



Think like a buyer to exit profitably

By Jerry L. Mills

Benjamin Franklin is credited with the adage, “In this world nothing is certain but death and taxes.” That statement is as true today as it was when he wrote it more than 200 years ago. We can add another truism for today’s business owners: You will exit your company one day in the future.

Your exit from your company may be planned or unplanned. The exit may bring satisfaction or dissatisfaction to you and your family. It may be to the benefit or detriment of your employees or associates. It may bring great financial reward, or it may bring financial devastation.

The exit may bring fame or shame to your family and friends. It may be the continuance or discontinuance of the company you have worked so hard to create and build. The exit may be to the benefit or detriment of your competitors. Regardless of the consequences, you will some day exit your company in one form or another.

“Begin with the End in Mind” is a saying made popular by Stephen R. Covey. This is wise advice and should be adhered to by every business owner.

One of the attributes of entrepreneurs is that of being a visionary. Keeping that in mind, it is prudent to begin a vision of a successful exit strategy from your company, since that end is inevitable.

I started my business in 1987. Like many entrepreneurs, in the beginning, “the End” was a tremendous effort to make enough money to feed my family. The End for me was to try to convince future customers they should pay me a fair price for what I was trying to sell.

The End was struggling through the frustrations of being a pioneer in a new industry

and the frustration of learning new skills to explain my vision to people whom I felt needed my services. In the beginning, there were many times that I felt the End might be the failure of my business, my vision and my aspirations. I know that many entrepreneurs feel the same way at the outset of their business endeavors.

It is no longer a struggle to meet the financial needs of my family. A business concept that was new and revolutionary in 1987 is now well-accepted in our business society and is easy to explain.

It is now time to follow the advice of others and join my fellow entrepreneurs with

A successful exit strategy is one that is planned, effective and beneficial to everyone. Well, beneficial to everyone except the competition!

a new vision of the End, one with a successful exit strategy that is planned, effective and beneficial to everyone. Well, beneficial to everyone except the competition!

What are our options for an exit strategy? Fortunately, the options are few and easy to comprehend. The central exit strategy themes are as follows:

- Sell the business to a third party
- Sell the business to family members or to employees
- Stop the business altogether, and convert the assets to cash
- Enter bankruptcy or forced liquidation
- Plan for an untimely death

Planning for an untimely death is easy to accomplish through the purchase of ade-

quate life insurance with specific instructions on using the money.

Personal or family representatives, insurance agents and attorneys can all help create a plan that will most likely help you accomplish your key goals. This type of exit strategy should begin now and should not be delayed.

THINK LIKE A BUYER

If your exit strategy is to sell the business — whether to a third party, family members or employees — planning how to maximize your income by the sale of your business is essential. Let’s assume you wish to sell the company in the future at a fair market value, regardless of who might purchase your business. What, then, are some of the things you can start planning to make this a reality?

Discussing the sale of an entrepreneur’s business is an interesting exercise. Most business owners are adamant about the amount of money they want for their business. They’re usually reluctant to accept any outside critique that might conflict with their dollar amount.

Regardless of your feelings about the value of your business, it will most likely be sold using a factor times your company’s EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization) averaged over a period of time. The information on this subject is easy to obtain and won’t be discussed here. Rather, I prefer to try to help you take a step back and look at the big picture regarding the future value of your company.

I’d like to share with you some ideas about the future value of your company in a way that perhaps nobody has suggested. The easiest way for me to help you with this subject is to have you assume that *you* are going to

buy a business. Let's forget about selling your business for a moment, as you consider the following scenario, which will ultimately lead you to a better picture of how to improve the value of your own company.

Pretend that you are the buyer and are interested in purchasing a company. The seller's industry is different from the one with which you are familiar, but the future of making money with this company looks very promising. The potential purchase of this company meets your goal of diversifying your own existing business.

You meet with the owner, talk to some of the customers, visit with some of the employees and become excited about the transaction. You have a CVA (Certified Valuation Appraiser) give you a document verifying that the asking price is fair.

