EXIT STRATEGIES

FYI: Dr. Wall Street

BY GEORGE GENDRON

Not in recent memory has it been so difficult to gauge the prospects for going public, but a veteran entrepreneur helps clear things up.

FYI

These are stressed-out times in the world of pre-IPO companies, as you can see from two articles in this month's issue, "The Road to Wall Street," by Jill Andresky Fraser and Emily Barker, and "Finding the Perfect Pitch," by Susan Greco. I can't remember a time when I've seen as much confusion and downright cynicism about Wall Street on the part of CEOs of fast-growth companies.

With that in mind, I called up Tom Golisano, who went public with his promising young *Inc* 500 company, Paychex Inc., in 1983 and never looked back. Today Paychex is an $870-million payroll-processing and human-resource-services company based in Rochester, N.Y., with a market capitalization of almost $15 billion and a price/earnings ratio of 54, placing it in the elite of publicly traded businesses.

Golisano is someone we've frequently turned to for wisdom and perspective on one of the most charged relationships in the **Inc** universe -- the waltz of emerging growth companies and Wall Street. He seemed like the ideal person to provide the kind of levelheaded thinking about the public-equity markets that we so desperately need right now.

What would you say to growth-company CEOs about what's happening on Wall Street and their own prospects for going public?

They should just be patient. These things go in cycles, and we've been through some pretty dramatic swings in the past few years. It takes a while for a market to recover -- sometimes 12, 18, even 24 months. Then, all of sudden, we'll be back in a normal market for IPOs. So my advice is to be patient, work on the fundamentals of your company, and -- when the time is right -- go for it. Don't get frustrated just because conditions aren't favorable today. Those conditions will change.

What about the perception that Wall Street has become increasingly ruthless about expectations and punishes companies mercilessly for any slip?

I think that's a symptom of the fact that companies were tremendously overpriced. The price/earnings ratios got so high that even the slightest bit of bad news would lead to a dramatic reduction in a company's stock price. And I'm not talking about just Internet and tech companies. Our P/E at Paychex got up to 110, which was wild. When there's bad news about a company that's sporting that kind of P/E, the downside is huge and fast. It has nothing to do with investors' being ruthless or unforgiving. High P/E ratios inevitably lead to extreme nervousness and volatility on Wall Street.

Do you see any signs that the situation is changing?

Somewhat. Our P/E is down to 54, which is still higher than it's been for 75% to 80% of the time we've been public. From one perspective, you could say that our market capitalization has been cut by 30%, but it's also true that our stock price before was completely out of line with our history. So maybe the market has just corrected its mistake.

You sound awfully calm for a guy who owns more than 10% of Paychex's stock.

Well, I've always had the philosophy -- and I hope it's come through to the public -- that I want Paychex to be around for a long time and that I can best help make that happen by staying focused on its financial performance from day to day, month to month, and year to year. I'll let the market experts decide what the value is at any given moment.

I also know the value is going to fluctuate all over the place regardless of our performance. A long time ago someone told me there would be three factors determining our stock price after we went public. One-third of the price would reflect how well we were doing, one-third how well our industry was doing, and one-third how well the stock market was doing. I took that advice to heart, and I learned not to take stock fluctuations personally. A lot of them have to do with things beyond my control.

For as long as I've known you, you've always preached the virtue of consistency. Still true?

Absolutely. It's crucial to have consistent, predictable financial growth. That's really the best thing you can do for your stock price over time. For example, we increase our sales

organization 10% to 14% a year. People always ask me, "Why don't you increase it 25% or 30% if the demand for your products is there?" First of all, a sales organization can't take that kind of growth on a regular basis. Second, it would give us erratic spikes. Third, I don't think that the market would reward us for doing it. Our rewards have come from being predictable and consistent.

So what kind of growth do you look for?

During the 1990s our annual growth was 17% to 19% in sales and 25% in after-tax profits. In this decade, once the economy gets straightened out, we expect to grow an average of 14% to 17% on the top line and more than 20% on the bottom line.

In the past you've said that the pressures of the market enforce a healthy discipline on companies. Do you still believe that?

Basically, I do. I've seen too many cases of CEOs' blaming the public arena for their companies' failure to perform. I don't buy it. Being public, with all the disclosure requirements, generally has the effect of keeping you honest with your shareholders and making it more difficult to wander off in the wrong direction in terms of investments or new products. It also forces you to be more focused and structured in terms of your responsibilities.

But what about the relentless pressure on short-term performance?

I don't think it's unhealthy to the degree that some people say, and I'm not sure it's unhealthy at all. During the dot-com era, there were problems because a lot of investors got into what I would consider speculation. They were caught up in the internal dynamics of the marketplace. They sought to make money by timing the purchase and sale of securities. They weren't focused on the companies themselves.

When you go through an economic downturn and the market gets hit pretty hard, people go back to basics, which I think is good. Somebody asked me recently what I thought about the Enron scandal. I said I thought we needed an Enron scandal every now and then to keep us honest. Look what it's doing to the accounting companies. They're certainly paying attention, and they should be.

Does Enron create a competitive advantage for companies that have a clear business model and utterly transparent accounting procedures?

I've always believed that those things give you a competitive advantage. At Paychex we work very hard to make our information as clean, as simple, and as understandable as it can be, and we get tremendous kudos from Wall Street for doing that. We want our disclosure to be absolutely consistent and available to all our shareholders at the same time -- from institutional investors to retail investors. We're also extremely careful about what we put on our balance sheet. The company doesn't own airplanes or a fleet of luxury automobiles. We're very moderate when it comes to capitalizing costs. There are no intertwined real estate holdings, with the company leasing facilities owned by shareholders. We don't play any of those games. By the same token, our executive-compensation levels are very conservative. That's been our philosophy all along, and it's been a strong positive for us in the public arena.

But you do have an airplane.

I own it personally. When I use it for company business, Paychex is charged a charter rate that is way, way below the market. That's how we've always done it, and I believe we've been rewarded for that practice and others like it.

A surprising number of founders took their companies public in the past four years, hoping for short-term liquidity.

There are four basic reasons for going public. First, it's one way to obtain the financial resources you need to grow. Second, it does great things for your marketing. Third, it's an excellent tool for recruiting employees. Fourth, and probably most important, it does provide liquidity and an avenue for eventually cashing out of the company -- but only in the long term, not in the short term.

By the way, both Susan Greco and Jill Andresky Fraser have new books that will be of particular interest to *Inc* readers. Greco is the coauthor, with *Inc* 500 CEO Mary Naylor, of *Customer Chemistry: How to Keep the Customers You Want -- and Say "Good-bye" to the Ones You Don't* (McGraw-Hill). The book explores the methods used by Naylor and others to identify their most valuable customers and build intense, long-term relationships with them. It's a wonderful source of new ideas about selling in today's crazy market.

Fraser's book is *The Business Owner's Guide to Personal Finance: When Your Business Is Your Paycheck* (Bloomberg Press). It's filled with the kind of information you need to increase and protect your personal net worth as you build your business. Placed strategically throughout the book are tips and war stories from Pat McGovern, Ruth Owades, Tom Stemberg, and other

legendary entrepreneurs, which are a great touch.

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