Buyable

Your Guide to Building a
Self-Managing, Fast-Growing,
and High-Profit Business

by

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ISBN: 978-0-9984478-4-1 (hardcover)
ISBN: 978-0-9984478-7-2 (paperback)
ISBN: 978-0-9984478-5-8 (e-book)
ISBN: 978-0-9984478-6-5 (audio book)

Advance Review Copy (ARC) published by:
Amershire Publishing, Glen Allen, Virginia

Printed in the United States of America

Cover Design: Jason Anscomb
Text Design and Illustrations: Iram Allam
Editing and Indexing by Christina Palaia
Proofreading by Barry Lyons
Digital tools: Zoltán Ember and Yasser Hawas

To Dora, the love of my life and best friend.
Thank you for keeping our family on track to achieving our dreams.

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PREFACE

It was August 2011 and the European debt crisis was all over the news. Greece, Ireland and Portugal were on the brink of bankruptcy. Banks were running out of money and had stopped lending to companies. Stock indices were dropping and investors were pulling back from buying securities. Mergers and acquisitions transactions screeched to a halt because buyers had no liquidity, nor any confidence to make acquisitions.

This was terrible news for the business I owned at the time in Budapest, Hungary. At MB Partners, we helped small business owners raise expansion capital and attract international investors. All six transactions we were hoping to close that fall were interrupted, stopped until further notice.

My wife, Dora, and I sat at the dinner table in our vacation home at Lake Balaton, contemplating our future. The trauma of the financial crisis three years earlier was still vivid in our memories. In September 2008, I had attended a private equity investment conference in London, just after Lehman Brothers went into Chapter 11. That week the Bank of England had approved dramatic measures to save the UK banking sector, pouring £500 billion into it in a single day. The patterns unfolding in the financial sector then reminded me of what I had read about the tumultuous events that triggered the Great Depression in 1929.

On the flight back from London, I was seated next to the mergers and acquisitions chief of Deloitte, my company's biggest competitor, and we had discussed how the impending crisis could decimate our businesses.

At that time, I was convinced MB Partners was in a touch-and-go situation and that I had to cut expenses immediately to conserve whatever cash we had for the long winter ahead. The next morning, I downsized my team and eventually let go of seven of our 15 professionals. This dire measure had helped our company survive 2009 and rebound in 2010. By 2011, I felt like we were back at the top, en route to our best year ever. Then Europe plunged into financial trouble again.

"This Eurozone debt crisis is strike two for the business after the 2008 debacle," I told Dora. "Can we afford to wait for strike three?"

After dinner, I started researching options, and by the end of the weekend, we had decided that we would try emigrating to America.

In the spring of 2012, as we prepared for the move, private equity fund manager Krisztián Orbán called me. He suggested that our two firms merge and that we become partners and build a leading merchant banking operation in central Eastern Europe. I was flattered by his suggestion, but because Dora and I had already committed to move, I turned down his partnership proposal. I invited him, however, to make an offer for an outright purchase of MB Partners. The timing could not be better—I thought.

In hindsight, I wish I hadn't. His written proposal a few days later shook me to my bones. Krisztián offered to buy our fancy office furniture and computers but proposed only a fee-sharing deal for our transactions already in the works.

Further, he asserted, I was personally critical to MB Partners as CEO, rainmaker, dealmaker, newsletter editor, and public face as chief cook and bottle washer. I also was integral to the top-level investor relationships that drove the business, and with my departure, MB Partners would have no goodwill value.

I felt humiliated. After spending ten years advising business owners how to build "buyable" businesses, I got caught with my pants down. Worse still, we were facing a much harder transition to America without the full bank account I expected to have after selling MB Partners.

I wish I had had what I now call a Buyable Business because it would have given me options and flexibility. But the business was not buyable—there were no recurring revenues, predictable cash flows, or documented repeatable processes. Without me, there was no marketing machine or sales engine, and I had neglected to groom a management team to run the company. Though MB Partners was profitable, cash flow was choppy and the fortunes of our transactions could and regularly did change overnight. Valuing such a business was problematic.

The business was not sellable and it could not run without me. I had no other option but to keep steering the firm forward and try to generate profits while we settled in the New World. It made for a much trickier transition for our family of six.

