MAXIMIZE BUSINESS VALUE PODCAST - EPISODE 10 Transcript

Tom Bronson: 0:04

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Announcer : 0:05

Welcome to the maximize business value podcast. This podcast is brought to you by mastery partners where our mission is to equip business owners maximize business value so they can transition their business on their terms. Our mission was born from the lessons we've learned from over a hundred 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: 0:37

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Tom Bronson: 0:37

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 their businesses. In this episode, we're going to talk about some of them, some of

Tom Bronson: 0:52

the many options business owners have to ultimately transition their business. One of the basic truths that we live by at mastery partners is that every business will transition even the largest companies in the world. Transition. Think about the transition from business icon, Jack Welch, to his successor in 2001, that was very much a business transition. And GE spent many years thinking through the transition process. I've often wondered why most business owners don't give more time and attention to their business transition because like it or not, it's coming someday. The more time a business owner devotes to transitioning a business or a transition planning, the more successful the outcome will be. Let's look at the numbers each year, more than 250,000 lower middle market and small businesses SMBs come on the market for this illustration. We'll say that any business with less than a hundred million in revenue fits into the SMB category of the more than 250,000 that come on the market less than 45,000 actually close a transaction that translates into a 17% success rate, which means that each year 83% of the businesses that want to transition fail to do so.

Tom Bronson: 2:25

I hope you find that as alarming as I do, but one thing we know for sure, business owners that invest time in the transition planning process have a much better chance of success when the time comes for a transition. Many business owners think that there, there are only a few options to transition a business, but as it turns out, there are many let's break down the transition options into three major categories, internal transitions, external transitions, and other transitions. So this is not meant to be a complete list, but it at least points out that there are many options for business owners. So let's start with internal transitions, commonly referred to as transitions to insiders. Typically about a third of business owners are interested in a sale to insiders. A transfer to insiders is arguably the most successful transition available to business owners today, primarily because it reduces risk and provide significant benefits to the insiders who take on the business.

Tom Bronson: 3:35

The three primary types of insider transitions are a sale to family members, a sale to current management or a sale to employees or what we would call an ESOP employee stock ownership plan. So let's talk a little bit about transition to family, despite the challenges inherent in a family transition. Uh, there are many offsetting rewards and benefits, uh, which are also the result of careful planning. However, there's also an enormous risk to this type of transition because only 30% of transitions to the next generation are successful leaving a whopping 70% failure rate. So some of the advantages to an insider or a transition to family is that typically the family members who have been involved in the business already, it's a great way to leave a family legacy. And it's a favorable way to transfer family and generational wealth. Some of the downsides would be many times the buying generation wants to do things differently to leave their Mark, which sometimes rubs the selling generation.

Tom Bronson: 4:46

The wrong way. Family communication issues may arrive, uh, arise, family members, not inside the company may feel slighted. And it also typically delivers a lower financial value to the seller. The next type of transition internal transition is a transition to management. This type of transition is commonly referred to as a management buyout or MBO and an MBO. The current management secures funding from a bank and investment partner or the current owner, some of the advantages are that this type of a sale is it comes with the security of having well-seasoned management who already know the business. It provides a level of security for the business owners legacy, as well as future payments to the business owner or new investors. A couple of key disadvantages are that there's a need to secure funding. And many times the current management does not have the ability to do so without help from the current owner.

Tom Bronson: 5:56

Finally, in of internal transitions, let's talk about the employee stock ownership plan or an ESOP, a small percentage of business owners consider an ESOP and exit strategy. This path is particularly appealing to those who wish to transfer their companies, to known entities, perpetuate their current mission or culture, or keep their company inside their communities. Some of the advantages are that it rewards your current employees and management by providing ownership in the company. Typically it allows the owner to stay involved in the business post-transaction and it allows the owner to continue his long relationship with the employees, vendors, and customers, which ultimately retain, uh, the business owners sense of belonging. Some of the disadvantages are it's somewhat complicated to navigate the business owner and employees will need to seek outside help, which can be costly. The business has, uh, has to be able to borrow or find investors to pay the owner at closing. And many times the owner carries a long-term note from the company, even though he's typically no longer involved in the day to day operations of the business. We're talking about the types of transition transitions that business owners should carefully consider. Let's take a quick break back in 30 seconds

Announcer : 7:25

mastery partners, equips business owners to maximize business value so they can transition on their own terms. Using our four step process. We start with a snapshot of where your business is today. Then we help you understand where you want to be and design a custom strategy to get you there. Next, you execute that strategy with the help of our amazing resource network. And ultimately we help you transition your business on your terms. What are you waiting for more time, more revenue, if you want to maximize your business value, it takes time. Now is the time get started today by checking this out @masterypartnersdotcom or email us at info@masterypartners.com.

