Testimonials from a variety of John's clients:

I want you to know I would come to you again, without hesitation, to use your services, because of the way you won my trust and confidence in every phase of our work. Thank you again for your excellent work.

John Hoyt, President Picture Source, Inc. Seattle, WA

You have made me a stronger leader helped me increase my staffs' development, accountability and cohesiveness and increased my focus. All of this has increased my sanity

Sallie Neillie, CEO, King County Project Access, Seattle, WA

The ability to have you available to use as a sounding board to toss things around with when things got tense and emotional proved to be a benefit for me.

Matthew Finnigan, President, National Concrete Cutting, Fife, WA

John successfully acted as my advisor/investment banker to help my buy a >$10MM operating business. John is extremely well connected in this market place in Washington, is well regarded by other service providers, resulting in strong deal flow. John also has a unique method of finding available businesses, which often results in a great transaction for all parties. I strongly recommend working with John and would use his services again in a minute.

Bill Tenneson, President, Downstream Partners, Inc., Seattle, WA

We appreciate the work you have done for BSSI this year and look forward to our continued relationship. Without your help I would be out of business. I am sure that "keeping us on track" seems daunting, but at least your efforts are appreciated.

Ken Becker, Pres., Burhans-Sharpe Sales, Inc., Seattle, WA

When I think about the help you gave me, the value I received was not in the hours of help, but in the quality of help. You played a key role in helping me achieve my dream. Thanks for everything!

Keith S. Jackson, President, Industrial Revolution, Inc., Redmond, WA

We appreciated the fact that John is very knowledgeable in his field and we felt very confident with his help. We recommend John's services to anyone selling a business. His fee is well worth it. His service is excellent.

Richard and Judi MacIntosh, Print Media (sold), Everett, WA

One of the things that I have appreciated has been John's ability to draw out and internalize the objectives, criteria and priorities that I have established for myself, and to be guided by them in his efforts. John has provided invaluable counsel to me throughout this process, and there has never been any doubt that he was looking out for my interests. I would recommend that anyone utilize his services.

Gary Tashjian, Seattle, WA

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Without An Exit Strategy You Have No strategy

A collection of previously published articles and checklists

John Martinka—Martinka Consulting/"Partner" On-Call Network

"Partner" On-Call NETWORK
STREET SMART ADVISORS SUPERIOR RESULTS

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Why Your Business May Not Be Worth What You Hope It Is

Twenty reasons it may be worth less

1. **Dependency on owner**-too many businesses suffer from the all-controlling owner who not only knows how to do everything but also insists on being part of everything. Don't let yourself be the bottleneck. A buyer may pass or offer a lower amount when they see how big the shoes they have to fill are.
2. **Customer concentration**-no buyer wants there to be a small number of key customers doing a disproportionate share of your volume. Diversify your customer base and realize if you have a highly concentrated customer (or industry) base you may be asked to include an erosion clause that lowers the price if a top customer leaves.
3. **Financial statements and tax returns differ**-there isn't much to say about this. Have good accounting systems and safeguards and accurate statements. Don't rely on too many adjustments for the tax return or an overwhelming amount of 'add-backs' (to profit).
4. **Dependency on a key employee**-a company had severe problems when their top salesperson left and took most of their accounts. This problem could manifest itself with a technical expert, machine operator or office manager (who knows how everything in the firm works; see dependency on the owner above).
5. **Poor lease or no lease available**-you may think a month-to-month arrangement is great as it offers flexibility. Buyers and banks think about how expensive it is to move. In fact, for other than a professional type business (like consulting, accounting, etc.) your buyer won't get a bank for longer than the term of the lease including options. Too short of a lease means too short of a seller and/or bank loan and too high of payments to make the deal feasible.
6. **Behind the curve on technology**-while some owner's don't think this is important, to a buyer doing things more efficiently has a cost for hardware, software and implementation. Use your experience of your business to get technology up-to-speed, show increased efficiencies (and profits) and sell for a higher price.
7. **Skimming cash**-there isn't a CPA around who will let a buyer be convinced to pay a price based on unreported cash. First, you are cheating the IRS. Second, is it worse that you're skimming or worse that you say you are but really aren't?
8. **Too small**-a business doing $2,000,000 in sales will not get the same multiple of profits as a similar business doing $20,000,000. There's just

Don't do what your CPA tells you! By that I mean, don't do all you can to minimize taxes. Show profits. Show a high salary. Make it easy for a buyer to justify your price.

I recommend you stop actions such as:

- Taking cash — it can't be proven, if you mention it you cast suspicion on your whole operation (how trustworthy is someone who cheats the IRS and admits it) and buyers may think you're saying you take cash but really don't.
- Expensive junkets — forget the family trip to Hawaii disguised as your annual corporate meeting or the fishing trip to Alaska.
- Automobiles, etc. — don't provide a car for your spouse, kids and parents. Don't pay your spouse a salary if they don't earn it (a buyer will never believe your spouse does nothing yet receives a nice paycheck), don't put your kids on the payroll so their college tuition gets paid with money taxed at a lower rate and forget about funneling personal, household expenses through the business.

Savvy business buyers look for situations where the seller is forced to sell. Selling a business is not like selling house. You can't fix, paint, landscape and have it ready in a couple months. It may take two to three years to make it presentable if you've been "playing games."

Statistics state that nationally, only 20-30% of businesses whose owners want to sell ever actually sell. According to a study by the Institute of Certified Business Counselors and surveys in Inc. magazine sellers settle for about 60% of their asking price. (For a free rating sheet for goodwill and other factors, call or e-mail me.)

Having an ACTION™ plan assures you won't rush the process, creating buyer suspicion and a lower price. Companies that sell and especially those that sell at or near their asking price, are those that pay attention to the details mentioned here. As with anything, doing it right the first time is much easier, more time efficient and more profitable.

improved margins, expanded his sales channels, streamlined the inventory system and tightened up the financial controls. He concluded by saying, “Just like in the business plan I wrote prior to the purchase.” His plan provided the roadmap to get to the next level. Whether one page or a book, do you have plan to guide you as you grow?

- Service — Connie Granston, the owner of Varland Design, always gives her clients that little extra. One of her clients told me he couldn’t believe the service they provide. They take care of every little detail, and then some. This instills loyalty. Think of the little extras that will keep regulars coming back.
- Marketing — Picture Source, Inc., a leader in the wholesale art industry, uses effective market research to determine how to meet their buyers. They know which trade shows to participate in and what to do at the shows. Two keys are to get a keynote-speaking slot at the shows and to sponsor a dinner. At one recent show, a twenty-foot electronic sign continually displayed their company name and their sponsorship of the dinner for the two-hour event. Do you regularly research the market, the competitors and survey your customers?
- Technology — Seattle Publishing, Inc. has developed a technology that interfaces desktop publishing with databases. Their initial market is any company putting out a catalog with at least 1,000 items. This technology shaves weeks off the production time, saves thousands of employee hours and many thousands of dollars. What technology are you <u>not</u> using that could aid your employees, increase security, reduce theft, help your customers and ultimately increase profits?
- Operational structure — Do you have an organizational chart? Is there proper delegation, do your employees accept delegation and do they operate as a team? Again, don’t let the company be dependent on the owner. A buyer wants a smooth transition with structure in place. Can you meet that goal?

Your financial statements should be straightforward and accurate. I’ve seen too many businesses that sold for less than they could have because their accounting system was sloppy and financial statements were not perceived as accurate. One client lost his two top acquisition prospects because he refused to get his financial statements in order, after a year of prodding, pleading and pressure. He finally sold for a very low down payment and the balance on an earn-out.

more risk factors the smaller the business is. An issue that is a major disruption to a small firm is a minor hiccup to a larger firm.

