Why Understanding Your Business: Worth And Creating An Exit Strategy Matters

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Kerry Bolton is Australia's most respected Exit Strategy Advisor and CEO of the Exit Strategy Group. Welcome to this week's segment.

KERRY BOULTON: What made up each of those shifts? So how did they create those circumstances for themselves to be able to feel good and have a successful exit? The first thing was that they had a crystal clear understanding of who they are, what they want out of business, and why. So what type of CEO are you? Are you a benevolent dictator? Are you a respected but feared? Are you demanding of others and yourself?

Understand that autocratic management can significantly devalue your business. Now you may already know why you're in business and if you're like most business people, entrepreneurs, you're doing it to earn your own living and to be your own boss. That's something that clicked in your brain years ago and that's what you want to do.

You know, you want to build a great company, you want to serve the world and you want to become financially independent. So that's what you want out of your business. Maybe. So I know it takes a lot of hard work to create a good business and you need to recognize that doing that is not the end of the journey at all.

Look at your business through the eyes of a potential buyer or investor in terms of their due diligence process and whether in fact you're ready for that type of investigation. Because it's a pretty thorough look at what you're up to inside your business. If you, in fact, take your eye off the ball while that sort of thing is happening, your business could really suffer and you'll find that the value will drop significantly.

So to create market value, you need to look at your business through the eyes of a buyer and an investor, what are the things that they're going to look for? If you were going to buy your business, what would you be looking for? What are the things that are going to be valuable? What are the qualities that will be there? What's going to cause them to pay more for it and what's going to cause them to pay less for it? Where are you vulnerable in your business?

So these were the characteristics and people looked at to be able to know that they were able to create a successful exit. So once you start identifying where the weaknesses are, you can then work on eliminating them. In other words, you'll begin to view your business as a product and you'll learn how to make it a top of the line product and you'll have a much better, stronger and sellable business as a result.

This is the third characteristic was that they had the right kind of help. So they had people who are professionals help them in the business. You need a team of people to help you get your exit strategy together. You'll need specialists definitely in terms of accounting, financial, legal depending on the size of your business.

You may ultimately need somebody who's experienced in mergers and acquisitions. But the best type of help you can get is from somebody who's been a former business owner, because they can then help you understand the processes that they've been through when they successfully sold their business, which is why I'm doing what I'm doing quite frankly.

Because I think that having had that experience is something that I can really help pass on to everybody. And you can mitigate any sort of dangerous waters that you might find yourself in by calling on experience from other people who've been through the process.

The fourth characteristic that they had was that they really came to terms with the responsibilities that they had to their employees and investors. So no matter how you look at it, you've got to take into account what those people, how those people are actually going to be affected, because they are. If you spring on them, the surprise that all of a sudden one day you've sold your business, how do you think they're going to react? Any clues?

AUDIENCE: Negative.

KERRY BOULTON: Yeah, absolutely. So that's one of the reasons I asked you earlier about what type of CEO are you and what type of business do you run. Because if you're autocratic and you're not used to sharing information, then that might mean that you need to change your leadership style over the course of the next few years to get your business up and ready for sale.

KERRY BOULTON: Ironically, when you do actually find yourself more engaged in your business, ironically, it might mean that you don't want to sell your business. And that's okay, because along the way what you've done is created a really valuable enterprise, which is fine. Sometimes the fear that you have around, if I share this information with my staff, they might leave me and all of a sudden I've got another problem on my hands.

You know what? Quite often it's the opposite because they see the opportunities and it's like anything else it's the way you sell it to your people that makes the difference for the future.

The fifth characteristic is who are you selling to? Have you thought about who might buy your business? So are we thinking a strategic buyer? In other words, it could be vertical, it could be horizontal. Is it a supplier? Could it be a customer? I was chatting to a client the other day.

He got the biggest surprise of his life when a customer came in and said, ‘Are you ever thinking of selling your business one day? I’m really interested.’ ‘Oh.’ He never ever thought that a customer would buy his business. And of course the funny thing about that was, and he said, ‘Kerry, this has just happened. It’s fantastic.’

I said, ‘Oh, really good, Barry. What do you think you’re going to do then?’ He said, ‘Well.’ ‘What’s your time frame? What are you thinking?’ He said, ‘Well, now that someone’s interested, I think I might say three months.’ No, no, not three months, I’m sorry. It won’t happen, it won’t happen.

His business is nowhere near ready to sell, even if it is to a customer who says, I’m interested in your business. Because that customer looking at the business the way it is now is not going to pay him what he wants to get out of his business.