Tom Bronson: 8:16

We're back with the maximize business value

Tom Bronson: 8:18

podcast. And we're talking about the types of transitions that business owners should be thinking about because after all, all businesses will eventually transition. The second group of transitions we're going to explore is external transitions. Uh, those include a sale to a third party. The majority of business owners, uh, close to two thirds are interested in this type of a path, which is often the first or second choice for Many business owners. A third party sale is often the easiest most rewarding

Tom Bronson: 8:56

option for business owners. The first type of external transition is a sale to individual buyers for very small businesses. The most likely buyer is probably going to be an individual sometimes within this industry experience or specific interests in the market served by the business. The advantages of an individual buyer are that they might keep the business owner's legacy alive. The individual may have industry experience allowing for a very smooth transition. The owner may be able to stay on long term consulting under an agreement, providing additional cashflow as they transition to act three, which is the retirement phase of your life. And individual buyers may have a shorter due diligence process than other types of buyers. This advantages would include, uh, individuals may not have the ability to pay cash or be able to finance a transaction, therefore potentially requiring owner financing. And the individual may not have industry experience typically causing a longer transition period, whether the owner wants to stay or not.

Tom Bronson: 10:14

The second type of external transition is a sale to financial buyers. There are several types of financial buyers, such as private equity firms, venture capitalists, family offices. These buyers typically have the cash to invest, but don't always have industry experience. Some of the key advantages are financial buyers of all types are experienced at business transactions. So for the most part, they know what they're doing. Financial buyers will typically ask the owner to stay on and retain some ownership so that they can have a second bite of the Apple. When the business sells again, many times financial buyers will pay the highest price for a business, mostly because they have committed capital that needs to be deployed and put to work for their investors. Some of the key disadvantages are they sometimes don't have specific industry experience and therefore are not particularly helpful with operational issues and challenges.

Tom Bronson: 11:20

Sometimes they do have a panel of people that can help make, make decisions, but make no mistake. They're about driving higher revenue and profits because they will eventually sell the business. Again, financial buyers will have a higher level of scrutiny on financial performance of the business. Even if the owner stays on in a key role. And of course financial buyers will almost always require the owner to stay on with the company, although they rarely disclose it during the purchase process, financial buyers always have an investment thesis and the owner will have to conform to the new business strategy, or they may be forced out by the way, the average tenure of a former owner of a business that sells to a financial buyer is about two years, which actually could be an advantage if the owner would like to exit the business in that time frame.

Tom Bronson: 12:21

So the third type of external transition to consider is a sale to a strategic buyer. A strategic buyer is usually a larger company that has some reason they want to buy the company, which is usually technology or product or the customer base. They also are usually entrenched in the same industry as the company, but may also be in a related industry and looking to expand into the company's market. Some of the key advantages are by definition, strategic buyers have a specific strategy in mind when they complete an acquisition, they are frequently the highest offer for the business netting, the owner, a higher value outcome. In most circumstances, strategic buyers know a great deal about the business and are buying it for strategic reasons. Therefore they typically have great industry experience and can, and can contribute in a meaningful way. Many times a strategic buyer is also interested in the owner of the business and therefore may offer a short or even a long-term employment agreement providing additional income and security for owners looking to walk away quickly.

Tom Bronson: 13:45

Strategic buyers also may be a great option because they already know the business. Some of the disadvantages include, uh, because strategic buyers are likely in the same or very similar business. They may not need all the former overhead. So some of the employees may lose their jobs or some of the facilities may be closed for business owners that personally own their real estate. If the buyer decides to vacate the property, the former owner may not be able to find another tenant for the space, thus reducing future income potential. If a transaction with a strategic buyer falls apart, the buyer will have tons of information about the acquisition target that could negatively impact the business. Although it's important to note that this can be mitigated with a solid nondisclosure agreement. So finally, the last type of external transition we'll talk about today is the initial public offering or an IPO.