I have written this book to spare you that pain. You can prepare well ahead of a transaction and create the options I didn't have by building a Buyable Business years before you need one.

INTRODUCTION

Are you an entrepreneur who runs a business that is not living up to its potential? Is your company growing and profitable, but not yet itself a valuable asset that can make you financially independent? Are you frustrated that you are not creating the kind of success that you dreamed of when you were first starting out?

You're not alone. According to Data Axle USA, 1.7 million businesses with 10 to 250 employees operate in the United States.[1] Statista, a leading provider of market and consumer data, reports that between 2015 and 2019 on average 21,000 mergers and acquisitions transactions occurred per year.[2] This means that if you own one of these businesses, there is a 1.2 percent chance your business will be sold within a year.

Further, an article in the *New York Times* quotes Gene Marks's Small Business Desk Reference in asserting that the average age of a small business is 8.5 years.[3] (Compare this with the average longevity of *Fortune* 500 businesses, which according to a 2019 McKinsey & Company report is 18 years.[4]) According to the Small Business Administration, small business longevity has been a stable statistic over the years.[5]

Taking the average small business life span and the chance of selling in any one year together, we see that there is only a 10.5 percent (or 1 in 10) chance that your business will ever sell over its lifetime.

This is a tragedy because running an "unbuyable" business means stress, frustration, and little reward to compensate its owner. In contrast, operating what I call a Buyable Business—a business that others would want to buy because they recognize its value and potential—allows you to enjoy the personal freedom of having a self-managing business. You can sell or harvest your equity in the company to support your personal purpose, the purpose you were put on this earth to pursue, and manifest the ideal lifestyle that you deserve to live. A Buyable Business is fun to run and develop. With it, you can create and nurture great relationships with like-minded entrepreneurs and build a worthwhile personal legacy.

If you are the owner or the CEO of a privately owned business that makes between $2 million and $50 million in annual sales, this book can help you improve the sad statistics I just shared. There is no reason that the 10.5 percent buyability rate of entrepreneurial businesses could not be doubled or quadrupled when owners take a systematic approach. I firmly believe that if you are intentional and smart about it, you can make almost any business buyable, which means you build it into a business that grows, matures, and flourishes beyond its predicted short life span while providing you with choices in how to harvest its gains. You just have to hunker down and implement the ideas and disciplines laid out in this book.

So, who am I to tell you how to build your business? Why should you listen to me?

I have spent more than 20 years helping business owners prepare their businesses for sale, finding buyers and investors for them, and coaching CEOs and leadership teams. I have assisted more than 250 companies and business owners in such endeavors and tell the stories of more than 40 of them in this book, using actual names and details of those who have consented to appear here. Along the way, I also share the story of how I made my own business buyable after all.

Throughout my career, I have been fascinated by the question of how Buyable Businesses are created. Some of my clients intuitively got it and built companies others wanted to buy, whereas many struggled with owning a business that found no willing investors. In several instances, my team would find only a single interested buyer to close a deal, while at other times, more than a hundred bidders were not enough to finalize a transaction. What made these businesses unbuyable?

There were always reasons for the failures, but rarely could I build a convincing case and articulate why one company was definitely buyable while another was destined to remain unsold, thereby trapping its entrepreneurial owner in an unwanted stasis. Figuring this out felt like a hit-ormiss process; often luck and timing appeared to be the most tangible factors explaining a business's success or failure. But I knew the answer had to be more specific and predictable than that.

My experiences over the past 20 years, first as an M&A advisor and later as a business coach and a curious student of management principles, led me to discover how any viable business can be developed into a Buyable Business. In 2016, I turned my raw ideas into a workshop for business owners, which I presented to more than 50 Vistage and other peer groups. Feedback, questions, and comments from hundreds of business owners and CEOs, including my coaching clients, helped organize my thoughts and experiences into the content of this book.

You hold in your hand the puzzle pieces I have put together for you. Each phase of creating and monetizing a Buyable Business corresponds to a profession I have practiced during my career, including management consulting, mergers and acquisitions (M&A) advisory, and business coaching. Thus, I feel uniquely positioned to paint a comprehensive picture of the "Buyability Process."

