing in new ICT hardware. Preventative maintenance can solve many problems before they occur.

Many of these matters may not immediately increase headline profits, however it will reduce the uncertainty surrounding the probability of achieving them. While no-one knows what the future holds, it is this management of uncertainty that makes a business more attractive. The attractiveness and value of the business will grow proportionately, with prospective purchasers willing to pay higher prices for having key risks mitigated. Structure and value retained in a business can be the difference between obtaining a 3x or >7x multiple of earnings when exiting a business or trying to raise new capital.

An additional benefit of having a robust business is that it will be considered more 'bankable'. The reduction in key risks is more attractive to external financing, business partners and joint venture partners and increases the flexibility to adapt to new situations such as adding new product lines or divisions as gaps in the market are identified.

Once a business has established a robust business model that will resist failure, it should consider whether it can become 'anti-fragile'. Nassim Taleb coined this term in his book by the same name, and it addresses increasing the capability, resilience or robustness of a business. Anti-fragile systems benefit and thrive on disorder.

Taleb went so far as to say "I'd rather be dumb and anti-fragile than extremely smart and fragile."

So how does one bring out one's inner Hydra?

- If under threat from a new emerging technology or new competitor, ascertain whether they are truly in the same industry and targeting the same market. Consider aggressively acquiring staff, patents, know-how, and capabilities in this new target area. Blockbuster famously turned down an offer to acquire Netflix in 2000 for $50m after incorrectly assessing it as a small niche business.

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- Testing ideas and new products quickly and expecting the majority to fail. People can spend too long developing a product or service for which there is simply no market, or for which someone else is quicker to market. Once the business proposition is validated, ask should this be internally rolled out or externally acquired? The quicker the turnaround in this iterative process of idea –> validation –> execution, the higher the chance of success.
- Refocusing. Realistically measure and assess underperforming areas of the business and either discontinue product lines or divisions or consider divesting them. This can free up capital to pursue either core competencies or new areas of growth. IBM took a cold hard look at themselves and decided to exit the hardware business that they had been dominant in for so long to become a cloud computing, analytics, cognitive computing and AI company and has finally arrested its declining revenue numbers. LEGO took the opposite approach and staved off bankruptcy in 2004 by selling off everything not vital to its core product and refocusing its product lines. LEGO has since recorded phenomenal growth.
- Value your human capital. Consider sufficient incentivisation and appropriate retention of key staff. In our experience, this is often the single largest contributing factor to poorly executed M&A. Forecasts mean nothing without experienced, capable and committed staff to execute the plan.
- Creating redundancy in operational procedures by making sure key organisational knowledge doesn't sit with any one person, key supplies can be sourced from multiple vendors, or computer servers are not sitting in one physical location.
- Creating optionality. By reducing its reliance on any one particular hardware supplier, Apple has been able to switch back and forth from vendors to supply computer components. This optionality insulated Apple from market changes and supplier dependence, letting them keep a foot in each camp.
- Similarly, with the Blockbuster example, while we have the benefit of hindsight, $50m would have been a small price to pay for the option to see how a new media content delivery service played out and, if successful, scale up operations. Today Netflix is worth $170b and Blockbuster has gone into bankruptcy.
- Don't assume a static industry in which the status quo will continue forever. Businesses should always be open to new ideas and assessing new avenues to grow.

Change is inevitable. It is how quickly you can adapt to it that will determine your success. Only once a business has incorporated elements of a robust or even an anti-fragile business plan is it on the right path to becoming a truly sustainable business.

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