MAXIMIZE BUSINESS VALUE PODCAST - EPISODE 63 Transcript

Announcer (5s):
Welcome to the maximize business value podcast. This podcast is brought to you by mastery partners, where our mission is to equip business owners, to maximize business value so they can transition their business on their terms. Our mission was born from the lessons we've learned from over 100 business transactions, which fuels our desire to share our experiences and wisdom. So you can succeed. Now, here's your host CEO of mastery partners, Tom Bronson.

Tom Bronson (36s):
Hi, this is Tom Bronson and welcome to maximize business value. A podcast for business owners who are passionate about building long-term sustainable value in your business. In this episode, we're going to walk through the timeline and anatomy of a business sale to insiders other types of business transitions. For example, a sale to outsiders would differ from this. And we actually did a podcast on that a couple of weeks ago. So this podcast is specific about transitions to insiders. A few weeks ago, I did that podcast on the steps to successfully sell a business.

Tom Bronson (1m 16s):
And after several requests from our listeners who don't want to sell their business, but rather transition them inside to insiders today, I wanted to focus on the steps for internal transitions, like selling a business, transitioning to insiders. Typically take some time more time than most business owners realize. Well, internal transitions cut out. Many of the steps needed to transition a business to a third party buyer. There are still things that need to be done to successfully transition the business. There are seven major steps to a successful internal buyer, exit strategy.

Tom Bronson (1m 56s):

They are define the exit strategy, the date and the valuation number to achieve buy-in from all parties. Third, prepare the buyer. Fourth secure funding. Fifth due diligence. Yes, due diligence, even to an internal buyer, six closing, and of course, seven post acquisition integration. So let's run through each one of these and discuss the details and timeline. First define the exit strategy. I would do this at least two to five years before the intended result. So you've decided that you want to sell your business internally to family managers or employees.

Tom Bronson (2m 37s):

Now the steps for planning, an Esop and employee stock ownership plan, where the business is sold to the employees are slightly different than the sale to a family or managers. So we'll cover that in a future podcast. So don't, so we won't really cover the steps to an esop today. So if that's what you're interested in, either call me, or look forward to a future podcast, but like a business sale to a third party, internal transitions take more time than most business owners. Think when owners asked me how long in advance they should start planning for an internal transition. I tell them as simple, as soon as possible, and at least two years before the plan transition, ideally much longer than that.

Tom Bronson (3m 26s):

Now surprisingly, the success rate for internal transitions is not much better than the success rate for external transitions or external transitions, as you already know. And as I've said over and over and over again, the success rate is 17%. Yes, 17%. That means 83% of attempted external transactions never actually reached the finish line. Now for internal transitions to managers or family, the success rate grows to a whopping 30%, which means that 70% of internal transitions fail to reach the finish line. And the number one reason for those businesses that achieved success is of course, advanced planning.

Tom Bronson (4m 13s):

Everyone now advance planning. The first step is defining the exit, setting the timeline and determining the valuation. Now it's important to know that in most cases, not all, but in most cases, the valuation of an internal transition is slightly less than a or sometimes significantly less than a sale to a third party. The reason for this is that typically business owners want to reward family or managers for their years of service and loyalty, and therefore are willing to offer the business at an advantage purchase price. Now, therefore internal transitions are best suited or owners who are more concerned about rewarding the buyers than they are concerned about the valuation, but just like an external sale.

Tom Bronson (5m 5s):
Unfortunately, most business owners don't know what their business is really worth or how businesses or in their industry are valued. So a great starting point would be to get a valuation on the business. Now, I don't recommend just like in external transitions, I don't recommend getting a certified valuation, which is something that can be used in a dispute or in a court of law. Rather. I strongly urge all business owners to get a valuation that would tell them what the business would be worth if they transitioned it now. And I use of course the word transition and exit interchangeably.

Tom Bronson (5m 45s):
If they exited the business, now they want to know what it's worth. You can get one of these for free, right on our website. Aren't we generous, or you can engage with us in the first step of our four process, the transition readiness assessment or tra in the tra we complete a 360 degree assessment of your business, identify things to work on and provide a complete opinion of enterprise value. So you know exactly what the business is worth. Either way you go. Once the business owner has the valuation, they should clearly articulate the ideal desired outcome and timeline for the internal transition, which includes the date type of sale and the buyer or buyers as the case may be.

