SPRINGFIELD STRATEGIES
PLAN · EXECUTE · EXIT

Prepare to Exit

Congratulations. After years of sleepless nights, eighty-hour work weeks, overcoming challenges you never expected and had no idea how to resolve, and in the face of overwhelming odds, you have succeeded. You have built a great business! Now it's time for the hard part. How do you exit?

Anyone who has ever attempted or succeeded at building a company knows that it takes a special kind of faith and conviction. To go out on your own with no security (and often no clue) is one of the most challenging financial decisions a person can make. Statistically, you are almost certain to fail. Mentally, you are likely to experience a place of doubt you never knew existed. Physically, you are likely to be exhausted for years. But on the other side of that is a reward like no other. Financial freedom, independence, and increased quality of life are just a few of the many blessings that come with a successful entrepreneurial endeavor. To fully enjoy those rewards as a small to mid-size business owner there is one final step—the exit.

Selling a "main street" or "lower middle market" business (usually defined as businesses doing less than ten million in annual gross revenue) is a complicated process. There are an endless number of moving parts and potential pitfalls for both the seller and the buyer.

We have developed this short guide to help you learn things you should do today in order to prepare for an exit in the future. We will review the number one thing you MUST do before selling your business, how to select the right intermediary, and how to avoid the wrong one.

Since most entrepreneurs don't start out with an exit in mind, ideally you'll need to start thinking about it two to three years in advance. This provides an opportunity for the changes you make and policies and procedures you implement to have a meaningful impact on your historic financials and operations. For those looking for a quicker exit, even if you haven't been planning for the past couple of years, do not fear, hope is not lost. There are still things you can start doing now that will have a significant impact on the success of selling your business in the near future.

1. **Do this before you do anything else.**

The first and most important item that MUST be addressed prior to taking a business to market is to get your financials in order. This is absolutely critical because without thorough, accurate, and easy-to-understand financial records, your business will likely be nearly unsellable. Tax returns will not cut it. You must spend the time and effort to have proper records created for a minimum of three full years, ideally five, prior to taking a business to market.

The two most important reports you will need for the average main street business are the Profit & Loss (often referred to as the P&L or PnL) and the Balance Sheet (BS). Other reports, such as Cash Flow Statements, become more important as the size of a transaction increases, but for most small business sales you will hit a wall right from the start without these two items. There is no amount of money you can spend to create these that will not be returned tenfold. I cannot stress this enough. Without proper records, buyers will discount your business **heavily**, and banks and the SBA will not touch it. You will likely receive offers for pennies on the dollar and be asked to owner-finance the majority of it (more information on owner-financing can be found on the "Learn" page of our website).

As an added bonus, by generating accurate financial records, it's entirely likely you'll discover better operational insight that will lead to a more efficient business and higher profits during your exit period.

2. Take Off the Hats

Numbers two and three on the exit planning checklist are probably a toss-up in priority, but if we had to pick one it would be to take off the layers of hats. You're the CEO, the Plumber, HR Director, General Manager, Salesperson, Janitor, Cheerleader, and Marketing Director. I get it. We've been there and done it.

Unfortunately, when you run your business this way, you're not selling a business to someone, you're selling a job to someone. In fact, you're selling eight jobs to someone. I know it can be difficult and costly (short-term) to start delegating responsibilities, but the more you can remove yourself from menial daily activities the more valuable your business will become. You might just find that your mental health and quality of life improve as well!

3. Cozy up to the Taxman

Number three on the list (and you're going to hate this one) is to stop using your business as a piggybank.

Many business owners use various "tax saving strategies" to lessen the pain of the annual tax bill. While items like your personal 401k and health insurance are easy for a potential buyer to understand and digest, the trip to Mexico, weekly visits to Costco, and your "mobile office" (meaning the RV and the truck to pull it with) start to worry buyers when they see a page full of discretionary add-backs on the financial statement. We always like to advise clients that when you utilize some of the more colorful ways to save money on taxes, it's the equivalent of taking an advance on your exit price. The more discretionary expenses you have on your PnL, the more likely you will get a lower purchase price. The ideal scenario is that in the year or two prior to your exit, suck it up and pay the taxman. Those personal vehicles…get them off the balance sheet. Ready to pay the check at dinner? Grab a personal credit card. You will be rewarded in the end.

4. Choose Your Intermediary Early

Don't wait until you're ready to sell to select your Broker. You will be trusting your intermediary to handle the sale of one of your largest assets, and you will likely be rewarding them with a significant fee if they're successful. You should have a relationship with your broker and they should be advising you on exit planning over the weeks, months, or years as you prepare to sell your business. This is the choice you will make where everything will go right or catastrophically wrong. Don't let it be the latter.

When you hire a real estate agent to sell your home the process is fairly straightforward. You make a few calls to friends asking for referrals, or you respond to a postcard that showed up in the mail boasting a well-dressed smile and all the recent transactions in your neighborhood. You hire an agent, they might give you a few tips on things to do to your home, they run a comparative market analysis on the recent sales in your area and come up with a price that is likely to be fairly close to market value, and the sign goes in the front yard. You get an offer from the buyer's agent on a standardized form that's used in every modernday transaction, have your home inspection, do a little back and forth over items that need to be addressed, and thirty days later you drop the keys on the closing table and walk out the door. Transaction over.

Selling a business is an entirely different animal. Let's start with the big question: How much is your business worth?