Tom Bronson: 14:55

An IPO is the sale of the business to the public markets, typically through one of the stock exchanges for more or more rarely by purchasing a shell, which is already public IPOs are typically reserved only for very fast growing businesses that have reached at least a hundred million in revenue or for disruptive businesses that have raised significant investments already and have attracted lots of attention. And therefore only a tiny percentage of business owners even consider it a viable exit option. So some of the real pros to an IPO are the, the advantages are a capital infusion to the company for new stock issued that can be used for R and D uh, growth debt reduction and other things, financial benefit to the business owner and early investors who can now liquidate their formerly illiquid asset. And it often generates publicity by making the company and its products known to a wider potential swath of customers.

Tom Bronson: 16:07

Some of the disadvantages are that IPOs are really expensive and the business owner will need lots of help from experienced service providers and professionals. There is increased reporting requirements, not to mention added scrutiny of the securities and exchange commission. And of course, companies going public have to invest in things that they may not have previously considered like the generation of financial reporting documents, audit fees, investor relations, departments, and accounting oversight committees. Finally, let's talk just a few minutes about other types of transitions. Although technically other options might be considered either internal or external transitions. There are a few that just don't fit neatly into one of the other categories. They may include often overlooked exit strategies that could be viable options for business owners. First, let's talk about role transitions. Perhaps one of the most overlooked exit strategies might be considered no exit at all.

Tom Bronson: 17:17

A role transition from owner operator to owner investor is one where the business owner retains management ownership of the business, but stops working in the business day to day. So this is an excellent option for businesses that produced high cashflow for the owners that can genuinely hand over the reigns and learn to manage like an owner rather than an operator. It's also a great option if the company and the business owner are in great health, the key advantages are the business owner retains the benefit of the high cashflow. The owner can potentially keep or add significant fringe benefits. If the business already has a great second tier management team in place, the transition can be easy and seamless. And the business owner ultimately retains control over the asset that they started or built. Now, some of the key disadvantages are many times. This transition is hard for business owners, as they have been heavily involved in the day to day operation of the business for a long time, if internal management candidates are not available, the business owner will have to recruit and train new managers to run the business.

Tom Bronson: 18:40

And finally, some of that high cash flow may need to be invested in the new management, uh, for compensation and incentives, other types, uh, or another type of transition. Uh, other transition is a liquidation fewer than one in five business owners view liquidation as a viable exit strategy, except in rare occasions, liquidation is preferable only to death and as a means of getting money out of the, or as a means of getting the money out of the business without any planning, however, liquidation may become the owners only viable option. The advantages are you staying in control of the process and you can sell the assets over time or sell them at a plan to time to close the business. The, this advantages of course, are the business owner may not be able to find buyers for all of the assets and liquidation can be a long and labor some process.

Tom Bronson: 19:46

Finally, let's just mention my least favorite transition option, which is the death of the owner. Okay, don't laugh. I hated to add this to the list, but unfortunately death becomes the default exit option for too many business owners. It is almost always the worst possible outcome because the business is left to the typically, uh, inexperienced hands of the heirs and employees with no plan for what to do to keep the business viable. The advantages are the business owner is no longer burdened with the business. Well, because he's no longer alive. And frankly, I don't know any other advantages to this one. The disadvantage of course, is that the heirs probably need the cash and the, that the business formerly generated in order to survive. Notice that I say formerly because without the owner, the business almost always starts to decline very rapidly. The business is left to the

EHRs then to decide what to do. And most of the time they have no experience in the business. And of course the business will have to be sold or may have to be sold at a fire sale or liquidation, which will generate far less value for the years. So in the end, it is so important to explore all of your options and decide which direction the business owner wants to go only. Then can they build a strategy to get there and execute it like their future depends on it because it does remember all businesses will eventually transition

Tom Bronson: 21:39

[inaudible] the earlier you start planning the better your chances of transitioning your business on your terms. This is the maximize business value podcast, where we give practical advice to business owners on how to build longterm sustainable value in your business. Be sure to tune in each week and follow us wherever you found this podcast and be sure to comment. We love comments and we always respond to them. So until next time, I'm Tom Bronson reminding you to stay safe, consider all the options while you maximize business value.

Announcer : 22:28

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Tom Bronson: 23:13

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Tom Bronson: 23:14

That was perfect. I wouldn't make any changes on that.