I am deeply passionate about helping you, the owner of a private business, turn your venture into a valuable asset that supports Your Ideal Life in and outside that business. I believe that as a business owner, you have a unique opportunity to make an enormous positive difference in the lives of your customers, your employees, your vendors, your strategic partners, and their respective families. Depending on your business, you can innovate new products, services, and processes; forge a talent-attracting culture; and establish a personal legacy. If you do some or all of these things, then almost certainly you will reap rich financial rewards for yourself and your fellow shareholders. Rewards are a normal by-product of creating value for others.

Building a Buyable Business takes some time, depending on where you are in the Buyability Process. You may have already created value and are ready to monetize it over the next 12 to 18 months. Or you may own a small business where you wear most of the hats and the business is worth next to nothing at the moment. In that case, you may need 5 to 10 years to build the business that can take you to your destination.

Rome wasn't built in a day either, and as author and start-up specialist

Gene Landrum lays out in *Entrepreneurial Genius*, even the most successful entrepreneurs of our time, such as Jeff Bezos, Steve Jobs, Bill Gates, Richard Branson, Michael Dell, and Mark Zuckerberg, took at least 15 years to break through.

However long it takes you to move your business to buyability, your journey will be shorter and more straightforward when you apply the principles you'll learn in *Buyable*.

This book is structured around the four parts of the Buyability Process.

Part One, Design Your Future, is about determining Your Ideal Life, that you want to live in your Next Chapter and what you need from your business to get there. What do you love doing the most? What fulfills you? What would you be doing with your waking hours if money was no object?

Once you understand how you want your future to look, you figure out how much it will cost to create or live the life you've envisioned. What does it take to get from where you are to where you want to be? How much business value do you need to create to achieve your goals?

Often, reaching your destination is more achievable than you think. Occasionally, you need to allow more time to accomplish this vision, or you might even need to rethink your plan. Sometimes you are already close and then I will invite you to envision much bigger goals.

Part Two, Orchestrate Your Business, is about arranging the moving parts of your business for optimal functioning. Are you applying each of The Seven Management Concepts to run your business well? Do you have the right people in the right seats and are you empowering them? Do you have a vision and a plan, and are you moving forward each week and each quarter, or are you driven by crises?

In this part, I walk you through 10 Management Blueprints that you can implement to shortcut the business orchestration process. We also take a deep dive and review selected Management Blueprint tools that help you implement the Seven Management Concepts.

In **Part Three, Drive Growth and Value**, you will lay the foundation that all Buyable Businesses must have in place to avoid scrambling when opportunity knocks. We will examine your business records, customer profile, assets, and contracts and make sure you structure everything properly from the get-go.

Then you will learn how to position your business in a "blue ocean" and remove all that could hold you back from revenue and profit growth. Next comes fine-tuning the engine driving your business.

When your company's value has reached orbit, you will groom the business for a transaction that harvests the value you want to take. The goal is to situate your business at its absolute best for when investors show up.

In **Part Four, Construct Your Ideal Life,** we come full circle. You now have a Buyable Business on your hands, and it's time to review your options for monetizing your investment, perhaps via a full or partial sale or a cash-out transaction, which allows you to keep full or majority ownership control. Depending on your goals, you will want to optimize the combination of company valuation, timing of cash payouts, and risks you retain, and I will show you how to evaluate your options and the implications thereof.

Then we review how a transaction unfolds and the critical success factors you can focus on and the pitfalls to avoid when harvesting your business.

This part wraps up by discussing the options you have during and beyond the transition, whether you stay in or leave your business—critical considerations because ultimately the whole Buyability Process is designed to help you live your ideal lifestyle and purpose.

Specifically, you will learn from this book:

- Why you need to build a Buyable Business regardless of whether you ever consider parting with it.
- The difference between proactive and reactive entrepreneurs and how their approach determines their financial and emotional success.
- How to design the ideal future state of your business, from which you can reverse-engineer the steps to getting there.
- How to determine your personal financial goals, which your business should help you achieve.
- How to estimate the value of your business right now and how you can determine the value your company must be worth in the future to allow you to harvest the cash you need for your Next Chapter—Your Ideal life.

