EXIT for Success Series

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Why Business Owners Give Their Companies Away

There are three common mistakes business owners make when they sell their companies. Most will make multiple mistakes but any one of the following can cost the owner between 20–80% of the company's real value.

Mistakes Commonly Made

1. ***Selling at the wrong time***
2. ***Selling to the wrong buyer***
3. ***Not understanding the company's "real' value***

Selling at the Wrong Time

Business owners often claim that the sale of the business will finance their retirement. This is usually the extent of their exit strategy. Unfortunately, market forces and positioning will determine if he or she is successful.

While 100% of business owners believe that their business will someday return their blood, sweat and equity, only 18% are ever successful. That's one in six companies that will successfully find a willing buyer. There are internal issues that affect the successful sale of the company – all of which are within the owner's control given the right advice and sufficient time to implement the necessary changes. Many of the reasons are outside the control of the owner. These are called market forces.

Market forces can be both "favorable" and "unfavorable" and are numerous and complex. Let's look at three:

- High unemployment
- Rising Interest Rates
- Low dollar vs. other major currencies

In times of high unemployment, companies are shedding employees, expenses are being slashed and only a few well-positioned companies are looking to acquire. Most are looking to steal companies.

In times of rising interest rates, the return on invested capital and the cost to borrow the funds necessary to finance the purchase increase. As the buyer's costs increase, the price they are willing to pay decreases.

What about low dollar vs. other major currencies?

Selling to the Wrong Buyer

Most owners of smaller businesses do not know that a business, unlike real estate has many values. If we assume that value is solely a function of profit and cash flow, we may leave as much as six figures of value on the closing table. There are three different buyer types with subsets of buyers within each who will all perceive the value of a company differently. The buyer types are explained below:

> ***The Owner Operator*** This buyer may come in a variety of forms – sophisticated, unsophisticated, emotional, etc. Many are middle management types seeking to control their own destiny. Since these buyers will be stepping into the shoes of the present owner, they have a minimum expectation of receiving the same economic benefits that have accrued to the present owner in recent years. Therefore, their measurement of value is based largely on cash flow and trends, i.e., are the company's revenue and profits stable, increasing or declining? They are also interested in the level of risk associated with the owner's influence over customers, account concentrations, financing capabilities and employee turnover to name but a few. This is why two businesses in the same industry with similar cash flow and sales trends may have two completely different values. The two owners have managed risk differently.

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The Financial Buyer These buyers are groups of investors, sometimes referred to as Private Equity Groups (PEGs). These groups typically "assemble" small companies that fit their investment model. Sometimes they will buy under-performing companies, fix them and sell them, but the motivations of these groups differ greatly. Sometimes they will pay more than the "owner operator" buyer and sometimes less. Professional Merger and Acquisition Firms have first hand knowledge of which deal might fit a PEG's appetite, especially when that PEG will pay more than the owner operator.

The Strategic Buyer This buyer type can vary amongst competitors or companies in totally different industries seeking diversification or distribution channels or twenty other reasons that are unique to their strategy. Because of this, cash flow may be way down the list as to its importance to this buyer. Again, trained Merger and Acquisition Professionals can usually discern these "value drivers" and advise the owner as to the appropriate strategies needed to attract these buyer types. The most interesting point to be made here relates to price. Strategic buyers have been known to pay 3 to 7 times that of the other two buyer types, however, these multiples are typically based on some perceived value that is specific to the buyer.

Understanding Value

So now we understand that a business can have a different value to different "buyer types" depending on the benefit they hope to derive. This is the real value provided by the M&A professional.

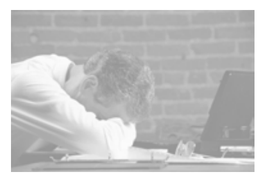
If this were not enough, there are many other external factors that affect the price one receives.

The BIZ*MACH* Answer

Let's assume we have three buyers for your business. Each one offers a price within 5% of the other. During the week while you are studying the offers, the Fed announces a ½ % increase in interest rates. Nothing has changed in the business and yet all three buyers pull back their offers and re-submit two days later. You note that each one is between 5% and 15% less than the original offer. What happened? Suppose this was a $3 million acquisition and the buyers were expecting to borrow two-thirds or $2 million. The cost to acquire this company just rose by $100,000 a year in increased interest cost.

Let's suppose that the buyer was going to pay cash, as many large companies do. Let's also assume that the Prime Rate was 4% before the ½ % rise. This new increase in rates is a 12.5% increase in Prime, therefore the buying company adjusts its "return rate" by 12.5% or a new offer that is 12.5% less than its original.

As the seller, you did nothing wrong and your company is performing as it did last week and yet you have suffered a price hit of 12.5% due purely to external influences. Interest rates are but one of many external factors to consider.



The above illustrates that the decision to sell is not always under the control of the owner – not if he or she wishes to maximize the price. Market timing is critical and can add or detract from value by as much as 50% or more even if everything about the business remains the same.

The Conclusion

There are two important lessons that business owners should take away from this newsletter. Both address the **"principle of positioning"**

1. An "Exit Strategy" is a process that involves a strategy that will position the company to attract the right "buyer type", a plan to implement that strategy and a timeframe that is realistic.

2. The "optimum" timing for the sale of the company is totally out of the owner's control, especially if the owner hopes to achieve the maximum value. Market influences can affect the final price by as much as 50% or more.

The good news is that there are proven strategies to enhance the "value" of almost any company so long as the owner is motivated, flexible and willing to commit to a 12-24 month timeframe to implement the strategies and realize the benefits. Also, the market has cycles that repeat.

The ability to read the market is a critical function of positioning.

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Too often business owners are persuaded to sell when the market is wrong and the value received will be minimized. At Biz*MACH*, we won't recommend taking a client to market unless we feel that the client company has been properly positioned to achieve the maximum price.

This process begins with a comprehensive Business Evaluation. This evaluation highlights the strengths, weaknesses and risks associated with the company and results in an immediate short-term plan to correct the negative and emphasize the positive.

The final step is the creation of a well-defined intermediate strategy to create a "competitive advantage" that will insure that the economic or market benefits that represent the greatest appeal to the "buyer type" can be sustained, thereby providing the return to justify the price paid. This data is then measured against market conditions and the underlying motivation for the purchase.

Maximizing Value is Goal #1 at BIZ*MACH*

BIZMACH
POSITION FOR TRANSITION

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