# The Top 10 Roadblocks in Exit Strategies & How to Get Past Them

For many businesses starting, surviving & growing takes your entire focus. Rarely do you think of existing; until you have to. When you do think of exiting there are as many roadblocks as there are options.

The options run the gamut from going public to a merger to liquidation. Likewise, the roadblocks run from legal to operational to legacy issues. Let's look at the top 10 roadblocks you can run into in planning & achieving your exit.

1. **The 1st real exiting roadblock is your actual desire to exit. Are you willing to completely walk away?**

Many business owners (whether you are a single person or a small group) have been working so hard for so long in your business with the singular focus of making it successful & sustainable that when you are ready to sell, you are *not* really ready to sell. Meaning you are not ready to walk away.

In order to successfully exit your business, *you* must exit. You must be ready, willing & able to walk away. Forget about this business & move on. The new owners will *own* the business. They will do with it whatever they want. If you can't accept this, you're not ready.

To help you determine this give yourself a little test. Ask yourself:

a) What you will do when you no longer have this business?
b) What will you do with your time?
c) Can you afford to live off what you will be left with?
d) What will drive you in the future?
e) What is your next project?

Answer these questions and you will prepare yourself for your next step in life.

2. **Next there is the price/value question. Is the entity worth, to the market, what you think it is?**

Ok, so you have decided you are ready to exit & walk away. Congratulations. Next challenge; is the firm worth (to the market) what you think/want/need? The answer, in reality, is usually not. Our ego & perspective makes the value of our own entity worth more in our eyes than the objective eyes of the market, a prospective buyer or lender.

Why do I say this? I have financed or advised on the sale/purchase of hundreds of businesses over the years. I have yet to see a single instance where the seller didn't feel the *value* of their firm was significantly above what outside, objective observers agreed it should be.


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There are 3 ways to approach this. One is to not exit & continue to run your firm because the value is not there. This works if you are not in a hurry & can afford to wait. Two, is to accept the market's valuation & exit now at the market price and move on to your next challenge. The third option is to hold off selling until you have built up the value to something closer to what you want/need. This 3rd option takes time, planning & execution. This is where a good strategic plan is worth the investment because it pays huge dividends.[1]

[1] (if you would like a FREE strategic assessment email me at dsfeiman@BuildItBackwards.com)

**3. Not having clean financials**

The vast majority of privately held, successful businesses want to pay as little tax as possible. Very understandable. And you want to do this while maximizing the actual return you receive. No argument here. What ends up happening then, in many cases, is you take a very aggressive (creative) approach toward expenses. The result being a firm that appears to have less financial success than it *could* have to an outside party.

Is this a problem? To a prospective buyer, absolutely. And it could impact the value a prospective buyer is willing to pay for the firm. The solution? Assuming you file your taxes properly & have appropriate financial statements ("books"), you need to start making the expense (financial) choices that put the firm in its best possible light; have the books reflect the *real* results. The more profit & cash flow shown the more value is perceived by a prospective buyer.

The challenge is the *grey areas* of deductions on the income statement that an independent leadership team would not choose. Eliminate these moving forward to make the firm more appealing to those who will succeed you. All legitimate, yet this looks better to your successors.

Additionally, any prospective buyer worth dealing with will, in all likelihood, restate your financials for their valuation purposes as part of their due diligence. They will go through your P&L to look for any items they would eliminate, or reduce, under their ownership. This will give them a better picture of the projected net income under their management.

Typical examples of items *added back* to calculate the revised net income include:

- personal expenses you feel are appropriate but they don't;
- non-recurring (1 time) items
- excess compensation (direct & indirect)
- excess benefits
- unusual expenses
- discretionary expenses
- tax-loss carry forwards

- allowances for doubtful accounts
- investment in affiliates
- transfer pricing between related entities

Also, most businesses structure their tax returns using cash accounting & aggressive noncash deductions to minimalize taxes. This is ok. Your financial statements use accrual accounting & straight line noncash deductions to maximize profits. Also ok & perfectly legitimate as long as they reconcile.

On a related note, your bookkeeping and financial reporting systems provide the evidence which details the financial performance, position and to an extent the value of your business. If your reporting system is not adequate or producing poor quality records, your chances of convincing a buyer to purchase your business at a price/value you feel is appropriate will be substantially reduced. Why? Because they probably won't feel they can trust the numbers.

If you plan to sell your business in the near future, you need to consider whether or not your reporting system adequately provides, accurate and timely reports which are capable of meeting the needs of not only management and the board but also the financial investigations and due diligence of a potential buyer and their advisors.

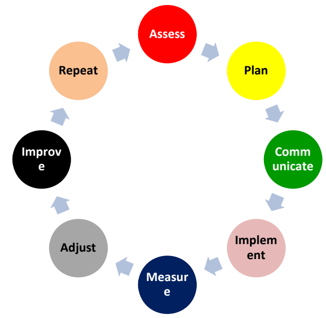
If you are not satisfied with the flexibility of your accounting system or the quality of information it is currently producing, you should consider reviewing your options and making a change to help your chances of securing the right offer based on more reliable numbers.