Tom Bronson (6m 37s):
Once you've done all that, that it's time to move to step two, which is achieving buy-in. And I would do this at least two years prior to the anticipated date. Now that you've got the defined ideal desired outcome and know who the prospective buyers are, it's time to

share the plan with them. Of course, you might also include them in the prior step, but personally, I think it's ideal to get, to get it really straight in your own mind first, and then share it with your team, make sure to stay flexible, because they may also have some thoughts about how to achieve the desired result and you want to stay open to their input.

Tom Bronson (7m 20s):
So there's always a risk of getting hurt feelings during this step in the process, the buyers may think that you want too much for the business, or they may not want to own the business at all. Remember not everyone is cut out to be a business owner. Some very good employees may not have a desire to take on all the headaches of business ownership. You no one knows better than you. The headaches of business ownership. And some people are just not cut out of that cloth, but it's way better to find that out early than discover it at the end when you're close to pulling the trigger.

Tom Bronson (8m 0s):
So have those conversations early. So let me give you a story about this. I once talked to a business owner who was in his late seventies and was very excited that he was planning to leave his business to his children, assuming that they would buy the business from the estate and run the business and take care of his spouse for the rest of her life. By the way, the kids had been working in the business for many years. And it looked like at the outset and ideal situation, they're insiders their family, they want to buy in, or they, the plan was to sell them the business. Unfortunately, in this case, the children had no desire to own the business and plan to sell it.

Tom Bronson (8m 45s):
As soon as the founder was gone, that's a terrible situation because in most cases, the business would almost certainly begin to decline. As soon as the founder is gone. And ultimately then the exit value for the family would be less than what they could have achieved. If the business were sold while the founder was still there. Now, that's why it's important to talk about these things and gain agreement from the perspective buyers, if there had been open communication in this family, they would have understood that perhaps we should explore a different exit strategy rather than the children buying it.

Tom Bronson (9m 28s):
So don't run the risk of getting hurt feelings here, be honest and open and, and be willing to accept whatever it is now. Most baby boomers, I'm a baby boomer myself, most baby boomers say, I didn't even want my kids to be in this business. And a lot of, a lot of kids are saying, I don't want to be in mom and dad's business. So, so if you know that already at the outset, that's fine, but you also may find that your internal management, maybe they don't want to buy the business. So, so it's important to have those conversations and get buy-in from all from all parties. Now it's time for the next step, which is preparing the buyer. And I would do that at least 12 to 18 months before that target date.

Tom Bronson (10m 10s):
So yeah, not only you've decided define the outcome and you have buy-in from all the parties. Now it's time to prepare the buyer for their future role as business owner. So at this point it would be a great idea to get a third party assessment, to develop a strategy, to get the future owner or owners ready. That starts by understanding the skill set needed to assume the owner's role, comparing that to the current skillset of the future owners and determining a strategy to kind of fill that void or fill that gap. There's almost always a gap in the skills and therefore careful planning needs to be done in order to fill that gap.

Tom Bronson (10m 54s):
Once the current owner transitions the business to the new owner. Now this can be accomplished by training or hire others to fill the void. Also, the current owner should get busy, documenting everything that resides in his or her head. You know, the things that you're the only one who knows how to do or knows what to do and how to do it. So the new owner won't skip a beat when they take over as the owner of the business, by the way, it's always a good idea to do this. Anyway, just in case something happens to you by going through the sometimes painful exercise of documenting everything, you can reduce owner dependency and increase business value, something that is very near and, and dear to my heart, as you already know.

Tom Bronson (11m 49s):
So this step by the way, takes time, don't rush, but also don't delay. It agreed to the strategy at the beginning and then work through it on a regular basis, at least monthly. So the future owner will be ready when the time comes too many times, business owners delay this step preferring to kick the can down the street until it's either too late or the future owner gets tired of waiting and moves on. Don't let that happen to you, make a plan, stick to it and do it relentlessly.

Tom Bronson (12m 30s):
So once you've done all that, it's time to secure funding. And I would do that genuinely as early as possible because there may be some surprising twists and turns there. So now that comes the tricky part, securing financing. So at the outset realize that in most cases, the new owner will not be as shall we say, financially healed as the current owner, meaning that they probably don't have enough reserves to buy the company outright and they'll need financing to do it. There are three primary paths to doing that the first, which is the easiest, but also probably the least desirable path would be for the current owner to finance the transaction.

Tom Bronson (13m 18s):
After taking some sort of down payment from the buyer. Now I call this least desirable because in some cases more than I care to go into the buyer defaults and after some period or defaults after some period of time and the seller winds up taking the business back or worse, there's nothing to take back at this point. And therefore the businesses no longer got any value to it. So be careful of that one and, but be prepared for it because that may wind up being the only viable option. The second path would be to secure bank financing or maybe SBA financing on the deal.