9. **You are blending too many personal expenses into the business**-yes; there are advantages to paying for things with pre-tax dollars instead of after-tax dollars like employees have to. Carry it too far and it’s almost as bad as skimming. Bottom line, buyers and banks like to see profits. Show a lot of profit, pay some tax and it will come back to you in multiples when you sell (and make it easier to sell and finance the business).
10. **You have to work too hard *in* the business**-buyers look for businesses they can work on not work in. They may not have your passion for your product or service; instead they have business skills to leverage what you’ve done. Step away from doing things an employee could do.
11. **Financing is hard to get**-banks don’t like your industry, your business or acquisitions in your industry. If you industry requires a high level of industry experience a buyer without that experience won’t get an acquisition loan. However, you may get a higher price by financing more of the deal.
12. **No business or marketing plan**-while a plan may not directly reduce the value of your firm (other than via the fact that companies with a plan have significantly higher profits), a business and marketing plan may add to the price a buyer is willing to pay.
13. **Poor or no management team**-buyers like to manage and lead; they don’t like to do. A poor team means a lower value.
14. **Salary is not profit**-an appraiser will want to know what is the fair market salary for the job of running the company. If you weren’t there you’d have to pay someone to be president and that salary is not profit (by a long shot).
15. **Saturation**-this is often a function of franchising and/or low barriers to entry. Eventually this leads to competition based on price and it’s hard to win in that situation.
16. **Special skills or license needed**-about 2/3 of all small businesses need an owner with general business skills and business common sense. Those are the types buyers like the most. If you have to be a PhD in an advanced scientific field to own the business, well good luck finding a someone with money who wants to own a business.
17. **Vendor concentration**-don’t overlook this. The vendor(s) may not pull any tricks but what happens if your sole source has problems, goes out of business, etc.
18. **Working capital needs**-you pay your people this week. You pay your suppliers in 30 days, the rent and other overhead every month and your

customers pay you in 90 days. That's working capital and that's why fast growth can be a problem. It takes cash to grow and if you don't have access to enough cash you've hit a bottleneck (see the first reason on this list).

19. **You have a job and it's not as CEO**-in other words, you work in the business not on the business. If the business can't survive if you're not on the shop floor you aren't a manager you're a working employee. This probably means growth is stagnant, as you have no plan, leadership or management.
20. **You've bled the business**-every last cent goes into your take-home pay and the assets are in need of repair or replacement. This leads to lower profits. One owner was so cheap he wouldn't buy a new printer. After the sale the buyer bought a new printer, the accounting department stopped having their systems freeze up when something printed and their efficiency soared.

Without an Exit Strategy You Have No Strategy

employee has less than three years tenure. Perhaps "hard to match" means they don't stay very long.

"Gross profit margins have been stable even with the sales growth." This statement accompanied financial statements showing a 15% decrease in gross margin over the past two years. If nothing else, be accurate.

The company does little or no marketing. The owner feels there is the potential to double business with a little marketing. Then why didn't the seller do some marketing so he could tell the buyer what works and what doesn't work. Of course, the seller expects the buyer to pay for this potential.

The owner is motivated to sell because he wants to retire. Sounds great, except in this case the owner was about 40, wanted all cash and a price about four times what the business was worth. I'd be motivated too!

What exactly should you transmit to a buyer? Start by determining your logical buyer. Is it an individual or small business that needs profit based on the way you're doing business now? Or is it a large corporation that will consolidate, absorb overhead and seek rocket ship growth.

Roland Martin, of Martin Brass Foundry in Torrance, CA told me his two key factors in company evaluation. First, he looks at the sales. Exactly what do they produce, what is the potential of that product, how capable are the production people and is the facility up-to-date.

Next, he assesses how it will fit in with his current operations. It must be complementary with his current operation. The skills of his employees, the new employees and the management team must be in harmony. Since we tend to be experts in our specific field, straying too far can be dangerous.

Keep it realistic, avoid hyperbole and you will move ahead much faster. You have to live with the buyer after the sale, so present everything with integrity.

The intricacies that make your company special (and profitable) along with the operations are truly the key. I previously mentioned the non-financial factors. Let's look at some specifics, real life examples.

- Pricing — My good friend, Ted Leverette, President of Business Valuation Network, Inc., determined early that the price for his product really didn't matter (within limits). People bought if they wanted it. Therefore, he prices his product at the upper end of the market range and limits the number of customers. How do you price your services?
- Planning & structure — Tim Johnstone bought Anywear Shoes and updated me on some of the things he's accomplished. He explained how he's

The non-financial factors include employees, customers, suppliers, the competition and your lease. People are always a business' top asset, especially in the early 21st century. No matter what the economy there seems to be a mismatch between the employee skills needed and those people possess. Loyal employees are valuable and a necessity especially if you think there is any chance they will be tough to replace.

Management structure is a key to getting a high price and a smooth transition. Whether your buyer is an individual (a financial buyer) or a company (a strategic buyer) they don't want to see a one-person show. If you can take a vacation for one, two or even three months and upon your return the company is stronger than when you left you have quality management.

Having management, processes and systems is not enough. You must massage and structure them so they so they happen automatically. To use an old cliché, the left hand must know what the right hand is doing. The marketing plan and production must relate. It doesn't do any good to generate scores of new customers every month if you can't provide them the best in product or service. Production can't be so far ahead of marketing that inventory piles up and puts cash flow into disarray.

It takes teamwork between people and between systems.

Transmitting means presenting. A buyer must see the company for what it is. Nothing more, nothing less. Present the potential, but have supporting research. Potential is the word most overused by business sellers.

The basics of presenting your company to a buyer include covering the obvious things like sales, profits, product or service, etc. Emphasize the little things that most sellers forget about. Customers, employees, the lease, supplier relationships, marketing, competition. Go into detail, without giving away any trade secrets. Astute buyers will notice this. Remember when buyers have to dig for information they always wonder why the information was so hard to get and what else the seller could be hiding.

Here's some blatant examples of errors I've seen in the presentation of businesses.

> *The company doesn't have any [serious] competition.* Right, let's get serious. There is always competition and if there isn't maybe it's because the industry is dying.
>
> *The employees have a loyalty to the company that is hard to match.* I saw this comment in the prospectus of a business where the most senior

Without an Exit Strategy You Have No Strategy

10 things a business owner/seller should not do

Business owners do a lot of things right. This is especially true of the owners of profitable companies. However, many of the habits, traits and actions that got the business from startup to where it is now are exactly the things holding it back from the next level. Here are the top 10 things a business owner and/or seller should not do:

1. **Emphasize potential**—too many owners look at what their business could be not what it is. Of course, they expect to be paid for that potential (before its realized) because "it's such a great business."
2. **Hang on too long**—know when it's time to get out. Too many owners coast and then wonder why buyers ask skeptical questions. Keep in mind that a decline to you is a little less profit. To a buyer, with acquisition debt payments, it can be a disaster.
3. **Cheat the IRS**—don't skim cash. After all, what's worse, a seller who says he skims cash or one who says he skims but really doesn't. Also, don't deduct your personal expenses that could be from Costco, the grocery store, vacations, your kids cars and insurance, etc.
4. **Have to tell a story**—if you have to explain why your business is better than the financial statements and tax returns show it is then you have problems you should have fixed a few years ago. It doesn't matter who you have to explain it to, banks, buyers or prospective (key) employees.
5. **Be a lone wolf**—nobody wants a business that dies if the owner leaves, gets hit by a bread truck or sells. Build a management team and prove they know their stuff by taking a month long vacation. Better yet, for three months don't do anything day-to-day. Don't make sales calls, go on the shop floor, do any accounting, etc. Spend all your time on vision, strategy and recreation.
6. **Be small**—you may think it's a sign of good management to keep the business small. Buyers think it's a sign of stagnation. Continually grow the business, show what you did to grow it and don't let up.
7. **Not show profits**—banks and buyers love profits. All the excuses in the world only go so far. The bottom line is, show profits and pay taxes.
8. **Be unprepared**—not having your people, process, systems or financials in order is a deadly sin. If it doesn't lower the price you'll get it's because your lack of preparation already scared off the buyer.
9. **Wear down your assets**—when a buyer sees future capital expenditures they naturally assume there will be other expenses upcoming. Operate the business like you plan to maximize profits for the next decade.
10. **Have no written plan**— The lack of a business plan is the number one business mistake and companies with a plan have sales and profit growth

twice that of companies without a plan. Owners without an exit strategy have no strategy.

Bonus reason, #11 – Waiting for the perfect offer—While it happens all the time, in 2010 there were a lot of owners who wish they had taken that "too low" offer from a few years ago. That's because that same offer is now considered outrageously high.

An ACTION™ plan to sell your business

Originally in PARKING published by the National Parking Association

Selling a business is tough. Even profitable, well-run companies must overcome obstacles on the way to a win-win deal. Examples of obstacles include:

- Profits drive the price. If you don't have high profits you better have something else to create value. This includes proprietary products, proprietary technology or an unexploited niche.
- While buyers want a well-run, profitable company they also want potential. If you present your company as running at maximum efficiency you will scare away those buyers who fear any change will cause profits to decrease (after the buyer has valued the business based on the high profits).
- A buyers skills and interests must match the attributes needed to run the business. The business cannot be extremely dependent on the owner (no management structure).