So thinking about who you’re selling to, thinking about it strategically will influence the way you position your business now. If you think it’s only going to be a financial sale, then you’re going to be looking at a multiple of a return on your profit basically. Strategic buyers look at the way they can integrate the business into theirs and you’re likely to get much higher multiple for your business than you would be just from a straight financial buyer.

If you think about what’s actually motivating the people to buy your business, you can then position it so that you work out what you need to do. It never ceases to amaze me that people don’t do this research about what can you do to make your business attractive to that particular type of buyer that you’re targeting?

So if you get to know the way that type of buyer might operate or if you’ve specifically got a target in mind that you really want to be able to sell your business into, you can construct it in a way and change things in a way that makes it really, really attractive to them. You got to remember that they’re in selling mode as well because they’re selling themselves to you as much as you want to sell your business to them.

So it’s a two-way street. As I mentioned to you, we were involved in the Hocking Stewart Franchise. And Greg Hocking actually sold his master franchise to nine of his franchisees. Now the interesting thing was in that process, he got some surprises, because he didn’t anticipate that the other franchisees would bring in an expert to help them, an M&A person. So they ended up in quite a negotiation during that particular process.

When he thought about what would he do with the business, it was obvious that a management buyer was going to be the way to go. It made life easy because the due diligence process was pretty simple because they already knew the business, so they weren't an external buyer. The interesting thing about it was that he was happy to stay on and it was part of the contract.

He was happy to stay on for a year and, you know, help them and consult and what have you. And so he did that. But after three months they said, thanks very much, Greg. We don't want to see you anymore. And there's the door. And not only, I'm not telling tales out of school here, not only did they say thank you very much and there's the door, they actually escorted him out that day out the door.

So do you think that was a bit of a shock? Yeah, it was a surprise. And he still talks about it to this very day. And I think actually had his exit from that business, had he been treated more fairly by those that purchased the business, there would not be another Greg Hocking franchise growing. Three years later after his non-compete had expired.

So it's very interesting when you think about when you're exiting your business, how you treat the owner that's actually gone. So yeah, I was gob smacked when that happened. But as I said, there's a new competitor. That's also taken a giant market share.

The last characteristic. And at the risk of laboring the point, it's about having a vision of what you're going to do. You go from being top banana to just a piece of fruit in the bowl the next day. And you know what? That's a mental shift. That's not easy. Because your sense of purpose is no longer your business. And a life without purpose is no life. If you're in a marriage, a partnership, as I've said to my husband, I married you for better or worse, but not for lunch.

If you think that you have something better to do, then sit down and write it out. Force yourself to write down what it is that you're going to do. It's really important. Because when you're the biggest fish in the sea and suddenly you're gone, it is a very big mental shift.

So just recapping, these were, in fact, the five metal shifts that the successful business owners were able to make when they exited their business. They felt that they'd been treated fairly and appropriately compensated. They felt a sense of accomplishment. Others were rewarded and treated fairly. They had a new sense of purpose and they had a pride in the legacy and the achievements that they'd left behind.

On to the seven life-changing and business transforming questions. How much longer do you want to be actively involved in the business? When do you want to exit? So it's about, you know, give yourself at least two years to prepare because you've got to have some tax records, you've got to have some financial records and you want to show maximum profitability over that period of time to get yourself the best price.

You can't start pulling things together the month before you sell. I know many people in private businesses enjoy the benefits of private businesses. So it's really important for you to make sure that they're all completely straightened out and that you have at least two to three years, preferably three, very clean financials to be able to show any future prospective buyer.

So question two, who's going to be your likely successor if you're not around? So one of the key, one of the value killers in any business is key person dependence. If you are it.

You're in strife, but you've got yourself time to find somebody else. Get yourself out of the business. Your business needs to be able to function without you. Same thing applies if you're too dependent on a single customer. We had a policy at FMI that no one customer would be worth more than 5% of our business.

So if in fact something happened and we lost a key client, then we won't go to be in strife. I have a client at the moment who has one customer that's worth 80% of their business. It's a disaster. It's a very big business. They're working strategically to make sure to get that percentage down. So they've now got a plan. We've set in place a plan over the next three years to target other potential clients so that we can get that ratio the other way. That's most important.

How do you want to exit? Do you want to exit over time or do you want to exit in one event? If I had my way, I would say, get out as fast as you can, as quickly as you can. But mostly that's not possible, no matter how good your business is. If you're selling it off completely to someone else, it's very hard when you've been your own boss to go back and work for someone else. It's very difficult. I had it for two years.

