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Feeling welcome at the party when the host leaves first…the uncertain transition from relationships to customers

By Harry Gray and Chad Greenway

In middle-market investing, too often the pathway we face for transitioning from founder's relationships to enterprise customers is mired with tripwires. The high-stakes transformation from personal contacts to long-term company customers can be difficult for buyout investors and a daunting hustle for new management. The critical need to evolve and institutionalize the customer portfolio is most prevalent in services businesses, and can seem almost insurmountable when the top-line is also highly concentrated with a small number of significant relationships. In middle-market services businesses, customer concentration is common because many service businesses were started by entrepreneurs who simply turned their prior career into a business or built the business with a limited customer base. In these instances, the seller of the business may indeed "be the business".

We have found that an effective customer relationship bridge is easier to plan than execute. Naturally, a carefully constructed and detailed plan of introduction and presentation of a new owner or management team to the valued customers of the business is an essential inheritance step for ensuring the future success of the company. After priming the hand-off, however, customer service and relations will inevitably involve marketing plans and sales programs, as well as procedures for dealing with problems that occur in the sales process. Generally, formalization of this effort has been an afterthought for so many business owners who spend the majority of their time working in the business rather than on the business. When the time comes to transition, these sellers are often not prepared to map art to science by discussing in detail how the company gets new customers, how the company keeps the customers and how the company resolves conflicts in relationship with customers. As such, numerous middle market service companies are plagued initially by a balance of power that tilts increasing toward the customers after the seller/founder departs.

So how do you mitigate customer transition risk? From our experiences, after closing an appropriately-structured deal, new management must spearhead a few integral common-sense initiatives:

If practical, deploy the seller as an ambassador…not just as transition agent. Regardless of the length of the hand-off period, in the normal course, most sellers will still have a very strong attachment to the business, customers and the employees. Keeping the buyer-seller relationship friendly is even more important if the business is exceedingly complex. Notwithstanding the inevitable power shift after change of control, the seller will likely be a good source for brainstorming down the road. We have found that the transition period is also a fantastic time to seize the opportunity to begin the build-out of bench strength, and we recommend having capable and motivated subordinates piggyback the learning curve and hand-off process as appropriate by functional area. This shared learning curve tends to seed accountability, set the stage for delegation and foster ownership through responsibility.

Start with minor changes. In certain settings, customers may react unfavorably to sweeping changes. In these instances, and in a stable or growing environment, less tends to be more at the beginning. Making minor changes and paying attention to your customers' initial reactions can provide a sense for the elasticity of the customer relationship. We have found it priceless to understand the sensitivity and domino effect of tweaks. When seller charisma and personality are deeply reflected in the culture, for an appropriate post-closing period, consider keeping the seller in his or her office as-is. As soon as practical, new management must solve problems and make management decisions in front of the seller with the employee and customers observing the ritual shift of power and accountability.

Get beyond historical performance ratios…understand the customers' health. We advocate a forward-looking assessment of the credit worthiness of the customers to supplement traditional backwards-looking accounts receivable analysis. Strong relationships influence collections, but some customers can become "bad customers" to an organization that seeks to become larger and more professional after closing.

Prioritize an infrastructure plan that ultimately links customer service policies to cycle training. Customers are used to having issues handled in a certain manner and smaller businesses often do not have proactive best practices in this area; instead, they operate with reactive tactics. Review the documented and undocumented policies and procedures closely and maintain them for the first few months. After the transition is complete, documenting and amending the policies and procedures may be necessary, but make every effort to begin building a great customer-first culture through formal personal qualifications training. Training will emphasize standards and reinforce best practices, especially as the corporation grows and becomes less intimate with senior management.

Under-complicate the marketing plan. In the first 100 days, assemble the marketing plan in partnership with the seller. Repeatedly, we have found marketing is something that is made overly complicated by most companies. Rather, take a step back and approach the "first 100 day" marketing effort as simply a matter of finding out what the customers want, and then giving it to them at terms that make sense to you and them. Even if the target business excels at marketing, the functional activity will require continuous testing and measuring in most instances; but out of the gate, make certain that a mechanism for capturing customer needs is built into the corporate framework early.

Boost employee morale…but avoid amateur pitfalls. Pay close attention to the morale of the current employees. It's inevitable that some employees will be worried about the security of their jobs. Particularly with customer-facing individuals, morale and organizational esprit de corps is infectious and can be discerned by customers, even over the phone. Do whatever you can to maintain and even boost employee morale, but tread lightly as not to telegraph a forthcoming entitlements culture.

Develop CRM…as a strategy. We believe CRM is not a product or service, but rather it is an overall business discipline and strategy that enable companies to manage customer relationships effectively; only secondarily is it a set of discrete software and technologies. This is particularly important in the middle-market where many companies run sales, marketing and customer service/support organizations as decentralized functions. Investors and new management may struggle with these disparate activities without the founder's lock-step involvement and institutional knowledge. In fact, the decentralized framework can force customers to run from pillar to post when trying to meet their demands, creating a good deal of dissatisfaction, especially under the new owners. For instance, customer data is important yet, all too often, the data is locked up in spreadsheets or in key salespeople's heads; this situation would become exacerbated if the deal includes departing key staff members who own and manage certain customer relationships. After closing, as soon as practical, the investors and new management must endeavor to make the same information shareable with all customer-facing employees in the company, which will enable the company to present a uniform face to its customers when called upon to serve their needs. However, pursuing CRM as a strategy out of the gate also implies that the enterprise is customer-centric. As such, if the primary focus has always been to sell the products or services, as opposed to focusing on customer retention, the new owners will have to make this mark for the enterprise to inherit the customer. As the investment seasons, implementation of a technology-based CRM application as a common multi-channel platform for customer communication and interaction may make sense to improve customer responsiveness and build a comprehensive view of the entire customer life cycle. Even in an accelerated path to technology solutions, however, buyers should take heed not to muddle CRM as both a strategy and cultural framework with CRM as a software investment.

Finally, if it makes situational sense…invest in "new goodwill" by doing something nice for the customers. New management does not have to do this right away, but the pros and cons of various types of special offers or promotions should be evaluated as a means for creating goodwill with the inherited customer base. Again, tread lightly where such actions could condition customers for anticipation of deep discount and free services.

Ostensibly, these generic measures are less applicable to services businesses that enjoy long-term and recurring contracts, as well as to businesses with an emerging stand-alone sales force. However, we have found that many sellers/founders practice impromptu customer service through random spot checking for quality assurance. Such an undocumented effort may very well be an intangible asset and a secret sauce for sustaining the company's revenue lifeblood. In any circumstance and in any business, the happy retained customer is by far the best hook for new customer growth under the watch of the investors and new management.