Harvard Business Review
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HBR Case Study

Should First Rangeway remain public or go private?

Give My Regrets to Wall Street

by Mark L. Frigo and Joel Litman

Reprint R0402X

Increased public scrutiny, decreased stock-option appeal, and the relentless expectations of Wall Street are taking their toll on a once high-flying consultancy. Is going private the way out?

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Kenneth Charles and Matthew Phair sat on opposite sides of the conference room table, scratching away on their legal pads. As one voice after another leaked from the starfish-shaped phone, Matthew, the CFO of First Rangeway Consulting, took copious notes. Kenneth, the CEO, energetically doodled animals, as he often did when alone or with close associates. "During a conference call, no one can tell that you're drawing a dog," he liked to say, beaming approval on those who got the joke.

Doodling helped Ken focus, and his pen skittered across the paper as he listened to Victoria Michaels, a top-ranked sell-side analyst covering professional services stocks. Victoria was commending First Rangeway for its cost-control work and consequent increase in earnings. "But revenues are still flat quarter over quarter," she went on in a clipped voice that just missed being an English accent. "When and from where do you see revenue growth, and at what levels?"

"You know, Victoria, we've been holding client projects steady over the past year," Ken replied. "But proposal activity and engagement types point to an uptick next quarter, when corporate spending for our services should really kick in."

"We've already seen signs that we'll easily reach the targets we mentioned earlier," added Matt, jotting a number in the margin and drawing a box around it. "To reiterate, we stated a 10% quarter-over-quarter increase beginning next quarter."

The next question, from Kevin Danville of LRL Investments, was tougher. "Could you comment on how fruitful the business process outsourcing space might be over and above traditional consulting revenues?" Kevin asked, as Matt etched "BPO" into his paper, followed by three question marks.

Ken racked his brain for a response that

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would sound both encouraging and noncommittal. Not finding one, he settled for noncommittal. "We are investigating multiple revenue streams as we have in the past," he said, "and are prepared to move into those that complement our consulting work. However," he added, cringing inwardly at the necessarily oblique language, "it would be premature at this point to make any specific announcement."

That answer wasn't what the analysts wanted to hear, he knew. Although Ken had been a partner at First Rangeway since 1997—two years before the 2,800-employee consultancy's IPO and subsequent market triumph—he had been CEO for less than a year, and the quarterly analyst calls still made him sweat. On the day he accepted the top job, his wife, Cara, had presented him with a plaque that read simply, "All Things to All People," and for months it held pride of place on his office wall. Lately, however, the words seemed more like a command than a pleasantry, and Ken had banished the plaque to the nether regions of a desk drawer.

Thirty question-filled minutes later, the call operator finally rang down the curtain. Ken capped his pen and leaned back, puffing out his cheeks in relief. Matt tapped the on/off button on the speakerphone to make sure they were clear. The reassuring hum of a dial tone filled the air.

"Have I ever mentioned how much I love analyst calls?" said Ken, as Matt gathered his papers into a neat stack. "Because if I did, I was lying. How do you think my BPO response went over?"

Matt shrugged. "Kevin didn't mention Locklin-Ladd Associates by name, but you know that's who he meant. They've been all over outsourcing, and they've hired some top guns to make it happen. There's money there, Ken. It could easily mean 30% growth for us for several years. Plus, Mark and Amy and some other partners have serious experience in that area."

"It would also mean a ton of up-front capital," replied the CEO. "But yes, it's worth considering." Certainly the prospect was tantalizing, and Ken couldn't deny feeling that residual dream-big itch, which, without access to heaps of money, the company was unlikely to scratch. None of the new markets First Rangeway was contemplating were frivolous; all represented directions in which its customers were heading. Five years ago, pursuing such opportunities would have been a no-brainer. But after the market's fall, it was definitely a brainer. For that reason and others, Ken was no longer convinced that public status remained a compelling proposition. "Of course," he mused out loud, "the whole equation changes if we…"

"If we go private," concluded Matt. "It's item number one at the next management team meeting—and the big item at the board meeting." Leaning across the table, he tore the top sheet off Ken's pad and eyeballed it. "Nice giraffe," he commented, tossing the paper back toward the CEO.

A Troubling Exchange

An hour later in the lobby, Ken stopped by the reception desk to order a cab and snitch a handful of Hershey's Miniatures from the cut-glass jar. "I thought you were on a diet?" said Lindsey Carruthers, coming up behind him. One of First Rangeway's rising stars, Lindsey was also Ken's self-appointed conscience. The CEO raised his hands in mock surrender and put back the candy. The two walked out together through the big glass double doors.