Fourth question, do you know what your business is really worth on the market today. So there's lots of different ways to actually measure the value of your business, how much you'd actually like to sell your business for today. Technically a lot of people will go for EBITDA, earnings before interest, tax, depreciation and amortization, and they'll take a multiple of that. And the average today is around about one and a half times if you take that statistic as a financial buyer.

But if you're looking at a strategic purchaser, it could be anything up to 30 times. And it just depends on who you might be selling it to. And it depends on the type of business that you have. Because the other way of doing that is to create competition, just like in the real estate market. So if there's more than one purchaser out there that's interested in your business, you might be able to create, you can create competitive tension and you can get a better price for your business, a better multiple.

What should you be doing now to actually minimise your future tax liabilities? What way is your business structured? I'm certainly not giving you financial advice. I'm not an accountant of any description whatsoever, I'm no financial advisor. So I have to add that as a disclaimer. But how's your business structured? One of the other people that I've interviewed told me that her business was still in her personal name.

Her shares were still in her personal name. And she was about to sell a business into a public company. The tax implications for her were enormous. So, the sale process had to be put back to give her time to restructure her own affairs so she could get the most benefit, which is not to say you're going to do anything illegal, I'm not suggesting that for one minute, but I'm saying you need to be able to talk to someone who's a professional accountant.

And be able to understand what the best structure is for you to actually have your business in. And when you do give yourself the time, over the next say two to three years minimum, then you're not going to run to any issues as far as the government is concerned, as far as taxation is concerned. Then you're not going to be seen to be restructuring just for the sake of evading tax for the future.

And depending on how long you've been in business, of course, here. There's some pretty generous provisions for people in business. If you've been an owner for 20 years, I'm happy to tell you we got our payout from selling Hawking Stewart 100% tax free, which was great because we ticked the boxes on the tests. So it's important for you to understand what they are and what you need to do to minimise your exposure.

Number six, what do you want your business to accomplish prior to your exit? It's really important for you to think about your goals and what you actually want to achieve. You've invested a lot of time and a lot of money in building your business. And I'm sure you've earned the respect of trusted family members, employees, customers, and suppliers. So don't lose all of that for a lack of adequate preparation.

Think about the contingency plans, the 5 D's that I went over earlier. So plan ahead so you leave behind a great legacy and you're really proud of what you've done, rather than leaving behind great problems for someone else.

And lastly, what are the most significant obstacles and frustrations standing between you and your goals? So when you sit down and you really dig deep, you'll be able to find ways to be able to overcome those. And this is where it's often really useful to go out and get someone else who's a mentor, another business owner, a business coach, to help you go through that process so that you can actually have some objectivity around it, because we are all our worst enemies. And sometimes we are too hard on ourselves as well. We're actually bitter.

KERRY BOULTON: When you're looking at your business and the value that's actually in your business, only one measure of course is the financial results, the profits. But also another measure, and when you're thinking about it strategically, is your customer base. Because the purchaser might really not be too concerned, although they'll use it as a negotiating point in terms of what your profit is.

But what they might really be interested in is who you have as your clients because they can see the value of bringing those clients into their business and the leverage that they can get from that to grow their own business. And that's where you find those multiples will really increase.

So it's the really good demonstrations of thinking about strategic buyers as opposed to simply trying to look for someone who's going to buy your business for a multiple of your profit on the bottom line. And if you think that way, then you can sell it that way. That's what will happen. So now the rubber hits the road. Let's have a look at the four steps.

This is very simple in terms of it being only four steps, but certainly requires you to use your brains and put in a lot of thinking.

You will maximize your business faster if you actually follow these four steps. If you haven't come to the realisation already, exit planning is simply about aligning all of these areas. Your business, your personal goals, your business goals, family, because they're also going to be affected and financial. Once you align those goals, you'll maximise the returns, not only for your business, but also for your life, for the future.

So let's have a look at evaluate. So the first step is always taking a good look at where you are now. And we've done a little bit of that today, just through the process that we've been through. We've at least started the thinking process. So what do you need to do today to maximise the value of the business? Could your business be sold today? And if you could, add a price that you'd accept.

Personal side, when do you want to exit? When you do exit how you're going to spend your days? How will your sense of self and your identity be affected? For your family, who might be included in the sale decision? And how will your exit impact on every family member? Do kids want you around, if they're still around? They just want money, okay.

And then financially, okay, how much money do you actually need to live the life you want to lead? And what might you do to minimise your taxes for the future as well.

So once you've identified all those goals, then you need to make sure that they're in alignment. So for as an example, if your financial goal was to sell your business for $50 million, and your timing was to be out by your 66th birthday, and you're currently 64, well, that is probably not likely. So you're going to have priorities and you have to recognise what's the most important, if that's the case.