- The Seven Management Concepts that you need to master to orchestrate your business into a well-oiled machine.
- What a Management Blueprint is, the major principles involved, and how to pick one that is right for you.
- How Management Blueprints can help you create the vision alignment, execution, and team cohesion needed to build a self-managing, growing, high-profit, and talent-attracting business.
- A recipe for building a solid structural foundation for your business so you avoid landmines that could impede its future buyability.
- What the major value drivers of your business are and how to engineer them into your company to create the most value in the shortest time.
- The ways to groom your business into a product that attracts investors and buyers who will value it highly.
- How you can harvest your business, with or without selling it, to achieve financial security, your desired lifestyle, and the purpose that drives you.
- What your potential future roles in the business are and how to pick the one that fits your needs and personality.

As the former owner of an M&A advisory firm, I sometimes feel a pang of regret for having sold some of my clients' businesses too soon. If I knew then what I know now, I could have helped dozens of entrepreneurs grow their companies further and capture for themselves more of the value that their buyers ended up harvesting instead.

However, you are now holding that crucial information in your hands and can use it to build a buyable and highly valuable business, which you may not ever want to sell. No matter the industry, if you have the desire to create an extraordinary company, this book can help you articulate where you're going, organize your business into a self-managing entity, engineer your value drivers, build a solid foundation for a transaction, and groom the business so that you can harvest part or all of the value that you have created.

Here comes the recipe as I discovered it. Welcome to the journey to your Buyable Business.

PART ONE:
DESIGN YOUR FUTURE

Create a life that feels good on the inside, not one that just looks good on the outside.

—ANONYMOUS

Part One of this book takes you on a big-picture thinking journey to discovering what you want your business to help you achieve and how you will build a Buyable Business.

It starts by defining what a Buyable Business looks like, including cul-de-sacs to avoid what lead to an unbuyable business. Then, we compare the opportunistic seller and the strategic seller using real-life case studies before reviewing the main types of reactive and proactive exits and how they emerge.

Next, we talk about different versions of an ideal life so that you can frame yours more easily, whether you remain inside or outside your business. We'll determine your Magic Number, what you will need to transition there. Then we take a look at your business and determine the gap between its current value and future desired value. You will know what it takes to bridge that gap over your envisaged time horizon.

Welcome to the Buyable Journey.

1

WHY BUILD A BUYABLE BUSINESS?

Don't wait for your ship to come in. Swim out to it.

—CATHY HOPKINS

In the late 2000s, Mrs. Juhász, the aging owner of an auto parts company I'll call PartsCo, phoned me. She was facing a life-threatening operation within the next 12 months, and she wanted to settle her affairs before the surgery, including selling her business. This was critical because she single-handedly managed the business and no family member was able or willing to step into her shoes.

At first glance, PartsCo was a glorious niche business. It was making about $10 million in sales, with almost half of that dropping to the bottom line. PartsCo dominated its niche; all its competitors were much smaller mom-and-pop shops. Some years earlier, its primary customer had offered to buy out the company and, when that fell through, tried to set up a competing subsidiary, which failed. The auto parts business relied on expensive equipment and skilled workers, which created barriers for new entrants.

The trouble was that Mrs. Juhász had never intended to sell, and she was now unprepared and under time pressure to do so.

Here are the issues she faced:

- The business was managed solely by Mrs. Juhász. She had some helpers but made all the decisions herself. Not a single engineer or

even a college graduate was employed by the business who could have been elevated to a leadership role.
- PartsCo's financial records were a mess, handled by a semiretired bookkeeper she trusted, notwithstanding his incompetence and sloppiness.
- Mrs. Juhász's major customer trusted her and was wary of dealing with anyone else in her absence.
- That major customer generated an enormous part of revenues, and it would take years to diversify sales to eliminate the business's exposure to the risk of losing that customer.

These issues severely limited the pool of investors we could approach. No strategic or private equity buyers proved able to handle the financial and management issues or the risk of losing PartsCo's major customer. The business was virtually unbuyable.

The situation would have been different had Mrs. Juhász given herself two or three years to fix the business in preparation for a transaction. This would have been enough time to clean up the books and bring in and promote a successor or at least a talented individual who could run parts of the business without having to be micromanaged. Mrs. Juhász could also have cultivated new accounts to mitigate the concentration issue.

Because of the situation, we had to find an industry insider buyer who would be entrepreneurial enough to handle the issues and who had the experience and the reputation to maintain the buyer relationship. We also had to find private investors who would back the person leading the buyout.

The deal eventually worked out, but Mrs. Juhász received only half the price she could have harvested if her business didn't face avoidable issues that made it unbuyable.

