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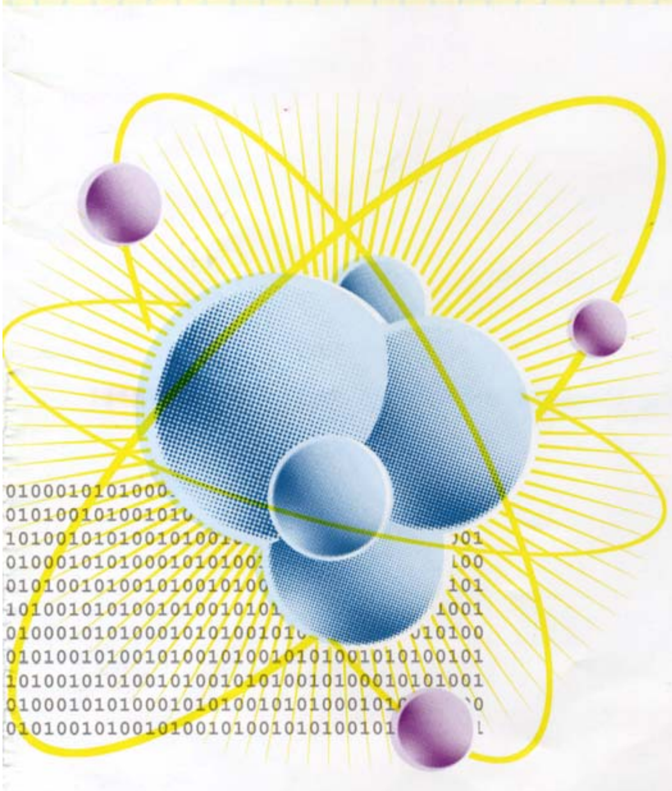
Deal or no deal

Given its project-based nature, design represents slim pickings for corporate predators and hasn't generated the takeover activity seen elsewhere in marketing services. **Bob Willott** offers tips on how consultancies can prepare for a sale or merger



THE PAST 12 months have not seen a great deal of acquisition activity among design consultancies. Indeed, as one observer put it, 'If Loewy hasn't bought it, nobody has.'

That remark is an over-simplification, of course, but there is an element of substance to it. The list of acquisitions made by Loewy Group – with a little help from private equity backer Veronis Suhler Stevenson – includes product design group Seymour Powell, public sector communication specialist The Team, packaging and branding consultancy Williams Murray Hamm, Epoch Design and, most recently, Branded.

Typically, Loewy's acquisitions have been earning pre-tax profits of between £500 000 and £1m.

The few deals in which Loewy did not feature ranged from the Publicis purchase of Stocks Austin Sice last September for an estimated £15m to some far smaller acquisitions by Start Creative.

Media Square sold its rather specialised Coutts Retail Communications subsidiary to private equity-backed The Bezier Group. The Australian Photon Group bought Corporate Edge. WPP bought Web design group Heath Wallace, which specialises in the financial services sector, and WPP's associated company Syzygy bought interactive agency Hi-Res.

Apart from these deals, nothing very much happened. And that was during a period of high acquisition activity in the marketing services sector as a whole.

So why is design in the deal doldrums? There are a variety of unconnected explanations.

Many are too small to appeal to the global groups or even the UK aggregators like Creston or Cello.

Most design consultancies are project-based and perceived to be rather risky for buyers who are seeking steadily growing income streams. For example, client rebranding projects may generate good revenue, but only come along sporadically, while direct marketing and public relations tend to be more continuous and predictable. The position has been compounded by the arrival of private equity investors that can initiate sudden cuts in branding budgets at client companies so as to maximise profits for short-term gain.

Design is still only on the periphery of the digital revolution – consultancies do the front-end work like website and content design but not the harder-hitting digital marketing campaigns.

Potential buyers are conserving cash as the credit crunch threatens to starve the industry of loans to fund acquisitions.

Results International chief executive Graham Beckett offers an additional explanation, pointing to the fact that many young designers leave college with a bias towards art rather than commercial gain. 'Often they start a business just to be their own boss, without thinking about selling,' he says.