To maximize price and streamline the selling process a business seller should follow an ACTION™ plan. Follow this plan and you will set yourself apart from other sellers. ACTION™ stands for:

Arrange all the affairs of the company

Coach and counsel the company. Its people, process and systems

Transmit and teach all the good "things" about your firm (and those "things" are)

Intricacies that make your company special

Operations and management systems in place that will make a transition smooth

Numbers, all the financials in understandable form, straightforward with no "tricks"

Arranging the affairs of the company is preparing it for sale. What's involved in this, the most important component of an ACTION™ plan? Pay close attention to the company's:

- Non-financial factors
- Marketing plan and efforts
- Management structure
- Processes and systems

spend thousands with a major radio station. Yet most of the people hearing his ads were never going to come to his store — no matter how good the offer he made.

There are a lot of things you can do to groom your business for sale. The more time you take to do so the better. The more emphasis on profits and what creates those profits the better. There will always be a good buyer, willing to pay a fair price, for a profitable company.

10 Ways to Pay More Taxes and Have More Money

It sounds counterintuitive but it's easy to pay more taxes and have more money left over. Too many owners do all they can to reduce taxes and profits and it can come back to haunt them many times over. Common strategies (to reduce taxes) include being cheap on people and equipment, morphing into a lifestyle business (a lot of personal expenses paid by the business), being lackadaisical about growth and not realizing profit comes back many times over, in price and cash at closing, when selling.

1. **Take manageable risks and reap the rewards**—Don't get comfortable. Whether it's because they have enough money, don't want to work any harder or have become risk adverse it doesn't matter. Taking "good" risks can increase sales, increase profits (more taxes) and generate employee enthusiasm (who may feel stifled because their ideas and creativity are ignored).
2. **Hire better people and sales and margins will increase**—Don't skimp on good people. Be like one client who hired two top salespeople. Both required a base salary double what the company had ever paid before. Both were in commission (sales above the base amount) within four months. The previous salespeople rarely made it to commission even at the lower base salary.
3. **Delegate to your people and use your creativity to grow**—Don't just hire good people, give them responsibility and let them go. You'll get higher sales, lower costs and more profit (more taxes, a good thing).
4. **Sell for a higher multiple (of profit)**—Here's a real kicker. Businesses sell for a multiple of profit. The larger your business the higher the multiple. The more profit, the higher the multiple. And the gain is usually taxed at capital gains rates.
5. **Sell for more, as the profit is higher**—It seems pretty basic; grow the business, make more money and a buyer will pay you more for your company. And, there's a good chance your tax rate on the proceeds will be at a lower rate than the tax on your salary or distributions.
6. **Create a growth plan—**Implement it, increase sales, generate more profit means as that means more tax and more net.
7. **Have access to more and cheaper credit**—Clean up your balance sheet, have retained earnings and your bank will want to lend more money to you (and at a better rate).
8. **Buy a competitor**—Instantly increase sales, absorb overhead and have a much higher net. Also consider buying a supplier, customer or business with similar customers as your and with different products.

9. **Make better decisions by having the right management reports**—Knowing where you are allows you to make better decisions. Better decisions mean more profit (and, again, more tax and a higher net).
10. **Stay in touch with customers**—A client once said to me, "It's amazing what happens when you pick up the phone and actually call your customers." Don't wait to hear from them, be proactive and generate more orders.

personal phone bill went through the company. Although she never admitted it, I'll bet some cash sales never made it to the register.

She acknowledged the fact that if she hadn't done all of this maneuvering the price of the business would be $150,000 higher. She saved, at the most, $15,000 a year in taxes. That's a lot of years to make up the price difference.

Have systems and document them

Having systems doesn't mean process management like at GE, GM or Boeing. It means documenting what you do, what's worked, what hasn't, etc. It could be as simple as "we don't order the customers product until the deposit is received," "we don't start a job until all the materials are in" or "we make bank deposits daily."

How your employees interact with customers (what they do and say) can be considered a system. In fact, anything that is done repeatedly is a system and needs to be documented.

Look at marketing, operations, sales, production, administration and financial. Keep a book of how different tasks are handled and why. Make sure your employees are familiar with what you do in these areas and why.

It all starts with research. Knowing what your customers want, how to get the best deal from suppliers or scheduling employees so you're covered during peak periods and not over-staffed during the slow times.

My daughter worked for four years at a coffee shop. A new manager organized things so that the employees don't have to keep doing tasks over and over (that should really be done only once). This is a system.

Marketing

Okay, admit it. For many of you, the word marketing leads to a cold sweat. It's the topic that will always fill a room and generate interest. It's the term most used by owners to describe the potential of their business, as in, "We're not very good at marketing so if a new owner could market the business there's a lot of potential."

The basics are really not that difficult. Again, it starts with research about your customers. It's knowing the problem you solve for them, the benefits they perceive, where they come from and why they do business with you.

The problem is that too many people confuse advertising with marketing. They try something, it doesn't work and they think that either they don't know much about marketing or that marketing doesn't work. A business owner with a retail customer base that is usually no more than 5 miles from his store was going to

London Calling, How it's done Overseas

Originally published in the Everett Business Journal

I recently returned from a European vacation. After a week hiking in the mountains in Eastern Europe (let me tell you, it's nice being where there are no phones or e-mail), we concluded the trip with a 180-degree turn, a week in London.

While there, I picked up the Sunday London Times. The business section had an article titled, "Grooming your firm to attract a buyer." Which was a good article with wise advice. Let me share their top tips and add a few items. Combined, this information will help you get a better price, better terms and give the buyer a greater chance to succeed.

Here are their four tips (I've edited these for brevity and put my comments in parenthesis) followed by my three big-picture strategies.

1. Take at least a year to prepare it. (At least a year is right. Three to five years is much better as buyers and banks will ask for three to five years of financial information and this give you time to show the results of your preparation. And be sure you know what it's worth when you start preparing so you know how much you have to do.)
2. Tidy it up inside and out. Get all accounts in order with customers and suppliers. (Very true and don't forget the financial statements. Make them clean, accurate and timely.)
3. Have a plausible explanation as to why you're selling. (Especially if you're not selling because of the "D's" — divorce, death or disability or some other catastrophic event.)
4. Don't tell staff or customers until you need to. (This can be a real killer as a friend found out when he ignored this advice and his two key people gave notice within a week of him telling them he was selling.)

Show profits

Amazing how profits will get a buyer in the buying mood. That's why it may take longer than one year of preparation time. Especially if you've been using a lot of tax avoidance strategies. I've always maintained that a company with a healthy bottom line and a nice salary to the owner is easier to sell than one where you have to justify all the expenses you claim aren't really necessary.

A client was buying a business that was for sale because the husband was deathly ill. The wife, who ran the company, took advantage of every strategy and loophole available to reduce taxes (and then some). Expenses like the

When Business Buyers Really Aren't Buyers

Ten Warning Signs of Non-Buyers

Selling a business: Beware! Too many (supposed) business buyers really aren't buyers. There are numerous types of non-buyers and traits they exhibit. They could be individuals, equity groups or other companies. Ten prominent signs to look for are as follows:

1. **The stealer**- they want to pick your brain and then go start their own competitive operation. Watch out for detailed questions about operations and marketing before you've agreed to a deal (or they object to a non-piracy clause in any non-disclosure agreement).
2. **The analyzer**-the bigger the spreadsheet the lower the chance of a deal happening-enough said!
3. **Columbo**-always one more question. A major question or a minor question it doesn't matter; there is always one more question.
4. **Bottom feeders**-negative about your business even though they say they want to buy it. They are subtly beating you down so when an offer is made they hope you're glad to take anything.
5. **The tire kicker**-they've been looking for years and just haven't found the right company (and never will).
6. **The dreamer**-not qualified and love thinking about owning. This is why seller's need to do more due diligence on buyer's than they normally do.
7. **Hunters (not killers)**-they tell stories of many "almost" deals. The reality is they can't pull the trigger and never will (like a tire kicker although they get much further into the process, wasting more of the seller's time and money).
8. **The "Own a job" buyer**-they are looking to buy a job if they have to but really want another job in the corporate world. Watch out if they talk about salary more than growth.
9. **The poor**-they have no money and hope you'll take pity on them and finance the whole deal (a bank won't so why should you?). Not showing your net worth statement or investment account statements is a sure sign they aren't financially qualified.
10. **The rich**-it's a hobby to search for a business; it gives them something to do. So if your buyer has more than enough money to live on the rest of their life why should they buy a business?

10 Reasons to Grow by Acquisition

Peak at the right time and you win a championship; even if your team wasn't the best over the whole season. Buy another business at the right time and your sales, profits and exit options grow exponentially. Here are 10 reasons why small and mid-sized companies should consider growing by acquisition.