"I'm glad I ran into you," said Ken, scanning the street for his taxi. "I'm off to your alma mater in Boston to do a presentation at the B-school—trying to rustle up some top-notch MBAs. You've done a lot of recruiting there, right? What will they throw at me?"

Lindsey thought for a moment. "Well, they're still interested in First Rangeway, definitely," she said. "But I had lunch with a couple potential recruits last week, and they were concerned about the stock price. I'm not surprised, because we're so option- and stock-based, but they asked questions about the stock's potential I really couldn't answer. Want me to come with?"

"No, you just enjoy your lunch," said Ken, as his cab pulled up. Through the window, he watched Lindsey walk toward the corner salad bar. She was one of his best people and would probably make partner soon. In its glory years, First Rangeway had recruited a lot of great people from her school, many attracted by those very stock options that were giving this crop of MBAs the willies.

And why shouldn't options make them uncomfortable, Ken thought. First Rangeway's price was more than 80% off its highs, and volatile to boot. With the precipitous drop in glo-

Mark L. Frigo (mfrigo@depaul.edu) is the Eichenbaum Foundation Distinguished Professor of Strategy and Leadership and the director of the Center for Strategy, Execution, and Valuation at DePaul University's Kellstadt Graduate School of Business in Chicago. ***Joel Litman*** (joel.litman@csfb.com) is a director with CSFB HOLT at Credit Suisse First Boston and Clinical Professor of Business Strategy in the Kellstadt MBA Program.

bal business, they'd downsized dramatically, laying people off, freezing hires. But things were looking up now. It was time to refocus on the people—on finding new blood to drive the business and hanging on to those partners who had made it successful so far.

Unfortunately, they would have to divert some of those new hires toward activities that would do nothing to build the company. Before that morning's analyst call, Matt had laid out the resources First Rangeway needed to stay up to snuff with Sarbanes-Oxley, SEC filings, and other cost-of-being-public requirements. The business was becoming more complicated: Innovative revenue and gain-sharing agreements with clients had made financial reporting a mare's nest. Matt estimated they'd need 12 more people, including in-house attorneys, audit staff, and dedicated systems folk to upgrade software for internal controls. He had ballparked the total at over a million dollars annually.

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Cutting corners wasn't an option, Ken knew. Anything remotely questionable about their reporting could hinder a potential rebound in stock price or—worst of worst-case scenarios—land him and Matt in jail for willfully certifying bad financial statements. "Neither of us wants to sign off on those filings unless they're 100% kosher," Matt had reminded him. "And by the way, we could also use two or three more bodies in investor relations."

The cab lurched, and a wave of nausea seized the CEO. Car sickness, nerves, or an empty stomach? Ken unwrapped the single chocolate bar he had secreted in one of his pockets and popped it into his mouth.

Too Bullish to Bear?

The presentation to the MBAs went swimmingly. Ken was justifiably proud of his oratory skills: The ability to motivate people was one factor in his professional rise. So inspirational was the CEO's description of his company's starry future that he was tempted to run out and apply for a job at First Rangeway himself.

Crossing the quad afterward, Ken noticed a tall woman in head-to-toe Brooks Brothers striding ahead of him. He quickened his pace and a moment later fell in beside Nancy Westview. Nancy was a prominent business personality, adored by the press, and had more pies than she had fingers to put in them. She was on campus that day guest lecturing at an entrepreneurship seminar. "I went in with six pages of notes and came out with 600 pages worth of business plans," she told Ken, waving a thick folder. "My favorite so far is an exercise service for small pets."

But small talk was a very small part of Nancy's conversational repertoire. One of First Rangeway's original investors (she still held a sizable position) and a member of its board, she soon switched to a subject of vital interest to the shareholders—and, most particularly, to Nancy Westview. "I know there's been a lot of talk recently about going private," she said, stepping neatly off the path to avoid a young professor on a Segway, "and I think it would be a mistake. The major indexes are all up for the year, and our stock is up twice that. The economy looks as if it's gaining steam, and I don't want it leaving the station without us."

Ken listened patiently as Nancy launched into a tutorial on the state of technology consulting. As expected, it was a study in upsides. Nancy's estimates of potential revenues from outsourcing slightly exceeded Matt's, and she knew from her prodigious networking that some of First Rangeway's competitors were entering other promising areas. There was also talk of industry consolidation: Nancy named three potential acquisitions that she deemed "tasty."

"There is no way we can talk about going private without taking these things into account—serious account," said Nancy, as they emerged from the grassy enclave onto a revving-up-for-rush-hour street. "I want to know what we're doing about these opportunities. The board meeting is Wednesday. I expect to hear answers."

