Family Business Magazine
The guide for building and managing family companies

In search of the perfect buyer

The Barrett family's VitalChek Network was a high-tech startup in a fast-growing business. Could they raise cash for expansion without selling their souls?

By Stan Luxenberg

Herb Barrett's fortune, like that of many entrepreneurs, began with a vexing personal problem. After years as a DuPont engineer in Delaware, in the early '70s Barrett returned to his home town of Nashville, Tenn., and enrolled his two sons in a private school—only to find on opening day that the school refused to admit his boys without birth certificates. Barrett lacked copies, and Delaware bureaucrats told him it would take six weeks to produce any. Barrett figured out that he could speed the process by sending cash via Western Union and paying to have the copies sent to him by overnight mail. He had the boys in their classrooms only four days behind schedule, but the incident rankled him for years.

"It stuck in my mind that there had to be a better way to do this," Barrett says. Why, he wondered, couldn't state offices use toll-free lines and credit cards the way other businesses did?

For ten years Barrett and his older son, Michael—who went to work in a Tennessee state office—kicked around answers to that question. By 1987 they had developed a crude solution: A caller who needed an emergency birth certificate would dial a toll-free number. The operator at the end of the line was Michael, working in his bedroom. He took down the information and billed the caller's credit card. Then he faxed the data to a clerk in the state office, who immediately began the search. The state could begin the process because the Barretts had already forwarded the necessary cash ahead of time. Once the clerk found the document, he would send it via FedEx. Using the system developed by Herb and Michael, an applicant could receive a document in as little as two or three days.

State governments probably could have created such a system on their own, but they didn't think of it. Besides, it cost money to buy machines that could handle faxes and credit-card transactions. The Barretts' VitalChek Network, as they called it, offered states a turnkey solution that cost taxpayers nothing. The family paid for all the equipment, and they charged each applicant only $5 as a processing fee. State bureaucrats loved the concept because it silenced complaints from taxpayers and state legislators.

"Within a month, we had signed up four states, and it just kept growing," Herb Barrett recalls.

Throughout those years of rapid growth, father Herb and son Michael made an effective team. The father acted as the front man and chief executive, making sales calls and soothing customers. The son served as chief financial officer, enlarging the firm's computer systems and introducing the back office to the Internet. Michael's former schoolmate William Burns became vice president for sales. After a year, Herb's younger son, Joseph Barrett, joined and became executive vice president. He was familiar with courier services from a job at a home health service that shipped drugs, so he set about speeding up the process of sending documents: Instead of relying on clerks to fill out FedEx forms by hand, Joe introduced software that would automatically generate a FedEx label as the clerk typed in data requesting a document.

Today some states use VitalChek systems to manage all their birth, death, marriage and divorce records. In some cases, you can order a birth certificate in the morning over the Internet and receive it via FedEx by 10:30 the next morning. VitalChek now operates in all 50 states, completing transactions for 2.5 million people annually.

It's one of the rare cases of a high-tech family business start-up, and by 1997 Herb Barrett confronted a problem entirely different from obtaining birth certificates for his sons. After ten years, VitalChek had grown to 62 employees and some $50 million in annual sales. But the company needed capital to seize the opportunities presented by the dawn of the Internet age. In addition, Herb, by then in his mid-60s, wanted a nest egg to provide security for the family.

"From the day the company started, we had re-invested every penny of profits back into the business," says Herb, now 68, speaking deliberately in the slow, rich baritone drawl of his native Tennessee. "The whole family decided it was time to take some money off the table."

Fearful that competitors might steal their idea, the Barretts had deliberately kept a low profile, never advertising or seeking potential investors. Even so, VitalChek received several buyout offers. The easiest solution to Barrett's quandary would have been to sell the business. But Barrett considered the offers too low. Worse, he feared that an acquirer would dismantle VitalChek, laying off a 62-person work force that included his sons Michael, now 45, and Joseph, now 43, not to mention other employees (like Michael's schoolmate William Burns) who had come to seem like members of the family.