4. **Lack of a clear direction/future: no strategic plan**

As good as your financials may be & as great as your product/service is today, prospective buyers are not buying your yesterday or even your today. They are buying your tomorrow. The best way to convey this message is not with conversation, anecdotes or even testimonials. It is with a strategic plan.

A real strategic plan is more than an operating plan (1 year) or even a business plan (2-3 years), it is long-term plan of where you're going, how you are getting there, why & for whom. This long-term plan is researched, validated & follows a solid model so the new owners will have a *roadmap to their success;* continuing the plan you initiated. You telling them where you are going is one thing. Doing the research to prove it is another. The former is conversation; the latter is a deal closer.

A good strategic plan takes only a few days to create but the results (questions asked, answers determined, decisions made) are of tremendous value to you while you still own the firm & to the new owners to see the possibilities. The best strategic plans include [2]:




- Vision (why the business exists)
- Mission (how it will achieve its Vision)
- Values (the guiding principles of the business)
- Goals (S.M.A.R.T.E.R.)
    - Long
    - Medium
    - Short
- Measurements (of what is most important to achieve)
- Actions plans
- APCIMAIR™ model [3]

[2] (if you would like a FREE strategic assessment email me at dsfeiman@Buil;dItBackwards.com)

[3] (for a demonstration of the APCIMAIR™ model email me at dsfeiman@BuildItBackwards.com)

### 5. Not understanding the difference between a financial & strategic buyer

There are basically 2 types of buyers of firms: financial & strategic. Financial buyers look to invest in a business because of the financial return they forecast (this may not match your forecast). Their *Return On Investment* (ROI) is calculated by taking their anticipated annual profit & dividing it by their investment. A $200,000 net income on a $2,000,000 investment is a 10% ROI. If that meets or exceeds the prospective buyer's target they may be interested in making an offer. If it doesn't they are not. Period. The decision is purely a financial one.

A strategic buyer on the other hand is looking beyond the financial return. Don't get me wrong here, they do want a target return, or better. However, they are looking for more than just the current dollars. They are looking for the *fit.* Does your organization enhance their existing portfolio of firms? Perhaps you have a product/service/process that they feel will magnify some element of their existing offerings so that 1 + 1 = 3! Not in accounting terms but in value terms to them.

If a strategic buyer calculates that you have something of value to them they will *always* pay more than a financial buyer because they are looking at the multiplying factor of your assets to their portfolio. If a financial buyer will pay "X" for your company, a strategic buyer may pay X+Y (10, 25, 200%...). It just depends of what the *synergy* is perceived to be.

Synergy is *not* cost reduction. Synergy is properly defined as the value created by the combination of entities that is greater than the sum of their separate parts. It comes from leveraging the *intangibles* that each organization brings to the other & then combined. The result is increased shareholder value.

Understanding the difference between these 2 kinds of buyers will allow you to negotiate from strength & knowledge. If you calculate the financial value of your firm first you will be in a position to subsequently estimate the additional value to a strategic buyer & seek them out.

6. **Lack of appreciation of the difference between an asset vs. stock sale**

Simply put, a *stock sale* is one where the acquirer purchases all of the shares of stock of a firm. Thereby, owning everything as well as any legacy issues. The advantage is nothing is left on the table. You own everything. The disadvantage is if there are "skeletons in the closet", such as claims that arise years after the acquisition, they become the new owners' responsibility.

Of course, there are legal remedies that one can put into purchase documents, such as "reps & warrantees", in an attempt to protect [indemnify] the new owners from these potential issues. However, if the seller has moved on, has no assets at the time of problems or has died, the owners are still left to deal with them. Caveat emptor.

The alternative is an *asset sale*. In this case, the acquirer purchases only the assets of the firm; usually both tangible & intangible. [And, in some cases, only select assets]. This way there is no possibility of legacy issues. Any issues that come up in the future, from the past, such as old product liability claims, as the responsibility of the now former owners; you.

When you are looking to sell your business you should consider both options. Because an asset sale means you, the seller, retain any, and all, liabilities existing today or that arise in the future you are justified in demanding a higher sale price. The exact amount should again be pre-calculated by you prior to entering any negotiations.

The reason for this higher price should be obvious. The buyer is getting all of the upside of the business with none of the downside; current or long-term. That comes with a premium price.

7. **Communications**

Communication* (actually the lack of or poor communication is the most common complaint I hear from people in client firms) is always a tricky area. What I mean here is *when, who, what & how much* to tell. (*see APCIMAIR model above)

- *When*: What is the right time for to tell your team your intention to exit? If you tell them too early do you risk some of your key people moving on if they don't feel they will be part of the new leadership team? If you tell them too last minute will they feel left *out of the loop*? In this case will they leave, be obstructionists or worse, saboteurs?

- *Who*: Which individuals to you include in your sharing of information? You need your leadership team aligned to make the transition as seamless as possible.

Who else? Do you include those *influencers* who impact everyone else? Too many people knowing what is going on & there could be a combination of revolt & exodus. Pure anarchy.

- *What:* Determining specifics to share is the next concern. Details of a done deal? Specifics of a proposed transaction? General exit plans?