1. To expand your customer base and your product base. Sell your products to the acquisition's customers and their products to your customers. All without adding to your sales force.

2. To get great employees who are not in the job market. Because you give more opportunities they'll want to stay and help you grow.

3. Access to vendors who might not consider you as a source to sell their products.

4. Enlarge your geographic footprint without the hassle and cost of starting a branch office and having to steal customers from competitors. This may also get you a desired location that otherwise is unavailable.

5. Eliminate a competitor so you can dominate a market or a niche.

6. Spread your overhead over a much larger sales base so much of the added gross profit goes right to the bottom line.

7. Qualify for volume discounts with suppliers now that you're buying more from them.

8. Get needed equipment that comes with nice things like customers, employees, cash flow and market share.

9. Demonstrate to future buyers that your company can successfully absorb another firm with out a loss of profits or market share. This is huge to larger firms and private equity groups.

10. Scaling the business gives you more options and a higher selling multiple when it's time for you to exit. All other things being equal, larger companies sell for a higher multiple than small ones.

Without an Exit Strategy You Have No Strategy

An article in the *Wall Street Journal* stated that 70% of mid-sized business will sell in the next decade and that 90% of them will be unprepared for a sale. Those owners face the prospect of being in a market glut and behind the leaders. Well-prepared companies will sell faster, sell with less hassle, be financed easier and, most importantly, and be a safer purchase for the buyer. All of this means a higher price and better terms for the seller.

Preparing a business for sale is not the same as an exit strategy. It is part of an exit strategy. An exit strategy is the plan for when to leave the business, determining the amount of money the owner needs from the business and how to get to that point.

Preparing it for sale is the tactical implementation of that strategy. It starts with creating a great first impression (clean offices and/or plant, sharp looking people, etc.). It's reviewing and cleaning up the financial statements and accounting system, implementing and tracking the results of a marketing plan, cleaning up all disputes (legal, customer issues, employee or union issues, etc.) and having all the information a buyer will want for due diligence in a logical order.

Last but not least it is having an advisory team (legal, tax and financial advisor plus an intermediary) and letting any management and employees who need to know what the owners future plans are be part of those plans. If you, as an owner, don't want to tell any of the employees that you plan to exit then drop hints like, "Retirement sure sounds good," or "I wish my vacation could last two months." Then they won't be surprised when a sale is announced. They'll be thinking, "Yes, the boss has been hinting at getting out."

I worked with a client who felt that too much profit was, "Slipping through the cracks." He had a growing and successful business and also had a "feel for the business" that told him he was not maximizing efficiency.

One of the things we did was facilitate a management team exploratory session, without the owner. We put the half-dozen managers in a room for four hours and probed them on what they did, how they did it, where they felt lacking, etc.

At one point, in discussing operational procedures and job tracking between departments, two managers looked at each other and at the same time said, "You do that? We do that too." In other words, they both used time and resources to create the same "report." Coordinating those efforts alone meant saving thousands of dollars a month in efficiencies.

A good first system is to define roles (an org chart, for example, is needed even if some of the people have their names in multiple boxes). Once everybody knows their job and their duties, whom they report to and whom they supervise they can communicate better. It sounds simple but is too often overlooked. Much more often than not this has to be created when working to improve a company or devise an exit strategy. One client had the owner, the owner's wife and the general manager all giving (different) instructions to the accounting department. What a mess! Cleaning up the employee and manager relationships reduced confusion and improved efficiencies.

Having rules, or procedures, and sticking to them does not have to be complicated. For example, a "system" for one client was having the sales and project teams meet before every job started. This eliminated the project team being in the dark and following instructions from the sales team to do the job as it had sold even if the project team knew from their on-the-job experience that there was a better way to get the product installed.

As one of my clients is prepared to make an offer to buy a company we noticed the firm was doing fine until two years prior when they had hired a COO, then sales and profits took off. My client stated that the COO put in systems. Given that his wife and he are "engineering types" this is good. He wants to take over a system, not just a business.

Conclusion

Business buyers are by nature a skeptical lot. They hear a lot of "pitches" and see a lot of clever disguises. A business owner who has taken the time (six months to a few years) to do what it takes make the business be what a buyer wants it to be is way ahead of the competition.

Without an Exit Strategy You Have No Strategy

What's my business worth (and why)?

Originally in published by the Washington Auto Parts Wholesale Association

"If my sales are $4 million I should be able to sell my company for $8 million, right?"

"I don't know, why do you think that?"

"Because I heard a business is worth twice its annual sales."

This was a conversation with a business owner and she was wrong! One of the many myths of business valuation is that a business is worth a multiple of sales. The value (and price when you sell) of a business is a function of profits, along with the company's assets, terms (cash talks) and market supply and demand. The more profits, the greater the value.

All things being equal

Your business is worth a multiple of profits based on industry norms. One business may be worth more than another, even if they have similar sales and similar profits. Why is that?

The assets may be different. A company with old equipment, needing replacement is not worth as much as a company with new equipment. A company with a high asset value is worth more than a service business with no assets.

Assuming assets are the same, the all-important non-financial factors influence valuation. Customer relations, employees and management structure, supplier relationships, the lease and competition are some of the non-financial factors that shed light on the future profitability of the firm.

A business with 400 customers, none accounting for more than 2% of total sales has less risk than a company with 50 customers, five of whom account for 10% or more of total sales. In the latter example, if one or two top customers leave so do the profits.

Tim's company has a management structure, key employees who can handle responsibility and systems that allow new employees to get up to speed in a very short time. This allows him to take vacations, visit vendors and attend trade shows, without fear of disruption or a collapse at headquarters.

Contrast that with this business owner, "To have a computer and e-mail and stuff like that is what makes it possible for me to go [on vacation]. If you could just walk away clean then they don't need you anymore." Jerry L., business owner. (*Newsweek*, June 27, 1998.) Jerry had a lot to learn. If his company and Tim's company were similar in size, scope and profitability, Tim's would have a higher value (and selling price) because of the risk Jerry's company has if he's removed from the scene. It appears he has minimal management structure (and doesn't delegate well).

A buyer is concerned with the profits continuing or growing after the transaction. The non-financial factors give a good indication. (For a 30-point rating form for non-financial factors, call or e-mail me.) Financial statements are the first things analyzed when evaluating a company. Too often, analysts, buyers, bankers and others overlook the non-financial factors.

Concentrate on the non-financial factors and the financials will take care of themselves.

The ultimate decider

The ultimate factor is what a business buyer will pay you for your company and that is based on their perception of what will happen. This means know your buyer. There are two primary types of buyers, strategic (corporations) and financial (individuals, small businesses or buyer groups).

Financial buyers are interested in their management salary, profits, an increase in their net worth, a job and manageable risk.

Strategic buyers place more emphasis on rapid growth potential, management structure, gross margin, key employees, systems and excess or duplicate overhead (which they can eliminate).

To increase the value of your business, increase profits. Concentrate on the non-financial factors that influence value and price. To increase the price a buyer will pay you for your company, be able to demonstrate why profits will continue, research who your best buyers are and mold your company to fit their objectives.

Myths of Business Valuation

The "rule of thumb" says my business is worth "X". In his book The Business Reference Guide, Tom West writes, "Rules of thumb have their place, but we don't want our readers to accept them blindly." West also states, "Rules of thumb do not replace or create a real business valuation — it is just what it says — a rule of thumb." In a recent edition of West's book there are almost 100 pages of rules of thumb, with many industries having multiple and widely varied rules.

They give an indication but do not substitute for a valuation, especially since the Great Recession. Use them for quick comparisons only. Using this essay's

Without an Exit Strategy You Have No Strategy

Too often business owners say that someone who is good at marketing will achieve faster growth than they are achieving. Is it true? Who knows? A buyer worries that every marketing technique available was tried and very little worked.

Are the financial statements true and correct?

Let's start with the Balance Sheet and some basic questions. Are the accounts receivable collectable? Is the entire inventory usable and salable? What about the fixed assets? What is the life expectancy of those assets and what will cost to replace them? Having these items under control gives a buyer confidence.

Moving to the Profit and Loss statement, everybody knows that one of the best advantages of business ownership is using pre-tax dollars for expenses for which an employee must use after tax dollars. A buyer wants to know what profit truly is. When speaking to groups I often tell owners to ignore their CPA (lots of great facial expressions, especially from the CPAs in the audience). I go on to say ignore your CPA and pay high taxes because that means you are showing high profits. Buyers and bankers like to see profits on the tax return.

