Some Businesses Just Need Pruning

Not all struggling businesses need a turnaround. Sometimes they just need to stop doing unproductive things.

There is an important distinction between the two, particularly when investing in smaller companies.

A turnaround can be risky. The company's products or services may be outdated, no longer relevant to customers, or losing ground to competitors. The core business needs to be fixed, which is difficult work, often takes years, and takes flawless execution. Even with a capable CEO, there is no guarantee customers will come back or that the business can regain its former position. Oftentimes the business is already dead, it just doesn’t know it yet.

Pruning is different.

In this case there is a perfectly good core operation that has become distracted. It might have unrelated subsidiaries, unprofitable customers who are kept simply for their revenue, or just overhead that becomes unintentionally bloated over many years. The company is doing too many things, and some of them are destroying value.

A new CEO can make a meaningful, almost immediate difference by simply deciding what not to do. Sell the non-core businesses. Walk away from unprofitable customers. Cut unnecessary costs. Give the productive parts of the business more attention and resources.

The key is there is no need for the core business to reinvent itself. Management just needs to get out of its own way.

I find these opportunities particularly interesting in the microcap world. Smaller businesses generally have fewer moving parts, less bureaucracy, and simpler organizational structures. A new CEO can often make changes quickly and have an almost immediate impact on the results.

The market may see a struggling business and assume it needs a difficult turnaround. But sometimes the answer is much simpler.

The difference matters - turnarounds require a business to become something different. Pruning opportunities often just require a business to become a better version of what it already is.

These can be some of the lowest risk, highest return opportunities.