- *How much*: Exactly how much depth are you willing to go into? How much do you feel you need to share?

Think about these issues and prepare yourself early. Surprises will occur & you will have to adjust, but that is normal; right?

**8. Key employee's cooperation/continuation**

One critical area that is rarely addressed in these kinds of conversations is the continued participation, cooperation & support of your key employees. Without this team working together, and toward the same goal, a successful exit is difficult.

The reason should be obvious. Your key employees are your leaders, perhaps in fact even more than in name. Everyone else in the firm follows their lead. If they support the direction of the firm, it has a far better chance of success. If they do not, it may crash & burn.

Too often owners don't take into consideration how important their key employees are in day-to-day operations. Logically then, this extends to the future of the firm.

Assessing your key employees regularly is an important ingredient to any successful entity. As you approach an exit plan this needs to go deeper. Create a BASKET for every key position:

- ✓ **B**ehavior
- ✓ **A**ttitude
- ✓ **S**kills
- ✓ **K**nowledge
- ✓ **E**xperience
- ✓ **T**alent

By using the BASKET approach, you can indicate early what you expect/need from everyone. With expectations set, the individuals who step up & demonstrate the right combination of their desire, capability & commitment are those you can lean on moving forward.

This commitment can be extended to the new owners, assuming these key individuals are not them. If they are, they have proven they are the right choice.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### 9. Looking for perfect timing

The *Great Recession* caused a lot of business owners to put their planned exists on hold. The subsequent recovery was shallower than many expected, resulting in countless firms continuing to wait. Deals were being completed but at a slower than ideal pace for many, and the multiples weren't great. Waiting for better times, and better prices, seemed the best option for numerous owners.

As of this writing, multiples are up, offered prices are too. Time to exit or wait for an even better time/price? No one knows. Timing is about much more than just the price received remember.

Owners, sometimes, are paralyzed by fear of the unknown. Frequently, these types of owners hold one (or more) of the following concerns:

- "I don't think the business is worth enough to satisfy my financial needs and objectives."
- "If the employees discover I'm trying to sell, they will all quit."
- "Because I'm indispensable to the company, I'll be required to work years for a new owner and I don't like working for anyone!"
- "The sale process will take too long and cost too much."

This, *paralysis by analysis*, as it is called, can delay a reasonable transaction from ever happening. Your perfect timing may not be related to the market's perfect timing! What is driving you is more important than what is happening in the market. You should exit when you can get most of what you need compared to alternatives. And this may have little to do with the price received, as I said earlier.

Create a list of what you want, why you want it, when you want it, then sit down & assess the overall situation. When you can receive most, or all, of what *you* want, the timing is as good as it is going to get. Do it.

### 10. Forgetting due diligence is a 2-way street

Ok, you have addressed everything we have talked about above, have narrowed the field down to a solid prospective buyer so now it is the time to start digging a little deeper to protect yourself. Due diligence, as it is called, is the process of a thorough analysis of a business to establish its value to a potential buyer.

This includes looking at your:
- Operations
- Finances
- Marketing
- Management
- Legal

- Culture
- Tax
- IT
- Environmental
- Etc. [4]

[4] (for a complete due diligence checklist contact us at info@BuildItBackwards.com)

You need to start preparing for due diligence now. The challenges are enormous. At a time when you really need your business to be running seamlessly, and at its best, you don't have time to start preparing information that a buyer's due diligence team will request. The best strategy here is to be proactive & prepare as much of the information you know they will be requesting as far in advance as possible. Forewarned is forearmed.

And do not forget this is a 2-way street. You need to do your own due diligence on the buyer. This is may surprise you but it is critical to your successful exit. Why? Because the more you know about any perspective buyer the better chance you have to close the deal you want. Why? Because there are a litany of reasons a prospective buyer is not a fit, such as:

- They can't really perform.
- They're "window shoppers" who won't ever close a deal
- Their price is unrealistic
- Their demands are untenable
- Their goals for your firm are not in alignment with what you promised your leadership team
- Etc.

The *perfect* deal is one where all of your criteria is met (it ticks all your boxes) with a buyer who you negotiate mutually beneficial terms with and *closes*. The perfect deal rarely happens.

So the next best thing to a perfect transaction is getting as close as possible. A buyer who is willing to share as much *with* you as they are asking *of* you is one you can generally count on to perform.

In addition to agreeing on the terms & conditions of the deal, what you are looking for is a *partner* in the integration of the deal. A party who will work with you on:

- Determine the integration issues
- Planning and organizing an integration process
- Describing the execution process
- Doing exactly what they say so the transition goes as smoothly as possible.

Every exit is a challenge. Being aware of & dealing with these 10 issues will make it much less painful while increasing your chances of success sale. Welcome to your future.

For a free initial assessment or to discuss a more detailed analysis of these and other issues involved in developing and executing exit strategies, please call Daniel Feiman at 310.540.6717 or email him at DanielFeiman@BuildItBackwards.com or info@BuildItBackwards.com. For testimonials, case studies, a client list or upcoming events, please visit our website at www.BuildItBackwards.com.

Thank you


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