But this shortfall wasn't her fault. She had never contemplated the concept of building a Buyable Business because she was too busy keeping her lifestyle business together and making as much cash profit as she could.

If Mrs. Juhász had built her business to be buyable, and if she had prepared for transition three, five, or 15 years earlier, she would have had a variety of options to choose from when her health challenge arose, such as stepping back from managing the business to be a passive shareholder or auctioning it to the highest bidder.

It is impossible to know with certainty, but I believe she could have made a lot more money on this sale. If only she had groomed the business in the 18 months prior to the transaction, she could have easily added 30–50 percent to the value of PartsCo. Had she mastered the basics (Chapter 7) in the prior three to five years, the business would have easily been worth two or three times more. And had she also engineered value drivers into the business (Chapter 8) in the previous 10 years, PartsCo could have been worth a multiple of the sale price paid for it in the fire sale Mrs. Juhász had forced herself into.

Read on to find out how you can do better for *your* business.

IS YOUR BUSINESS BUYABLE?

What Is a Buyable Business?

So, if Mrs. Juhász could have done better with a Buyable Business, then let's start by defining what a Buyable Business would have looked like for her and what it could look like for you.

A Buyable Business is an enterprise that others would want to own, a business that is worth more than the sum of its parts because it has goodwill value. Goodwill value accumulates when an entrepreneur increases the value of the assets in the business by applying vision, organization, and energy and by harvesting the ideas and efforts of a group of people working in or for the benefit of the organization.

A Buyable Business is self-managing—it manages itself without the involvement of the entrepreneur who created it. In contrast, when a new owner must replace the entrepreneur, the original owner still embodies much of the goodwill of the business, making the company unbuyable. In other words, the emperor is naked. That is where I was in the summer of 2012.

A Buyable Business is as or more profitable than its best competitors. Buyers like to invest in businesses that are making healthy profits, because these companies are more likely to offer differentiated products or services and to have competitive advantages.

A Buyable Business can attract top talent, which ensures that it remains competitive and keeps growing. Talented people make businesses grow so they can grow with them.

Would you consider your business "buyable" based on these criteria?

Let me guess: The answer is no. How do I know that?

At any one time, 90 percent of small businesses are unbuyable and chances are likely that yours is not as self-managing, profitable, and talent-attracting as you would like it to be.

But if you love your business and don't plan to ever sell it, why would you need to create a Buyable Business anyway?

This is the wrong question.

The right one is: Why would you ever want to create an unbuyable business? There seems very little upside in building a company that is not self-managing, not consistently profitable, not offering you options and flexibility, not growing, not generating predictable revenues and profits, a company that creates stress in your life, leaves employees unempowered, repels A players.

The only business that is worth building is a Buyable Business: an organization that runs on its own, grows, generates profits, manifests a great and talent-attracting culture, and offers differentiated products and services provided by happy and striving employees.

A Buyable Business is a successful enterprise that is going somewhere while attracting talented people and great opportunities into your life. Do you see any reason to build anything other than a Buyable Business?

Unbuyable Businesses

Yet, the great majority of businesses remain unbuyable. Let me give you some examples I have come across. I am ashamed that my M&A firm, MB Partners, represented several such companies. Earlier in my career, I didn't always recognize their issues and sometimes offered to help them even when I could not.

In the following sections, I describe the red flags that indicate when a company is potentially unbuyable. When more than one such red flag exists, a company needs immediate owner attention to save it from extinction.

In the Middle of Nowhere

Some businesses are located in an undeveloped geography, someplace difficult to reach that has little access to talent. I once visited a porcelain factory located deep in a remote forest with no inhabited areas near it. The plant could attract no qualified management and had to pay well above market rates to attract senior or even junior employees. The company has been surviving on government subsidies ever since, and remains in an unbuyable, government-enabled vegetative state.

Aging Workforce

Early in my career, I visited with an engineering business where the management bragged about their workforce having more than 30 years of experience on average. In reality, the company could not attract talent, and scores of its key people were planning to retire imminently. The business was fast running out of people, so what was there to buy? Managing the talent pool of a company is critical to ensure that the business remains vigorous, with good people feeding management succession and energetic young talent funneling in ambition and fresh ideas.