"And answers you will have, Nancy," promised Ken, the first words he'd been able to get out in almost ten minutes. "Matt and I are still in research mode, but a direction is becoming clear." The last bit wasn't true, but Nancy, he knew, had a hate-hate relationship with ambiguity. Anxious to avoid a further monologue, he handed her into the first cab that pulled up, declining her offer to share the ride. As Ken raised his hand to hail another taxi, a bus rolled by, belching exhaust at him.

Public Enemy Number One

Ken arrived at his club at ten minutes past seven and hurried to the restaurant. The floorto-ceiling windows were awash with night, and waiters slipped unobtrusively from table to table, lighting candles. Greg O'Keefe was already seated in their usual spot. Ken dropped into his chair and brushed away the leather-bound menu being proffered by a waiter. "Flame-grilled rib eye, black-and-blue. No potatoes. No bread. Glass of the house red."

"Atkins, Ken?" asked Greg, raising an eyebrow.

"Ten pounds so far," replied Ken, not mentioning that two of those ten had recently made a reappearance. "And how about you?" he asked, noticing the tautness of his former colleague's jacket across his increasingly barrel-like chest. "Evidence of life in the slow lane?"

"Nothing slow about it," said Greg. "I've got plenty of consulting work, and, seeing as I'm a bred-in-the-bone consultant, that tends to make me happy. Can you say the same?"

"Of course," replied Ken, slightly annoyed. "First Rangeway is still a consulting firm through and through."

"Oh yes?" said Greg. "And a consulting firm through and through needs access to all that capital why? Consulting is a cash-based business, old friend. The math is simple: If 200 partners generate $200 million in profits, they each make a million dollars. All being public does is dilute that."

Ken sighed, wondering how they had managed to get off on this track so early in the evening. They'd been having the same argument for three years, beginning on the day Greg resigned from First Rangeway in the second wave of partner defections after the business downturn. Ken had bought into the former CEO's ambitious vision. But Greg saw only what was lost: an unwavering focus on consulting.

Greg had launched into his by-now familiar interpretation of events. "Because we were so fantastic at what we did, we were able to pull off a successful IPO, which gave us lots of money to spend on things other than what we did and were fantastic at. It's a catch-22 or a perfect storm or a tipping point…I can never remember which. I'm not arguing there isn't value in floating a small percentage of stock and gaining liquidity. But after that, what's the use?" he continued as the waiter placed a couple of green salads in front of them. He paused to fork some arugula into his mouth. "Private may not be sexy, but these days public isn't anything to get hot and bothered about either. The privately owned consulting model has been working for decades. Decades from now, it will still be working."

Ken scooped his croutons onto a spoon and deposited them onto his bread plate. "Look, Greg, do I really need to state the obvious here? We are profitable. Proposal interest is up. The economy is up, and we're in a great position to take advantage of that. Without the IPO, we wouldn't have had these gains. And if we go private now, we'll miss out on a lot of opportunities that the board—that the board and I—see in the coming year." He paused, realizing he was repeating some of the same rah-rah rhetoric he'd used on the MBA candidates a few hours earlier. "Anyway, you know the door is always open if you want to come back," he said more gently.

"Well, Ken, if anyone can make it work, it's you," said Greg, conciliatorily. "Personally, I think First Rangeway's gonna do great things. But it's going to have to do them without me." He smiled. "Unless of course, you change your mind about the private thing. Are you going to eat those croutons?"

P.O.'d

Closing the door of his den to stifle the sound of the Cartoon Network marathon unfolding in the next room, Ken sat at his desk and switched on the PC. He had an hour before the Saturday routine of soccer games and birthday parties kicked in, and about 100 e-mails to plow through. One from his brother in Maine. One from Amazon announcing that a recent order was on its way.

The third e-mail was from Tracy Durham, president of Bardwell Incorporated, and a longtime client of Ken's. The previous year, Bardwell had initiated a multimillion-dollar engagement, and the e-mail bore glad tidings of its progress. Tracy reported that she was pleased with the Rangeway partner running the project. The team of employees from both companies had proven innovative and collaborative, its results solid. "I do, however, have one issue I'd like to discuss," the e-mail concluded. "Call me when you can."

Ken checked the date and time stamp: 10/11/03 08:32 AM. Tracy was hard at it on a Saturday morning; it wouldn't hurt to let her know Ken was hard at it, too. Anyway, Ken couldn't enjoy the day knowing there was some problem out

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there preparing to bite. He had Tracy's cell number and had been instructed to use it any time. Ken picked up the telephone.

Two rings. "Hello?"