It comes down to, "What is the free cash flow of the business?" Free cash flow is what is left after all legitimate business expenses, allowing for capital expenditures and having assets accurately reflected. This is money the buyer can use to pay him/herself, put in their pension, pay off their acquisition debt, grow the business, etc.

A buyer client passed on a company because the accounts receivable were in such a state of disarray. He wouldn't take the risk of buying that history and the culture of not collecting monies due in a timely fashion. Another client had the price of the business drop by one-third after the inventory and work-in-progress were adjusted to correct levels.

Good financial statements are a big part in a smooth sale at the price fair to the seller and buyer.

Systems are important

Systems and procedures make the business less and less dependent on the owner. To use a sports analogy, some teams are always known as "over-achievers." The coach has a system and style of play that allows good players to play great (together). That's what I am alluding to. Having systems that allow you to add or replace good people without causing stress to have the day-to-day operations run without micro-management.

For Sale: The Next Step—What is Your Next Step Planning for your Future

Originally in The Crucible published by the Non-Ferrous Foundry Society

"What do you do besides help people buy businesses?"

"I also help business owners prepare their business for sale and formulate an exit strategy," I replied.

I was then asked, "What does it mean to prepare a business for sale?" "

The person asking me said they have heard the phrase "preparing a business for sale" before but didn't understand what the process involves.

My answer was that there are three main functions when preparing a business for sale (and lots of subsets of these functions).

- The financial systems and statements must be in order.
- There should be a proven marketing plan that has been successfully implemented.
- Systems should be in place to improve efficiencies and reduce the role of the owner.

Marketing - it's always an enigma

Five years ago I worked with a client who wanted to sell his business. After I interviewed the owner and reviewed the company's financial statements I told him nobody would buy his company. Profits one year were wiped out by even bigger losses the next. A graph of the annual profits/losses looked like a sine wave.

We determined that the erratic profits were a function of volatile sales and the sales were a result of inconsistent marketing. We put in a rudimentary sales and marketing plan, and most important, made sure the owner and the staff implemented the plan and monitored the results.

We started in July. By the end of the year, sales for the last six months of the year were 50% above the amount projected on June 30. These profits continued the next year and the years thereafter. Sales and profits have been more consistent and the company still has the same owner. There is/was a lot less motivation to sell when things are going well.

A good first step in preparing a business for sale is to:

- Have a sales and marketing plan
- Implement the plan
- Monitor results and document what worked and didn't work.

Without an Exit Strategy You Have No Strategy

opening statement, if you and your top competitor are both doing $4 million, you have $500,000 of profit and he is barely breaking even would these two businesses be worth the same?

I'm going to sell my small, privately owned company for the same price to earnings (P-E) ratio as a large, publicly traded company sells for. Not valid for at least two reasons. Public company P-E ratios are based on after tax profit and private companies are valued based on pre-tax profit (one reason being that small business owners have access to a wide variety of tax avoidance strategies). Second, there is a lot more risk in a small business versus a large, publicly traded firm.

Owner's compensation is profit. Profit is what is left after allowing for fair market manager's compensation. It's a multiple of profit that buyers are willing to pay (and most buyers of small businesses want to earn at least 20-35% on their investment). If you earn $100,000 and it would cost $100,000 to replace you, then you simply have a job and need to grow the business to build real worth.

I deserve something for my sweat equity. There is no such thing as sweat equity. Sorry, but no sane person is going to overpay for a business just because you put in a lot of effort to get it where it is today. Profit over a manager's fair market salary is your payment for sweat equity.

My business is worth the assets plus a multiple of earnings. As highlighted in an Institute of Business Appraisers newsletter, businesses are valued on either their assets *or* on their earnings. Not both. Your business is not worth a multiple of earnings plus the essential assets of the business because this "method" values those assets twice. The assets are worth the greater of what they will earn or what they can be sold for. Essential assets are those needed to deliver your product or service to your customers. They include equipment, inventory, vehicles and similar. Non-essential assets are cash and accounts receivable, because you don't need either to deliver your product or service, can be valued separately and are often added to the firm's enterprise value.

The price needs to cover the personal and business debt I owe. Back in the early 90's a seller told me that he set the price by adding together the business debt, personal debt and the price of a new RV.

The potential of this business is great, which is why the losses and my reduced salary over the last three years are a fluke In fact, you, as a new owner should do much better than I've done with my 20 years of experience. Therefore, I want you to pay me for the future profits I haven't been able to generate. Just look at the profit eight years ago.

T*here is a value to the cash I pocket (without reporting on my taxes).* If you're willing to cheat the IRS how much trust should a business buyer have in you? If you're skimming cash you've already been paid for it by not paying taxes.

So what exactly does influence the valuation and price of a small business? Fidelity Mutual Funds ran radio commercials featuring investment guru Peter Lynch. One of the statements Lynch made was "Profits drive the market." Well, profits drive the price of a small business.

- One times seller's discretionary earnings (SDE - owner salary, excess perks and profit)
- Thirty to fifty percent of annual sales plus inventory
- 1.5 – 2 times seller's discretionary income
- Four times EBIT (Earnings before interest and taxes)

Manufacturers rep firms pricing guidelines are a lot like those for CPA and other professional service firms. For years the AICPA has stated that CPA firms should be priced at one times annual revenues plus or minus 25%.

Most small to mid-sized businesses will sell for three to five times profit. Where the price falls within that range, or even makes it into that range (or is above) is a function of assets, the non-financial factors and the terms. For example, a company with 63% of sales to 63 customers has a lot less customer risk than a company with 63% of sales to three customers.

A company with tangible assets will sell for a company without assets. Larger firms with the same profit as a percentage of sales will sell for more than a smaller firm. I think you get the picture; there area lot of factors to take into consideration and that is why rules of thumb are just that, a method to see if you are, "In the ballpark."

One note, any formula that uses revenue is merely a starting point. That's why the CPA Institute has the buffer of 25%. If one business has 15% of sales as profit and another, similar size and type of firm, has 3% of sales as profit there is no way they will be worth the same. If your firm is doing (much) better than average, you will definitely agree with this.

Then there's the subject of terms. There is plenty of information that shows that the more cash at closing the lower the price. Sometimes substantially lower. It all has to be taken into account.

It's a long process and the above outlines three areas to start with:

- Determining your plans for your next great adventure in life
- Understanding who is your logical buyer and what they want in a business
- What is your company worth now so you know the job and timeline needed to get what you want or need financially

To circle back, there will be a lot of businesses on market and the prepared business will sell faster, easier, for more money and to a better buyer.

mom and dad were ready to exit (on a day-to-day basis as they remained on the board) he had been running the operations and sales. He was ready.

If you don't have family or management in line to take over your tactics will be different. An outside buyer wants to be assured that profits will continue and that systems are in place to make the transition smooth. Above all, they do not want the business to be overly dependent on the owner. To put it another way, they (and you) want high company goodwill not high personal goodwill.

Financial buyers are those who need a salary, profits and usually want to be the company president and make the decisions. Strategic buyers often are in the same or a similar industry, they care more about growth, management capabilities and the ability to absorb overhead.

When do you want to leave? Is it in six months or six years? Much of what you do is dependent on the answer to this question. If the answer is a year or less there are strategies you cannot do if you expect to see the results manifested prior to marketing the business. However, there are plenty of things you can do in a short time period. Cleaning up your financial statements is one of those things. Eliminating the excessive blending of personal and business expenses is something that's easy to do. Banks and buyers like to see a healthy bottom line and the extra tax you pay will come back to you in multiples.

Is it worth enough?

So what exactly is your business worth? While it's not the point of this article to delve into the subject of business valuations it is a subject on everybody's mind. When speaking, if I don't cover this I always get asked so I now include the topic.

In simple terms, the value of a business is generally a function of the business's profit. While there are exceptions, in most cases we can say that the higher the profit the higher the value (and price). Profit is a term that has different meanings to different people. A business appraiser will typically determine profit by adding together the net income on the tax return plus the owner's salary and owner perks and then subtracting a fair market management salary for the job of running the business.

Here are some "Rules of Thumb" from an industry book (and, of course, this two inch thick book has a disclaimer that rules of thumb are only that and a business should be properly valued). As you can see, they are all over the place. These are for the distribution and manufacturers rep industries in general. For manufacturers reading this, there is the same wide range of pricing guidelines.

My opening question in my presentation titled, "Getting the Deal Done" is, "What are the three key factors to successfully getting a business buy-sell deal done?"

I got the usual answers like price, terms, downpayment, etc.