In a search that ultimately took them five years, the Barretts managed to find a buyer capable of producing a large cash bundle while simultaneously keeping VitalChek's culture intact and the Barretts on board. The story of how the Barretts did it suggests that, with the right combination of patience and wisdom, a family business can eat its cake and have it too.

As financing strategies go these days, selling out to a public company is one of the best available. At a time when the market for initial public offerings has turned sour and many venture capitalists are sitting on their wallets, some public companies are aggressively buying family businesses.

"To boost sales in a slow economy, public companies like to make acquisitions," says family business consultant James E. Barrett (no relation to Herb) of Cresheim Inc. in Philadelphia. "By buying the right business, a big company can expand a product line or enter a new field."

Not all family businesses are realistic candidates for a purchase by a public company, Jim Barrett cautions. To be considered for an acquisition, a business must typically produce at least $20 million in sales. The revenues should come from loyal customers who provide repeat business or from systems that can be sustained by a new owner. With its solid contracts from government agencies and its annual sales in the mid-eight figures, VitalChek passed this test easily.

Before approaching any potential public buyer, the family must put its financial house in order, installing record-keeping systems that can pass muster with the SEC. Just as important, sellers must take time to think clearly about their goals and the kind of acquirer they seek. The most eager purchasers may be “financial buyers”—Wall Street outfits that buy and sell businesses, often stripping assets and laying off workers.

“If you sell to a financial buyer, you will get some cash,” notes consultant James Barrett. “But you may end up feeling miserable about the deal and thinking that you have to leave town because you can’t face your former employees.”

For the Barretts of Tennessee, these “financial buyers” held little interest. Herb had read many articles about the takeover artists of the 1980s, such as Carl Icahn and Henry Kravis, who made fortunes by borrowing heavily to buy companies like TWA, RJR Nabisco and Duracell International.

“In so many of those deals, the companies were split up and employees were let go,” says Herb. “I did not want that to happen to us.”

The Barretts searched instead for “strategic buyers,” who aim to incorporate an acquisition into their existing operations. Such purchasers tend to pay higher prices and are more likely to hang on to employees.

To weigh alternatives, Herb asked his lawyer about finding an adviser and soon hired James Rybakoff of Akin Bay, a Wall Street investment bank that specializes in family companies. Under their arrangement, the Barretts agreed to pay Rybakoff an up-front fee. In the event that the company was sold or raised capital through some financing, Rybakoff would refund the initial fee and take a percentage of the deal instead.

Rybakoff, a graduate of the University of Pennsylvania’s Wharton School, spoke the investment banker’s language of balance sheets and price-earnings ratios. But he had handled mergers of other family businesses and understood the special concerns they face.

“When a family sells their business, it is a difficult process because they are giving up their baby,” Rybakoff says. “Most of the time you can’t just auction off the company. You need to start by talking for a month or two about different alternatives and making sure that the family settles on an approach that makes them feel comfortable.”

From the beginning in 1997, Herb Barrett insisted on involving all the employees in the process. He called a meeting and discussed the investment banker’s mission. VitalChek would seek a way to raise cash, Herb said, and attempt to preserve everyone’s jobs.

“At the beginning, the three Barretts sat down with the whole management team,” recalls Greg Skirco, vice president of new product development. “They said that they wanted us to have a voice in what happened, and they would try to keep all our jobs. We believed them because there had always been a family atmosphere at the company.”

Rybakoff, the investment banker, started by studying the company, determining its strengths and weaknesses. At the Barretts’ urging, he interviewed employees to learn about their jobs. It’s unusual for a family to be so open with employees, Rybakoff says, but the plain talk helped the investment banker understand the company and its culture.

Soon Rybakoff concluded that the company would have to change its business model. At that point, the company had annual sales of $50 million and was investing all its profits in expansion. To pull out some cash for the family and speed expansion, the company had several alternatives: seek venture capital; issue an IPO; or sell all or part of the business to a corporate buyer. Rybakoff began investigating all those avenues.

To improve the chances for a deal, Rybakoff suggested that VitalChek try to increase its earnings growth and raise the company's profile. That's when the company began running ads on AOL. It also sent out direct-mail pieces to likely customers such as Little Leagues, whose players must submit birth certificates. VitalChek mailed thousands of notices to passport offices, telling agents how applicants could call toll-free lines to obtain emergency documents.