Poor Working Capital Profile

Some distribution businesses take on unsustainable risks. I have met several that paid up front for Far Eastern imports while delivering to their big-box customers just in time. This "strategy" requires ample working capital to fund the shipping and storing of inventories. Also, major retailers are often slow payers, which forces distributors to fund receivable balances as well. Such financing of high receivable and inventory balances could reach six to nine months of sales revenues in some cases, creating a ceiling on growth and spawning tremendous expense and risk for the owners.

These businesses are prone to go under in the next recession or upon the bankruptcy of a major customer or when shifting customer tastes make their inventories obsolete.

Lack of Documented Processes

Businesses without documented processes are at the mercy of their people leaving with the know-how in their heads. Worse, the lack of documented processes over time leads to inconsistencies, staff confusion, and costly errors. Buyers are not interested in acquiring companies that are at the mercy of a handful of key people who understand how the business works and who might leave after the transaction; often these people are the same as the owners, and that makes the company unbuyable. My former business, MB Partners, was an example of this before we implemented our Management Blueprints, of which you will read more in Chapter 5.

Buyers prefer companies that run on documented processes that are regularly updated and where each process is mastered by multiple people who can cover for the sudden loss or absence of individual employees.

No Recurring Revenues or Customers

Buyers of businesses love recurring revenues and value them highly. Unfortunately, not all businesses have or can create recurring revenue models, although many try. For example, construction companies are project driven, but they often sell maintenance or facility management contracts to generate recurring revenues. Professional services firms, such as law firms, rarely have recurring retainers, but they often have recurring clients who bring them billable work each year. Some businesses don't even have that, such as M&A firms, which have to sign new clients each year because very few of their existing clients have multiple companies to sell.

Buyers don't like businesses that depend on unsystematic business development efforts and will only buy them at a discount, if at all. On the other hand, businesses that have long-term or perpetual contracts are seen as sustainable, as long as they manage to keep client churn at a reasonable level.

At the Mercy of Customers or Vendors

High customer or vendor concentration can make a business be perceived as high risk. I represented a technology company years ago that earned more than 80 percent of its revenue from a global conglomerate. Even though this company's revenue came from 15 operating subsidiaries on three continents from more than two thousand relationships across the group, investors became alarmed and withdrew from investing in the business.

The same goes for a business that sources a large proportion of its products, raw materials, and services from one or two partners. This is called supply chain risk and can make a company unbuyable. Buyers are wary of situations in which the loss of a relationship can diminish 10 percent or more of the business overnight. They prefer businesses that have diversified away their dependency on individual customers or vendors so the loss of any one client doesn't threaten the company's viability.

Obsolete Technology

I once represented a printing company that supplied flexible packaging materials to blue chip, fast-moving consumer goods (FMCG) customers. The business was growing, profitable, and provided competitive products. We received an offer from a German strategic buyer, but the buyer abandoned the opportunity after noticing that the printing equipment was old and overdue for replacement.

Buyers are wary of businesses that require significant cash investment right after they're acquired. Beyond the unwanted monetary outlay, companies with run-down equipment are perceived as second-rate businesses, and buyers assume that old equipment is the sign of poor corporate health rather than conservative financial management.

No Internal Sales and Marketing Engine

Years ago, I advised a public relations company that provided excellent service and virtually never lost customers. Unfortunately, the firm had a weak sales process and the owner, who disliked hunting for business, could not attract reliable salespeople to join the firm. The company remained highly profitable until a major customer went out of business and a key executive left. After hiring a business development firm to no avail, the owner pulled the plug and took early retirement.

Having an internal new-business-generating engine is critical. Businesses that rely on good customer service for their growth or that outsource business development are not sustainable and are at the mercy of their business development vendors. Generating business is an indispensable core function of every company.

Selling Low-Margin Products

Low profit margins are toxic to a business's buyability. Buyers look for acquisition candidates with double-digit margins, as anything less implies commodity status and exposure to sudden shocks, such as a customer going bankrupt. A business selling at 5 percent profit margin will need 20 new customers to recover the lost receivables of a bankrupt customer. The owner is sitting on a time bomb. Furthermore, a single-digit profit margin is insufficient to fund investments in hiring, equipment purchases, and working capital that are often required for growth.