However, the top three factors have nothing to do with price, cash, terms or anything related to the structure of the deal. If these top factors are not present you won't even get close to a discussion of price, terms, etc.

Motivation

The key of keys, the reason of all reasons and the basis for a deal happening is motivation. Without a motivated buyer and seller there will never be a deal. "Paying me three times what my business is worth" does not make a motivated seller. On a 1-10 scale with 10 being the highest motivation, gross overpayment is a one. A 10 is when the seller has one of the three D's of motivation; divorce, death or disability. Somewhere in between, usually when the seller is a six to nine, is where deals get done. Typical reasons include burnout, retirement, boredom and stress because the business has grown beyond the owner's skill level. It could be the seller is now managing not doing (the making of, selling or delivering their product of service) and they don't like managing.

Buyers have motivations also and it's not just, "I want to own a business." Their current job may be a big hurt in their life. They hate their boss, they have peaked on the corporate ladder or they face a transfer and uprooting of the family. Their motivation may be the lack of a job and poor prospects of finding one (that can pay them their worth). There may also be reasons why a particular business increases their motivation. It's called opportunity, like when Bill bought a company when saw how he could improve the company's customer service, sales and the use of technology. In two years his sales and profits doubled.

Strategic buyers (other companies in the same or a similar industry) have different motivations. They may want to acquire a firm to build a bigger sales base to cover their overhead, to tap into new customers or to expand their product mix.

In any event, the smart buyer fans the flames of why the seller wants to sell. They ask questions that reinforce what the seller says they want to do. If post-sale the seller says they want to do a lot more fly-fishing the buyer should, every so often, ask where they will fish, reinforce how much fun fishing is, etc. The savvy seller paints a picture of the buyer running the business, controlling their future, etc.

Relationship

What I just described happens because of a good relationship between the buyer and seller. They must like, if not "love," each other. Both are taking a big risk. The buyer is putting down a lot of money and the seller is getting a portion of the price paid over time. There had better be some mutual admiration, trust and respect.

This is something I preach to my clients (and suspect a few of them get sick of hearing it). And it's true. Every so often I will hear about a first meeting between buyer and seller where they spent two-thirds of the time talking about life not the business. Life in this case could mean golf, fishing, business philosophy, family or just about anything. My reaction is that they are on the right track. It doesn't guarantee a deal (the business may not be a good fit for the buyer's skills or they can't agree on a deal structure) but it assures they will proceed.

The business buyer who sits down with the seller and say's "Show me the numbers" will struggle to buy a company. The buyer or seller who grills the other party right from the start will have a tough time doing a deal.

As a former client once said and what has been reinforced by many, "I would never buy from or sell to somebody I don't like."

Education

Education means both parties must understand there is a process to follow (and they must follow it). It's tough for some (especially buyers) to go slow and be methodical. They want to jump in headfirst ASAP. The simple version of the process is relationship building, initial analysis, financing alternatives, deal structure and due diligence (by both sides).

Due diligence is the process of proving what has been previously stated. It is where the buyer wants to confirm or prove what they've been told. It is not a time for discovery or surprises. When buyer's get into great detail before a deal is struck they can waste a lot of time and raise the suspicions of the seller (who doesn't want to disclose secrets without a deal). At the same time, the seller needs to check out the buyer; not just their financial statement.

Both parties also have to realize there is always some give and take or no deal will happen. They have to understand there is always buyer and seller remorse. And when they are inexperienced they tend to look at every little bump or request as a major deal disrupter.

Most importantly, they have to understand what the value of a business is. Most small businesses sell for 3-5 times profit after owner compensation. A 2011 summary of done deals from Bizcomps (a database of done deals) and

manufacturers and customers businesses depend on what they do and how they do it.

Your customers, employees and manufacturers should care. Ill bet your manufacturers are more concerned with this than customers or employees. The latter have more, quicker and easier options. Even in a tight job market good salespeople have value (caveat: the more narrow their expertise the more narrow their job market). Customers always have options; your competitors are probably trying to steal them from you every day.

If I'm a manufacturer I would be very concerned that my sales team (my rep team) will be still be there in five to ten years. I have a lot invested in them and their customers. Given the non-compete agreements many rep firms may have it may be a lot tougher to replace my rep firm than to replace a sales staff. I want to be sure you have taken adequate steps to assure a smooth succession with no disruption to my business.

When and for who to prepare

Common thought is that three to five years is the best lead-time when it comes to preparing for an exit or sale. This is the number of years of financial statements and tax returns most buyers (and banks) want to see. It gives the business time to show the affect of any strategies undertaken as part of the preparation process.

Do it before you're thinking of exiting and you get three benefits:

1. You're prepared if a catastrophic event hits. You will not be forced into a panic sale or liquidation.
2. Much of what you do to prepare for an exit or sale improves the business so you benefit over the years prior to your exit.
3. Banks and manufacturers will like this. It should open up financing and provide additional lines for you to sell.

The planning process starts with identifying to whom you will sell (the business). Is it family, staff or an outside buyer? If an outside buyer, is it an individual, equity group or another rep firm? These are important questions and often are not thought of. What you do with the business may be different depending on who you think your logical buyer is.

For example, if your logical buyer is family or employees part of the process may be coaching and training them on running a business. One client brought in their son, started him in sales, and moved him up the ladder to sales manager, general manager and eventually company president. By the time

Next Exit: Years Ahead. Good Luck.

Originally in Agency Sales published by the Manufacturers Agents National Association (and contains references specific to the Manufacturers Representatives industry)

Drastic change is coming. In mid-decade, 2000-2010 experts started predicting the largest transfer of wealth in history. In the later part of the decade we started seeing predictions that 50-70% of small and medium sized businesses would change hands in the next decade.

Fifty percent! This is a huge number. "Why is this happening?" It's a demographic phenomenon. The largest generation in American history is getting older. The first of the baby boomers are now able to collect social security, 10,000 people a day become eligible for Medicare (this will continue for about 20 years) and this is a very entrepreneurial generation with a higher than normal percentage of business ownership.

Something has to happen to these companies when the owner retires, dies, has health problems or just slows down. If you're an owner, ask yourself, "Am I ready if I have to or decide to exit in the next 5-10 years?" If the answer is no, you need to take some action. There could be a lot of competition and the unprepared business and owner will pay the price. It could be a lower price, less cash at closing, not being able to sell at all or you could lose valuable components to your company. One last fact, the following generation (Gen X) has 20,000,000 less people and according to a study by Intuit this generation is a lot less entrepreneurial.

Concerned? You're not the only one

If you're the business owner you should be concerned. Businesses that lose momentum or have an unfocused owner become stagnant and unhealthy. Employees get bored, unmotivated or so frustrated they leave for other opportunities. This further escalates a decline.

If customers don't see innovation, problem solving or excitement they become susceptible to the competition. And finally, what about your manufacturers? You are their sales arm. They wouldn't accept salespeople not performing and they won't accept you not performing.

Yes, the above are extreme examples and at the same time you don't have to come close to the extremes for your business and future to be thrown for a loss. Most manufacturers reps consider themselves problem solvers. They aren't just product peddlers, they are solution providers and their

the average ratio of selling price to EBIT (earnings before interest and taxes) was about 3.0. Now, some businesses are at the high end and some at the low end of any range. It's the non-financial factors, the terms and other factors that determine the actual deal. (Disclaimer: averages and ratios can be a trap. Reported deals are just a double-check or sanity-check. We never know if cash, AR or real estate is included in the deal. They need to be used with caution and with common sense; otherwise the great-business owner will get less or the buyer will over pay for a bad business. Also realize that done deal statistics are primarily pre-Great Recession).

Seller's who read about a Wall Street deal at 10 times earnings are mistaken. Buyer's who think they will get a great deal because the owner wants to retire and has no family in the business are mistaken (if profitable, this owner has all the options as outsiders usually mean a better deal than family). And, sellers sometimes erroneously believe a strategic buyer will pay them a lot more. Often they have the same parameters as an individual buyer. Plus, they know all the questions to ask and where the secrets are hidden.

Want to get a deal done? Start with motivation, relationship and mutual education. Then move on the price, terms and conditions.

Getting a buy-sell deal done - a different perspective

I thought it wise and interesting to get a different perspective on the subject so I interviewed Bill Pearsall, a long-time Seattle business broker. Bill is one of the best at what he does, strives for quality deals vs. quantity and is discriminating with whom he works with. He has a background in turnaround management so he knows what makes for a troubled company and how to fix it. His goal is to gain a 30%-50% value increase through the preparation process.