To increase revenues, Rybakoff suggested expanding some businesses that had been overlooked. While the company concentrated on vital records, it had largely ignored one source of business: trucking permit processing. Companies seeking to transport hazardous materials need a permit in each state where they operate. By using VitalChek, an interstate trucker can fill out a single application and clear paperwork in half a dozen states. If revenues of this business grew, Rybakoff said, the company would have strong appeal to public buyers considering an acquisition.

Once VitalChek started its expansion drive, Rybakoff began contacting potential buyers. A few bids appeared, but then in 2000 prices for technology companies collapsed along with the stock market. The trouble on Wall Street also clouded the outlook for raising cash from venture capitalists or IPOs, so Rybakoff put his efforts on hold until conditions improved.

That pause ended abruptly after the terrorist attacks of Sept. 11, 2001, made VitalChek a hot company. Suddenly, security-conscious government agencies and companies were demanding more proof of identity when they hired new employees. A defense contractor asked VitalChek to obtain thousands of its employees' birth certificates to prove that no aliens were working on a government project.

"In the year after September 11, we got five times the number of bids for the company that we received in the previous three years," Michael says.

From this new crowd of suitors, a seemingly ideal acquirer emerged. ChoicePoint, based in Alpharetta, Ga., was an entrepreneurial firm with a similar service: It provides risk management and fraud information for employers, insurers and state agencies by searching public databases and DNA records. Although its origins were nearly a century old, ChoicePoint had acquired new life in 1997 when it was spun off by Equifax as a publicly traded company in its right. Since then, ChoicePoint had grown rapidly through some 30 acquisitions, not to mention its high-profile heroics after September 11: Using its DNA laboratory, ChoicePoint had identified victims of the World Trade Center attacks. Last year, ChoicePoint assisted police searching for the snipers who plagued the Maryland suburbs of Washington, D.C. The company also helped the Transportation Security Administration conduct background checks on 100,000 applicants for jobs as airport security screeners.

Rybakoff, the investment banker, also talked to giant suitors like IBM, but these seemed likely to smother the VitalChek operations. Finally, last December the Barretts settled on ChoicePoint.

"We felt comfortable picking ChoicePoint," says Michael Barrett, "because they have a philosophy that involves responsible use of data."

Perhaps most important, ChoicePoint seemed to respect VitalChek's legacy as well as its potential. Under the terms of the deal, the Barretts got $120 million in cash; Herb Barrett and his two sons each got three-year employment contracts; and ChoicePoint promised to keep all of VitalChek's 62 employees on their jobs and provide resources so that VitalChek could grow. ChoicePoint also agreed to pay the Barretts $120 million in additional incentive bonuses if VitalChek meets growth targets over the next three years.

So far, the acquirer has kept all its promises, Michael says. The parent company has transferred some data-management experts to VitalChek, providing extra intellectual firepower. Marketing staff members from ChoicePoint are helping VitalChek reach out to more government agencies. None of VitalChek's 62 employees has been fired.

Will the honeymoon last? Consultant Jim Barrett cautions that many family business people leave acquirers before their employment contracts end. "A lot of times, family executives will get a three-year contract, and they will be gone after 12 months or so," he says. "The buyers allow them to stay for a short transition, and then they move in their own people."

Herb Barrett says he plans to finish the three years of his contract (although he's mum about how he plans to spend his $120 million proceeds). He remains optimistic that the deal will prove successful for everyone. VitalChek's sales now exceed $100 million, he says, and the company is aggressively pursuing new business. Backed by ChoicePoint's corporate resources, Barrett is drumming up new business from adoption agencies, which have been slow in processing cases and moving children from foster homes into permanent families. This new venture should bring more smiles among government cost-cutters, not to mention adoptive parents. By helping to speed the job, VitalChek can enable governments to cut costs and make some adoptive parents very happy.

"Since the acquisition, we have become a better company than ever," Herb says. "There is no reason we can't keep growing."

***Stan Luxenberg** is a financial writer who lives in New York City.*