"Hey, Tracy, I hope it's OK to call you on a weekend…"

"Not a problem, Ken. I guess you saw my e-mail. As I said, things in general are going well. But some of our people have complained that some of your people are pushing them too hard to reach certain milestones on the programming project before end of quarter."

Unconsciously, Ken picked up a pad and began doodling. Bardwell's compensation and culture, Tracy was explaining, simply weren't designed to accommodate 75-hour-plus workweeks. And the lead partner—whose energy and expertise she had praised in the e-mail—had been a little too aggressive about collecting on a bill ("and I let him know it, too," said Tracy, sounding peeved.) "I don't object to wrapping things up quickly," she continued. "But all of the pressure makes us wonder, Whose quarter are we trying to make: Bardwell's or Rangeway's?

"Making a quarter can't help a firm as much as losing a client could hurt it," Tracy said. "Right now this is not a huge thing." She paused, waited a beat. "Let's just make sure it doesn't become one."

Ken's pen was leaking, leaving moist blotches all over the page. This wasn't the first time a project team had been pressured in the name of quarterly revenue targets. And clients weren't the only ones hurting: His own employees were complaining of burnout as well. "I promise I'll speak to the engagement partner personally," he said hastily. "You've known me a long time, Tracy. You know we'll do right by you."

As Ken hung up, a chorus of voices summoned him into the living room to join the search for cleats.

Time to Yield?

On Monday morning, Ken's conversation with the lead partner on the Bardwell engagement went as well as could be expected. ("Did I really use the word 'unseemly'?" he asked himself later.) By 11 am, the CEO had moved on to other things. Specifically, he was back in the conference room with Matt, the speakerphone between them. Only this time, it was channeling the voice of investment banker Charlie Gremley.

"Going private is a pretty straightforward process," Charlie was explaining, "but that doesn't mean it's easy. If you plan to raise capital from financial sponsors, we can help you do that. If you're looking to raise the capital yourselves, we can help there, too. We'll start running valuation models now if you like. Needless to say, we're talking about something in excess of a couple of hundred million dollars."

As the investment banker spoke, Ken speculated on just how much money the partners could or would raise if they went this route. After First Rangeway's IPO, the owners' net worth skyrocketed, and many had sold some piece of their ownership. But others held on as paper gains gave way to paper losses. Then Charlie started to enumerate the people they'd need to steer the deal, and Ken pictured attorneys and accountants swarming over the company's headquarters like ants on a dropped popsicle. Talk about a distraction from the business…and the *cost*…

"There's something extremely *Alice Through the Looking Glass* about all this," remarked Matt as he switched off the phone. "I recall sitting right here five years ago listening to Charlie walk us through the IPO. Remember how helpful he was?"

"What I remember is how *encouraging* he was," replied Ken, with a touch of sourness. "Did I mention how much I love investment bankers? Because if I did…"

"Yes, I know, then you were lying," finished Matt.

Private Aye, or Nay

The management team meeting convened with the introduction of a tray of bagels and jugs of fresh-squeezed juice. It was 7:30, Tuesday morning. Ken gazed around the executive boardroom: The company's brightest and most seasoned players gazed back at him. "So," said the CEO, "may I direct your attention to the elephant in the room?"

Ken had ambitious goals for this meeting. Facing one of the most important decisions they would ever make, the team members couldn't simply react to current market conditions or focus on their own careers and wealth. Rather, he needed them to step into the ring for a little out-of-the-boxing. They had to consider the issue from many different perspectives.

The CEO nodded toward Laura Leadbetter, a senior partner sipping a tall cup of Starbucks's strongest. "Laura, if a client of our own strategy consulting group were wrestling with this issue, how might we advise them?"

As a 20-year veteran of business, Laura had facilitated more executive retreats than she could throw a creativity consultant at. Still, she mulled over the question a while before responding. "We all know there are big-money implications to either direction," she said finally. "We want to do what is financially best for the business as a whole and, yes, for us individually. But—forgive me if I get a little Business Strategy 101 here—wealth comes through *fulfilling client needs*. So if I were advising a business, that's what I would say: First, define your clients' needs, and then align your genuine assets and business strategy, including capital structure, accordingly."

That was the right answer, and Ken smiled his approbation. Customer focus had always been the CEO's mantra. The team could paint this picture any number of ways, but First Rangeway's clients had to provide the frame. Confident, now, that the discussion would proceed toward the best possible conclusion, Ken threw out this challenge:

"Being a publicly traded company affects us in almost everything we do. We have to consider not only what kind of business this can be, but also what it *should* be. What we are discussing now, and what I will present to the board tomorrow, is no less than the future of First Rangeway. Let's talk."

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