Where it all starts

Bill's first comment to me was that in order to sell a business it really helps to have a good business to sell. Here are some of his comments on this subject:

- The unprepared business (and seller) will have it take twice as long to sell (vs. a prepared business) and sell for much less.
- If there are problems in the business, you either fix them or disclose them to buyers.
- It is the buyer's perception as to what is a good business and/or what is a problem. Is it a problem or an opportunity? What is a wart to one person is a beauty mark to another.

- Selling a business is like painting a house. All the hard work is in the preparation; the painting is the easy part.

Why do you want to sell (now)?

Why not take some time so you can maximize your return?

This is the first big question to a business owner. What is motivating you to sell? Bill told me that 20% of the owners he meets have companies ready to sell now (see above about preparation). He states that if they need to sell *now* that he is probably not the person to help them sell their business.

His methods don't work well with someone who needs an immediate sale. And, as stated above it takes twice as long to sell a business that is not prepared and in Bill's opinion the owner will not get maximum value or price in this situation.

Also, buyers can be leery of too good a business. They often ask, "If it's such a good business, why are they selling it?" By showing it is a planned sale as part of an exit strategy virtually all fear (and skepticism) is eliminated.

What determines price?

Cash flow and assets are only part of the equation. It is all about risk or the perception of risk. Bill states that the perception of risk affects price, and more often terms. The greater the perceived risk the less cash upfront.

As a broker, Bill's goal is to have multiple qualified candidates for every business he sells. That won't happen if there are major risks such as dependencies (see below) or if the company is unprepared. Bill emphasizes that business buyers are different from pure entrepreneurs, those people who start businesses. One term he uses is "re-entrepreneur." Buyers are more risk adverse than people who start companies.

The pool of buyers is reduced when there are higher risk elements that do not have a path to mitigation. The number one issue companies have is various dependencies. Bill listed his top five for me (and these are the usual suspects) adding that often there are easy methods to mitigate these dependencies.

- The owner *is* the business. We see this all the time. Whether it's a control issue, poor delegation skills, lack of trust in employees or something else, the owner has most of the knowledge and relationships.
- Key employees have knowledge or skills that can hold the owner "hostage" to them.

mentioned in the first paragraph, more profit and a higher multiple when you exit.

It's not bragging if you can do it (Dizzy Dean, 1934)

A lot of business owners talk about their company's potential or the growth that will occur if the buyer just, "does some marketing." Of course, most of this is just talk. Business buyers, of all types and sizes, are a skeptical lot. When they hear too much about potential they think the seller has tried every conceivable way to grow and can't.

So prove you can do it. Go out and buy another company. Show that you can integrate the people, processes, financial systems, customer service and everything else into your operation. Private Equity Groups and large corporations make multiple acquisitions. If you can buy another firm, and successfully assimilate it, you become more attractive to these buyers.

They will assume you can do it again and that your management team is capable of this. As strategic buyers and equity group type buyers highly value management teams it can even increase the multiple (compared to having the same size company that has not made acquisitions).

Create a breath of fresh air

The sales manager at an acquired firm thanked me for getting the deal done and said that the new buyer was a breath of fresh air. The new owner, unlike the seller, listened to the employees' ideas, let them act on them and was willing to take risks. Too often employees get in a rut. They like the company and their job but it gets to be routine. When the boss ignores them, they lose enthusiasm and leave.

You can inject a breath of fresh air by buying another business. Enthusiasm is hard to teach and it's contagious. The excitement of an acquisition can fire up your team. It's a new and rewarding challenge. It can also fire up the team of the acquired business. Often their company is being sold because the owner is retiring or burned out. In either event, that owner has probably been coasting while the employees are constantly having new ideas. Putting two fired up teams together and letting them use their abilities is when you have 2+2=22.

Conclusion

Don't overlook growing by acquisition. The rewards can be immense and rewarding. The common ones are important and don't forget that you will eventually sell for more, are proving you can integrate an acquisition and improving the overall culture.

Behind the Scenes: Three Important reasons to Grow by Acquisition

Owners stress over growth like new parents fawn over their baby (maybe because the business is one of the owner's babies). However, they often neglect to consider buying another company to put growth on the fast track. There are many common reasons why businesses may want to buy another company. They include increased market share, a new geographic territory, talent, dilution of overhead and more.

However, there are three often forgotten factors that should motivate every business owner to acquire another company. These reasons are often overlooked and yet they are very important, especially as you look forward to your own exit strategy.

The bigger they are…

The bigger they are the more they sell for, all other things being equal. A $50 million (revenue) company with 10% EBITDA (earnings before interest, taxes, depreciation and amortization) will sell for a higher multiple of profit than a $25 million company with 10% EBITDA which will sell for a higher multiple than a $15 million company, and so on.

There are generally accepted ranges for multiples of EBITDA based on revenue. However, (too) many owners see in the Wall Street Journal that a $250 million company in their industry sold for 10 times EBITDA and assume their small business will also sell for 10 times. That won't happen; there's more risk in smaller businesses than larger so the desired return on investment is higher.

Example

Companies with sales of $5-50 million tend to sell for four to seven times EBITDA. A company that is profitable (at or above industry averages) on the lower end of the sales range will usually sell close to the four times multiple. Those on the higher end will sell close to the seven times multiple. Grow your $5 million company to $15 million and your multiple may increase by one times EBITDA (from four to five for example). Assuming 10% profit (and four times) you can see the price go from $2 million to $7.5 million (10% profit at five times).

The faster and safest way to grow from $5 million to $15,million is by acquisition. Buy another firm in your industry, a supplier, customer or an unrelated company that provides diversification to have an immediate revenue increase and a larger platform from which to grow organically. Get the benefits

- There is a top customer or customers that have too much of the companies sales (this is very critical when the relationship is with the owner).
- There is a top supplier and few other options.
- The landlord or lease is not favorable or holds the company hostage.

Buyer mistakes

Q: Bill, what are the top five mistakes business buyers make?

A: These are what I have seen in my years as a business broker:

1. Looking for the perfect business and the perfect deal. (John: I tell this to my clients all the time. There is always risk, you have to manage it.)
2. Misjudging the availability of the business inventory that fits them as a buyer because only a small percentage on the market appear to be good, viable long-term business models. (Buyers tend to overestimate the quantity of good businesses but underestimate potentially good businesses with snap judgments.)
3. Wasting time and opportunities looking at a business as a new, life-long career. Buyers should take a project-based approach and look at a business with the goal of exiting in 5-10 years. If they end up loving the business they can keep it longer.
4. Thinking they can eliminate all risk.
5. Applying corporate analytical models to small business. This means statistical models, six sigma, etc. (John: I have a saying that the bigger the spreadsheet the lower the chance a deal will happen.)

Conclusion

It's amazing how similar our thoughts are as to what makes a company salable and a good acquisition candidate. That's because the key factors are the same. If you have a good company with few deficiencies coupled with a qualified buyer you have a deal.

I know some of my questions got Bill thinking. Some of his answers did the same for me. As what usually happens in a situation like this is both parties learn something and I hope as you read this you get some benefit.

There is a lot of buzz these days about the turnover of companies as "baby-boomers" get to the "retirement" age. Those owners, no matter what age, who are thinking of selling anytime in the next few years are wise to consider what is written above.

Exit Planning—Grow by Acquisition? Here's why

The national press, from Newsweek to BusinessWeek to the Wall Street Journal, regularly has commentaries about mega-mergers. These commentaries are generally not complimentary.

Whether it was the old HP-Compaq merger or deals in banking, telecom (AT&T and T-Mobile) or pharmaceuticals the general opinion is that bigger is not necessarily better. One of the Newsweek columnists stated that if corporate America ever got this stuff right he'd be out of a job and right now he has pretty good job security.

There is also a shift in consolidation efforts. Mid-sized companies that would buy any small firm in their industry simply to add revenue and/or locations are now more cautious. As one intermediary told me, "It's swinging back to financial buyers." These are individual buyers, which can be defined as corporate executives and small business owners and private equity groups (especially smaller ones)

What doesn't work for big corporations often does work for small business! A little research confirmed my thoughts that I've been talking to more and more small business owners who want to buy (and are buying) another company. Not to dominate, but for a variety of reasons. These are pretty typical motivations as to why small businesses want to grow by acquisition.

Capacity/Customers

A big reason is to fill unused capacity. It's costly to have a facility that has 50% utilization. Buying a competitor and servicing their customers increases the utilization and drives the overall cost of the product or service down.

The chance of finding a company that sells exactly what you do to different customers is slim. There will be some overlap, but you may find it gives you the inroads to sell your products to their customers and their products your customers. What more could a salesperson ask for than to instantly have more quality products to sell with all the doors already open?