You talk about the transaction with your banker. The banker is supportive and agrees to advance money at a reasonable interest rate to help you make the purchase. Everything looks good on paper and feels good in your gut.

Just to be safe, you have a trusted senior-level executive look over the transaction prior to closing the deal. This person also feels good about the purchase, but he brings to your attention certain issues that you have not considered so far:

- The customers of the company do business based solely upon the close relationship they have with the company's owner.
- The company's computer hardware is being held together by the owner's brother-in-law on a "fix it when it breaks" approach. Some of the employees complain that the computer and telephone systems crash several times a month. Data is typically lost when the computers crash.

The file servers, routers and other company hardware will need to be upgraded or replaced unless the new owner wants to risk a lot of possible downtime with the computer system. It is likely this will cost the new owner six figures in investment.

- It is possible there will be liabilities for past services to customers. However, it is difficult to tell, because the database the seller uses is unreliable, and the estimated warranty issues are not known. You discuss this situation with the current owner. His reply is, "I'll take care of things." You, however, have a nagging feeling in your gut telling you this might lead to possible future relationship problems with the company's customers.

- The procedures for building the goods or delivering the service are not documented in writing. Your advisor raises the concern that the knowledge needed to create and deliver goods is merely in the minds of a few key employees. There is no guarantee that these people will stay after the sale of the company. In fact, the current owner tells you that a couple of key people will bolt when they hear about the business being sold.

- The selling company has about 50 personal computers, most of which have multiple versions of illegal software. Your advisor tells you that, regardless of the possible issue of software piracy, very few of the computers have the same version of the same software. It is estimated it will cost between \$70,000 and \$100,000 to correct this problem.

- There is no documentation regarding the intellectual property of the selling company. Doubts are raised by your advisor as to the authority of the selling company to transfer legal rights to these assets. There are also doubts about whether the seller legally owns the intellectual property claimed in the sales agreement and on the Web site.

- There is really no way to verify the accuracy of the numbers presented by the selling company's accounting department. The software is antiquated or corrupted. The conversion of data to a new system and/or the buyer's existing system is doubtful. It is estimated that any conversion or reliability upon the seller's accounting data will take months to accomplish, as well as a six-figure investment.

- The current owner is working seven days a week and almost 15 hours a day to keep the company going. He has agreed to stay with the company for a period of time after the sale to help with the transition. He also wants to take a couple of months off after you give him the check. Your advisor does a little homework and estimates that it might take three people commanding six-figure salaries to replace all the work being performed by the current owner.

START PLANNING YOUR EXIT NOW

With these facts in mind, what are you going to do now as the potential purchaser of this company? You and I already know the answer: You are going to take the suggested sales price and start subtracting dollars from that amount.

My guess is, from the little information disclosed above, that you will subtract a good seven-figure amount from the sales price.

Furthermore, you will have justification to go back to the seller to explain why the company is no longer worth the amount previously discussed — even if your banker has given you the green light to go forward.

With the information that you now have, there is nothing in this world that is going to convince you to pay the original sales price. In fact, you may decide that you no longer want to buy the business.

Now, let's consider the potential sales price of your own company. What do you think will happen to that future asking price should a buyer become aware of your infrastructure failures or weaknesses before the close of the transaction?

Well, we know the answer to that question: The buyer will either demand a lower price or walk away from the deal.

Today is the day to start planning for the sale of your company. Plan to hire key people if you do not have the time to document certain items.

You might need to bring in some senior-level people to organize and document your systems, sometimes known as infrastructure or internal controls. You may want to consider having certified audits performed on your company's financial statements.

Start asking your key employees to document their activities, with the assumption that someone else might fill their position without doing any damage to the company. Have an independent company take a critical look at your company's computer hardware and software. You might be unpleasantly surprised at the amount of illegal software on your systems.

We can agree that this activity may be expensive and will be time-consuming. It is not nearly as expensive, however, as the missed opportunity for selling your company for a fair price in the future. You have the choice now: Start planning and creating value for your future exit strategy, or be prepared for a future purchaser to have the ammunition necessary to lower your suggested sales price. The wise will do the former. ☺



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