Tom Bronson (13m 60s):
If the business has operated for many years, the bank may be willing to take a chance on the new buyer because of the long history, but don't automatically expect that to happen. Remember, the bank relationship is probably with the seller and if they don't know the buyer, although they've been a long-term employee, they may not willing be willing to take a chance on the buyer. Now, if that's the case, SBA financing may be the

best option. And for that, I suggest you go back and listen to one of the two recent podcasts we did on securing funding with guests, Joshua Kim, and bill king.

Tom Bronson (14m 42s):
They are two excellent podcast and help you position to get the funding you need. But by the way, if your bank is willing to finance it, they may require you to sign a guarantee for the note. So don't be surprised if they ask I'd push back as hard as I can, but don't be surprised if they ask you heard it here. First, the third path is securing equity or financing from a third party. Although I've used this method in some of my businesses, in fact, many of my businesses, many times investors prefer to have control in the business, which could be a deal killer for the buyer when securing financing explore all of the appropriate options or the appropriate avenues and choose the path that best fits your specific needs.

Tom Bronson (15m 34s):
So you're onto that. You've got the financing, you've got a willing buyer, family member, whatever you've done, it's time to move on to due diligence. Now, typically in an internal transition, the due diligence is not as rigorous as external as in an external transition, but it's still important to allow the buyer to inspect everything before closing, by the way, if the financing is provided by the bank or investors expect them to take a moderate to rigorous due diligence stance, depending on the size of the deal. By the way, also, you'll still need to have some of the formal documents in place at the beginning of this transition, like a letter of intent or a memorandum of understanding.

Tom Bronson (16m 24s):
And ultimately you'll have to agree on final purchase agreements. So don't forget that piece. Sometimes as many times that's done during the due diligence piece and not an advance or kind of right at the end of due diligence. So now that you have that final purchase agreement in place, it's file it's time for the sixth step, which is the closing closing of the deal, just like an external transitions. This is going to be a very emotional day for the seller. Be ready for it, make the closing day, the best day of your life. And you can do that by preparing for it in advance. We can help you get there.

Tom Bronson (17m 5s):
Then finally, most closing integration, and that can be short term or it could be open-ended. Now this is probably the most critical part, especially if you're financing the transition, many business owners who sell to internal buyers, remain with the business for some period of time, if not long term, this can give you a smooth transition to retirement or moving onto the next thing that you want to do. But it also ensures that the business will be able to make its financial obligations to service the debt.

Tom Bronson (17m 45s):
Regardless. It's important to remember to let the new be the owner and be willing to take a back seat, which may be uncomfortable at first, I get it, but learn to settle into your new role of being the trusted business advisor, the coach, and the cheerleader that help the buyer transition to their new role as owner. So there you have it, seven steps to a successful internal business transition. Again, if you're looking for information on the 10 steps to a successful external sale, then check out the podcast two episodes before this one, I really need to start numbering them.

Tom Bronson (18m 32s):
Don't you think so that so I could tell you that would be podcast episode 61. I know that, but we don't number them on the website. And I should start doing that. Sorry for that. If you're planning to sell the business to a family or employees start today, call me for a free consultation and get started on our four step process or join our mastery class today. We'll have a new class starting in in the fall, and you should think about starting that class. The sooner you get started, the smoother, the Transition will be, this is the maximize business value podcast, where we give practical advice to business owners on how to build long-term sustainable value in your business tune in each week and follow us wherever you found this podcast and be sure to comment, we love your comments and we respond to all of them.

Tom Bronson (19m 29s):
By the way, if you have topics that you want us to explore, let me know, shoot me an email, tom@mastering partners.com or text me my numbers right on the website. Let me know what you'd like to hear about. And I would be happy to cover a topic in the

future podcast. So until next time I'm Tom Bronson, reminding you to follow all seven steps to creating a great and satisfying internal exit experience. You maximize business value.

Announcer (20m 3s):
Thank you for tuning into the maximize business value podcast with Tom Bronson. This podcast is brought to you by mastery partners, where our mission is to equip business owners to maximize business value so they can transition on their terms. Learn more on how to build long-term sustainable business value and get free value building tools by visiting our website, www.masterypartners.com that's master with a Y masterypartners.com. Check it out.

Tom Bronson (20m 33s):
<inaudible> that was perfect. I wouldn't make any changes.