Geographic

Be it across country or across town, having another location can make sense for a variety of reasons. It opens up a new set of customers, delivery to existing customers in that area is now cheaper and easier and that market may have a different seasonality or business cycle. This is much easier than doing a "start-up" in a new market.

It may also open up a new labor market. Many large companies open operations in remote areas we don't think of as business centers. This is

Without an Exit Strategy You Have No Strategy

Customers — Acquire a direct competitor that allows you to sell the same product to more customers.

Synergism — Profits can increase through overhead reduction, more sales to existing customers, increased marketing efficiency, greater purchasing power and more. The owner of a magazine publishing company told me the following:

- "I found that when I had one magazine it required me to have one switchboard operator. Now that I have 23 magazines, I still need [only] one switchboard operator."
- "I probably get one call a week from somebody that publishes a singular magazine and wants me to purchase his or her company. I know how expensive it is to have just one publication. I do not want a loser, but show me a business already making money and I will make a lot more."

Unprofitable companies scare off most business buyers. The strategic buyer does not need to be as concerned with this. An individual buyer must have immediate cash flow. A company can purchase a profitable, breakeven or maybe an unprofitable firm (if you know the reasons why and feel you can fix them). Often the best deal is a company not earning up to potential where you can eliminate overhead and quickly make it profitable. The best deals happen when the owner is forced to sell, which could be due to divorce, death, disability, owner disputes, lack of working capital or similar.

The final obstacle is "corporate culture". You'll uncover some of it during due diligence and some of it after the purchase. You can avoid many culture problems by doing the following three things:

- Before searching, establish buying criteria. Usually ignored, this step saves money, time and aggravation.
- Check out the day-to-day operations and the non-financial factors of the business (customers, supplier relations, employees, etc.)
- Look at more than one business. Seriously look at dozens of companies and get a feel for what is out there. The publisher mentioned above told me he looks at 20 companies to find one worth acquiring. When searching for a business you must kiss a lot of frogs before you find a prince.

I read an article that summarized a survey about acquisitions. Over 75% of business owners felt they would acquire or be acquired in the next few years. Some will be happy and some will not be happy with the process and the results. Follow the correct steps to assure success without the growing pains.

Fast growth through acquisition

Would you like to grow your company at 50-100% annually without the pains normally associated with fast growth (especially cash flow problems)?

There are numerous ways to grow your company. Most involve slugging it out in the trenches. Doing the same things that all of the competition is doing is boring and often ineffective. This includes:

- Opening an office in a different geographic location
- Taking on new lines, either related or unrelated to your current product or service
- Trying to take away more customers from the competitors than they take away from you

As my good friend Ted Leverette says, "There's a sure-fire way to beat the competition. Why not eat the competition?" Growth by acquisition is going to be faster, cheaper, safer and easier to finance than any other strategy.

Consolidation and roll-ups are buzzwords with large corporations. The same can be true for smaller companies. No matter what you call it, the objective is the same, to give a company a larger market share without increasing overhead.

The reasons to consider growth by acquisition are numerous. The reasons small to midsize companies benefit from acquisitions are the same reasons large companies buy existing businesses.

Geographic expansion — why risk opening a new office and taking all the risk? It's almost the same as starting a business. A client bought a distressed business that became distressed because of an unsuccessful expansion into another city. When you buy, you assume the customers, market share, cash flow and you eliminate the one to five year ramp-up that many start-ups face.

Obtain Employees — I had two clients, at the same time, search for competitors to buy. For both the number one reason was to find competent employees (in a tight labor market).

Diversification — While it might not make sense to diversify too far away from your core business, it may make sense to expand your horizons a little. Perhaps you can buy a company with a product line you can't get on your own (and which you can also sell to your existing customers). Or perhaps the company you acquire gives you an up and running service department.

because the costs are lower, there is a need for good jobs and people in these areas tend to be loyal and hard working.

Synergies/Overhead

Buying another business won't significantly increase your overhead and may also give you more purchasing power with your vendors. Think of all the expenses that wouldn't increase if you bought another firm and merged them into your operation. Telephones, utilities, accounting, rent and many more wouldn't change much, yet sales would increase dramatically. The difference should go to the bottom line.

It's important to manage the process. Buying another business and keeping it "as is" means you're a "financial" buyer. That operation has to produce revenues and manage expenses to create profit, just like if there was still an individual owner who uses the business to support his or her family. A financial buyer is usually interested in profits, management salary, manageable risk and future salability.

There is nothing wrong with being a financial buyer. They account for the majority of business acquisitions. However, to achieve the economies mentioned above requires thinking, and acting, as a strategic buyer. This means you have be more concerned with growth, gross margins, management team and the synergies that allow this to be successful.

Here are two examples. A client looked at acquiring another firm in his industry, in a different location. He estimates he can save $50,000 by using his current supplier vs. the supplier used by the current owners. We won't use this in our valuation models or negotiations, but it's a good incentive for the buyer. Another situation has two competitors being approached by a third company. By consolidating the two into one location, two marginally profitable firms become one profitable operation.

Talent

Can't find good employees or management? Maybe it's easier to buy them. The more skilled your people are (and need to be) the more this option makes sense. Financial buyers are concerned with key employees. Strategic buyers like to see a good solid management team in place that can drive growth.

Talent can also mean non-human talent such as equipment. Rather than pay top dollar for new equipment or compete on the use equipment market consider buying a company to get the equipment and the customers who keep it busy. A client bought a competitor whom wanted to sell his business and who had the exact machine the buyer needed. It didn't take long to do a deal because it was a perfect fit. The machine was kept 65% busy from the customers that came with it and was fully utilized with work previously subcontracted out.

And what about product? A recent project had me helping a client buy a company whose product he admired and wanted to add to his portfolio. This ties in to acquiring human talent. You not only get the product, you get the people who know how to design, produce and sell it.

Go vertical

Whether you want to manufacture the product you distribute or vice versa, buying a link to the level above or below you may make sense. One company I know has their product made by a contract manufacturer. Their goal is to buy a firm with the manufacturing capability to make their product and take control in-house.

It can require some finesse to go the other way. You don't want to alienate your distributors by selling direct or buying a distributor, even if it's in another market. They may see that as "the handwriting on the wall" and look for other lines, leaving you in a precarious position.

Diversification

Sometimes it's not conceivable to buy a firm in your industry. Sometimes you may perceive your industry as not one you don't want to have all your assets in. This is when it may be time to think about diversifying.

You don't have to think like or be like GE to do this. One organization I know has divisions in at least seven different industries. These include sheet metal, machine shop, assembly, packaging and more. They are looking at acquisitions and are interested in a cabinet shop. Why? Because they believe the manufacturing process is something they know and the fact that the materials are wood not metal is not that important.

Think of how your systems and knowledge can be used even if the product is different. It may open some doors. Think of things that are niche products and/or industries. The more a product becomes a commodity, the greater the chance someone can compete on price.

To be successful -- Plan

Once you decide an acquisition makes sense (and why it does), don't just run out and knock on the doors of your targets. It's now time to plan so you do things right. The more time you spend on planning, the lower your frustration level will be in the future.

Without an Exit Strategy You Have No Strategy

Poor preparation is the reason many buyers (individual and corporate) fail. Here are nine steps to acquisition success:

1. Preparation & Search
2. Analysis & Investigation
3. Financing
4. Valuation and Pricing
5. Deal Structure
6. Negotiation
7. Due Diligence
8. Transition Plan
9. Closing

The first three are the most important. The more time put into determining criteria, putting together a comprehensive search plan and having a quick screen process (so you don't waste time on businesses you won't buy anyway) the better.

As you determine criteria, keep in mind that a company has different objectives than an individual buyer. As mentioned, an individual is a "financial" buyer. They must have salary, profits, growth, a job, etc. A company is usually a "strategic" buyer. They may not need a profitable company if it meets their primary objective. In fact, you may be able to purchase an unprofitable company, at a good price knowing that at the same sales level you will have lower overhead (that you will eliminate) and it will generate profit for you.

Steps two through eight are intermingled. They are done together with a lot of overlap. However, you can't get to these steps if you don't search correctly. The most critical factor to success in buying a business is to look at a lot of companies. Don't just settle for one that might work or just needs a "little" work (to make it profitable).

A good search can produce 20-30 candidates depending on your industry (unless you hit the bulls-eye early and stop searching). Having a handful of winners on your active list at all times is crucial.

Today's demographics are interesting and favorable to anyone wanting to buy a company. There is opportunity galore for a qualified buyer. Carpe res (seize the business deal)!