In other words, much of the design world remains a cottage →

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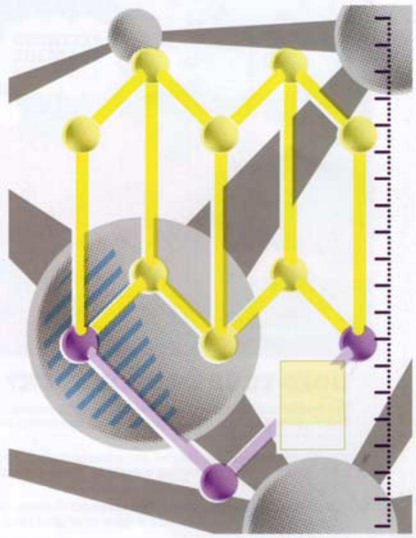

HOW TO PREPARE FOR A SALE OR MERGER IN THE FUTURE

- Don't aim to exit for a year or so while market conditions are likely to be unfavourable
- Examine your client list. Is it well spread with good quality names and not dominated by a single client? Have your best clients been with you for several years? If not, start working on improving it
- How well-rated is your work? Have you won some reputable awards? Have you any client research that proves the effectiveness of what you do? Take appropriate action
- Is your business well managed? Examine each major function and identify potential successors. Finalise a management development plan
- How does your financial performance compare? Study benchmark information and address any shortcomings. Can you show a consistent profit growth? If not, give yourself longer in which to achieve a better financial track record
- Ask yourselves what you want from the rest of your working life. Are you selling to retire? Do you really want to leave the business? Would you prefer to realise part of the business value and stay involved? How much money do you want? Take advice and examine all the options and how they might be financed. Be realistic – even cautious – about the company's potential value
- Finalise your realisation strategy
- Take tax advice based on the above strategy
- Prepare a first draft sale memorandum, recognising it will need to be updated before any prospective purchaser makes contact
- Find subtle ways of making your business known as being of possible value to prospective purchasers before embarking on a formal sale process. Unsolicited approaches are often the best, but may have to be engineered
- Wait until market conditions are favourable and your business is in best shape for sale, subject to any other personal timing imperatives
- Finalise your sale memorandum and start the sale process

industry whose activities rarely command the enthusiastic interest of potential buyers.

If owners of design consultancies are likely to want to sell eventually, they need to wise up at an early stage. Fortunately, the days are long gone when a designer would put an accountant in the same category as a tax inspector, treating him or her as an enemy of creativity and a danger to the business. The quality of profits, clients and creativity all have an important part to play in building value.

But even the most businesslike consultancies can be disappointed. The idea of building a bigger design capability rarely seems near the top of the list of priorities among acquisitive companies and it is unusual for sellers to find a long queue of potential buyers queuing to make an offer.

The consultancies that are the exceptions tend to be highly focused, businesslike and big. Stocks Austin Sice is the perfect example. It specialises in financial reports and graduate recruitment which are cyclically complementary. It's managed as a serious business by senior executives who can bring a lot to the table. Publicis wanted the management as much as the healthy profits which were well above £2m by the time the deal was done.

So what happens now? The opportunities to sell are few and far between. Cash is getting scarce and those that have it are being very cautious about how they spend it. Many design consultancies are still too small and immaturely managed.

Willott Kingston Smith partner Amanda Merron suggests that owners of consultancies seeking an exit should probably be prepared to wait. They certainly need to be generating pre-tax profits in excess of £1m if they want to attract serious buyers, but even then the choice will be limited and prices are likely to be less than exciting.

Buyers would probably be looking for something very special in the short term – like expertise in a particular design discipline or better management skills. And while digital expertise tends to have appeal, that expertise needs to be deployed in activities that will give the consultancy a demonstrable edge in the marketplace. Profitable market leadership in almost any component of the business is likely to make it more appealing.

As Results International managing partner Keith Hunt says, 'You need to be best in class with a good "sticky" client list. Prestige is very important.' The bigger marketing groups are rarely interested in adding another design group unless it offers something special.

Needless to say, not every successful and profitable design consultancy wants to be sold to someone else. Successful consultancies like Imagination and Jones Knowles Ritchie have been around for some years with no obvious evidence of a 'for sale' sign on display. ●

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