When you get ready to sell your home, you hop on Zillow, pull up the most recent sales, and say "these houses are more or less like mine and sold for x dollars per square foot."

When every business is different, how do you put a value on yours? An experienced, well-trained business broker has the expertise to look at businesses that have sold in similar industries as yours, understand the factors and drivers of value for that industry, and reach a Most Probable Selling Price (MPSP) to give you an idea of where your business is likely to be valued in the open market.

Arriving at an appropriate MPSP is an extremely complex task and too involved for this short guide (more information on the valuation process can be found in our book available on Amazon titled Plan, Execute, Exit). For now, the important thing to understand is that an untrained or poorly trained business broker may put a price on your business that is far too high. This can cause the listing to sit on the market for too long, leaving you frustrated and disappointed with the final transaction price. Some less scrupulous brokers will do this intentionally in an effort to "buy" your listing, knowing the price will come down to market value eventually.

Alternatively, they could price it too low, causing you to leave tens or even hundreds of thousands of dollars on the table.

Most states do not have a designated license for business brokerage, and I'm not aware of any that require any type of formal valuation training at all in order to claim the title of Business Broker, Business Intermediary, or M&A Advisor. If caution is not used in the broker selection process, you could find yourself putting your life's work into the hands of someone who bought a business brokerage franchise, has no advanced training, may not even have a real estate license, and possibly doesn't understand a balance sheet or the valuation process.

Going back to the selling a home analogy, your residential agent will likely need to handle some negotiations with the buyer's agent. Let's knock $500 off for a new water heater. We'll give you $5000 for new carpet, etc. Your business intermediary will constantly be navigating buyer and seller needs. These needs will often be in conflict. The buyer will be pushing to uncover every piece of information about the business during the due diligence process. As a seller, you need to protect confidential and proprietary information as long as possible. Your broker must be able to handle the task of keeping the buyer engaged and satisfied (or at least less disappointed) with the information flow while also maintaining their duty to you as a seller. They must be able to explain to both parties why a request is reasonable or unreasonable. They must be able to effectively translate "tell them they can go pound sand" to "he was a little disappointed with that." Your intermediary must be an expert negotiator.

The majority of residential transactions only have a few parts. There's the offer & the counteroffer. Then due diligence starts. You have the inspection, maybe some re-trading of the price based on the inspection, some state-mandated disclosures, then you close and walk away.

On the other hand, no two business transactions are the same. The due diligence process can be overwhelming. Issues could include:

Do you have a fleet of vehicles? If so, in what condition? What special licenses and permits are needed? Is the buyer able to obtain those? Can your lease be transferred? Can your lease be extended? Will your records stand up to a lender's requirements? Do you have accounts receivable? Who will that belong to after the sale? Will your employees stay? Will a potential buyer get to meet your employees before closing? The list of issues is endless and it's unlikely any broker can be an expert in every possible situation they face, but you better make sure you feel like they are competent and experienced enough to sort it out along the way.

In most residential transactions the seller will have an agent and the buyer will have an agent, and both of them will work together sharing due diligence issues and negotiations. This is known as co-brokering. In a business transaction it's rare that a buyer's agent will be involved. In fact, some brokers will not co-broker at all. To us, this is a huge red flag. Refusal to co-broker is extremely common in the industry and something we are personally hoping to change. Not only can it potentially take many buyers out of contention, thereby reducing competition and possibly the final selling price, but to us it also shows that the broker's interest is not aligned with a seller's interest. A good advisor should have a goal of achieving the highest selling price, not the highest commission.

The biggest tragedy of brokers refusing to participate in commission sharing is that many of them do not disclose that fact to their clients in advance of obtaining a listing agreement. We think that's negligent at best and borderline unethical. On second thought, it's not even borderline, it's simply unethical. How would you feel if you discovered you lost a potential buyer because they wanted their own representation, but your broker refused to work with them because he or she wanted to keep 100% of the commission?

Be sure to ask the broker you choose about their policy for co-brokering prior to signing a listing agreement.

A good intermediary truly must be a master of many skills: valuations; negotiations; license and permitting; knowledge of legal, regulatory, and tax issues; marketing; buyer and seller psychology; and most importantly, ethics and trust.

So, how do you know if your broker is competent, ethical, and working for you and not against you? Like all things in life, there are no guarantees. However, there are several certifications that can be obtained, and we **highly recommend sellers search for a broker who has some kind of designation related to the industry.** Examples include M&AMI (Merger & Acquisition Master Intermediary), CM&AA (Certified Merger and Acquisition Advisor), and CBI (Certified Business Intermediary), among a few others. Brokers who have achieved these designations show they are committed to becoming as educated as possible regarding their practice and being able to serve clients at the highest level. At the very minimum, make sure the broker is licensed in real estate and has experience in commercial transactions.

One last important point when selecting a broker; If you are selling your small business with a listing price under five million dollars and your broker asks you for a listing fee…. Run. If your advisor isn't sure of his or her ability to successfully find you a buyer in an agreed-upon price range, why would you want to use them at all? Whether you choose our firm or another, be aware there are plenty of great brokers out there who will take your listing on a commission-only basis.

We hope this short guide has been informative and we've helped you take your first steps toward your exit with confidence. If you would like a more in-depth look into the full selling process, you can pick up a copy of our book Plan, Execute, Exit on amazon, or grab a phone and give us a call today. We are entrepreneurs, we like meeting fellow entrepreneurs, and we love learning about great businesses!