But if your goals are flexible, well you can work around them and what needs to be achieved first. So there's variables in all of those. And of course there'll be outside market influences as well and you have no control over those. So you would be wise to have some flexibility around the goals that you've set for yourselves.

Next step is to explore. And here's where we empower you with the options and the in-depth knowledge that you can have for your succession and exit. So first of all, we'll have a look at all the external channels for your buyer. Could it be financial? Could it be strategic? As I said, both vertical or horizontal. Maybe it's an IPO. You're going to go public. That's always an option for exit.

That's when you're looking outside the business. Maybe there could be inside the business as well, and you look at the internal channels. It could be recapitalization. Do you bring in an investor? Recapitalize the business. Is there someone in the family who might take over?

What about if you've got co-owners? Could there be one goes out, one comes in? Management buyout, is that an option? Of course, there's employees. Maybe there's a structure that you can put in place that allows your employees to buy out the business.

There's a fantastic business in the United States, Springfield Remanufacturing Company, SRC. That a guy called Jack Stack bought as a leveraged buyout from International Harvester. It's nearly 30 years ago now. If you ever get hold of his book called The Great Game of Business and have a read of it, you can download it from Amazon. It's an absolute eye-opener as to what they were able to do inside that business with their employees.

And they're not alone. This happened in Australia. They had a philosophy of open book management. The business was losing money hand over fist when they bought it. I think the leverage was something like 630 to one. It was huge when they bought the business out. But over the course of the next eight to ten years they turned it into one of the most successful global businesses and it still is today.

With the involvement of the employees they were actually able to create a whole lot of other businesses. And the really interesting thing I believe in that process was for Jack himself and how much he had to engage his thinking as to how he was going to support those people when he left the business.

He thought the notion was that he'd be out of the business within 10 years. Well, 30 years later, he's just making his exit because of what was created over that period of time. It's a fascinating read. I highly recommend it to you if you have some thinking about getting your employees particularly involved in your business.

So, third step, so here's where we look at maximising the fundamental values in your business. During a due diligence process, buyers will look at all sorts of areas and you've got to be able to make sure that you can maximise those and show them to the buyer at on the up, rising up. Don't wait until your business is starting to go over the hill.

You've got to have market growth because when you're selling your business, when there's still a little bit left in it for the next people, you are going to get the best possible result you can. Once timing-wise, once it gets over the hill and starts to slide, then it's going to be much more difficult for you.

So even though you might be saying selfishly, I'm going to hold on for another couple of years because I think I'm going to get more for my business in terms of the market, maybe not so, because you can't predict what's going to happen out there in the marketplace. So when you're in a growth market and your business is going really well, that's the time to start looking for buyers.

And lastly, we're going to look at transition. When you think you've got yourself to that stage, the best thing you can do is actually get in somebody externally to do a mock due diligence on your business. And then you go to find out where the gaps are in terms of the information that you need to prepare and what's going to minimise the distractions to you over the course of time.

I mentioned before, selling your business when you've still got a growth market. The timing is crucial. Leaving something in it for the next person is really important and it's a dynamic process. Like in real estate, as I also mentioned before, if you can get competing buyers, you can conduct an auction.

And the next approach that you'd have in terms of getting out to the marketplace would be either going out and targeting a buyer and marketing to them and have that as a sale process or as I said, create a mini auction. So have competing buyers like in real estate. The best results that you get from any sale is when people are competing.

And I think it's really important that you're not under any illusion that even when you put your business out there for sale, if it's marketed through putting out information, create the information memorandum, which is in fact your selling document, it might, if you're going through an M&A type person or even a business broker, although business brokers tend to deal with smaller sized businesses.

Professionals at the M&A level deal with larger businesses. But once you put your business out there for sale, you might even send, if it was being spread around the marketplace, it might go to 100 different people, just with a teaser, not a whole information memorandum. Chances of getting more than half a dozen responses are pretty remote. Those are the sorts of numbers, no matter how far and wide you spread it.

I was chatting with somebody just a few weeks ago who's now actually had their business on the market for three years. Well that's not a sellable business. Three years on the market is not a sellable business. That business has got to come back and be renovated in order to make it sellable. So those are the four steps that you need to take. Evaluate, explore, iterate and transition.

And I like this quote. The question isn't at what age I want to retire. It's at what income. Good old George Foreman. So now you've got a choice. You can set aside the time that you need to be able to get your business ready for sale. So you can take the information that I've given you today and you can stay where you are or you can start to take some action and create the future that you want for yourself.

If you don't have a copy of Kerry's new book, ***The Uncensored Truth About Exit Strategy***, please visit https://freeexitstrategybook.com.au/