Fifteen years ago, my firm advised a prefabricated concrete manufacturer ("Prefab") that competed in a crowded market at razor-thin margins. Prefab's owner was a rainmaker, a well-liked manager who grew his business for over a decade until a nonpaying customer nearly bankrupted his company. Soon after, he died of a heart attack on the job. Low margins remove the buffer that can absorb inevitable mistakes and create constant stress. Bad for your health.

Exposure to Fluctuating Commodity Prices

Over the years we had several clients in the poultry processing business. Those companies oscillated between feast and famine as global supply and demand changes continually shifted poultry and feed prices on commodity markets. Two wonderful years when the poultry and feed prices diverged were often followed by a terrible one, when those businesses barely broke even, or lost money. Unstable profits kept investors away from the poultry sector, and strategic acquirers waited to pick off weakened competitors at fire sale prices or purchased retail brands from the receivers of bankrupted players.

Businesses that depend on un-hedgeable commodity markets are often unbuyable and only survive because their iron-fisted entrepreneur founder, sometimes with the help of government subsidies and grants, keeps them going.

Poor Financial Performance

Businesses are bought to make money. Investors and buyers seek profitable and well-run businesses that promise improving financial results. Poorly performing companies attract turnaround buyers at rock-bottom prices. Generating consistent and sustainable financial results is job one, without which a business is often perceived as unbuyable.

This is just a selection of issues that make businesses unbuyable. Unbuyability is the default position and where you'll find yourself if you're not intentional about building buyability into your business. So, let's turn to how it can be done.

Being strategic, instead of opportunistic, can make all the difference in harvesting the results of similar entrepreneurial efforts. In the following pages, let me share an example of each to illustrate the point.

An Opportunistic Seller

Struktoor was a construction company focused on major civil engineering projects commissioned by local and state governmental agencies, such as bridges, tunnels, river works, and flood prevention.

Two equal partners acquired and grew the company, one an industry insider engineer I call Sasha, the other a politician with money and connections; let's call him Ace. They grew the company rapidly by acquiring smaller competitors and amassing government contracts, and their business was highly profitable. Around 2006, they saw that the M&A market was hot and decided the time was right to sell the business.

They hired our firm to represent them and wanted to tie our fee to whether the sale price beat our valuation expectations. They insisted that we should get an unusually steep fee should we achieve an extraordinary valuation. I felt uncomfortable about this and suggested a flat percentage fee, but they questioned my commitment and trust toward them, so I played along, assuming that their target price was unachievable anyway.

Soon multiple offers came in for Struktoor and we signed a letter of intent (LOI) with the highest bidder, a global construction group (Gaffkont) for a purchase price of about $25 million. The next step was buyer due diligence to confirm the information we had presented in our sales memorandum and the customary deep dive into financial, commercial, taxation, and environmental matters that most buyers need before making a firm commitment.

The due diligence involved poring over data, documents, and contracts the sellers provided. A thoroughly prepared due diligence can be wrapped up in a couple of weeks, but it often drags out when all the information is not readily available.

Four weeks into the process, I sensed that Sasha and Ace may have been dragging their feet and asked what was bothering them. "The business has been doing better than we thought and we feel we should not sell at the agreed price," they informed me.

It is rare that a seller renegotiates soon after they accepted an LOI, but here it was, so I arranged a meeting with the buyers. We flew to Hamburg, where Gaffkont wined and dined us for two days. During the last meeting, the buyer's senior vice president, Erik, shared a parable about an Arab prince, with the message that this one time they would agree to changing the price, but we should not attempt it again.

Soon thereafter, the due diligence was complete, and we received a firm offer for $30 million. This happened at the end of the summer, and we started negotiating the sale and purchase agreement, but again progress was painstakingly slow. Struktoor's attorneys split hairs and challenged even customary contractual clauses.

I sensed something was amiss and asked for another meeting with Sasha and Ace. They informed me that their backlog continued to grow above expectations and that they had just completed the acquisition of a company that enjoyed a local monopoly on flood works in their county, which they expected to increase the value of the business. They felt that they would be squandering Struktoor at the agreed price and that we should get at least $37 million instead.

Again, I arranged another meeting with Erik, and after some wrangling, Gaffkont agreed to improve its offer. So much for Arab princes.

After that, negotiations gained momentum, and by the end of November we were close to concluding the deal. We set the date for signing the papers for Friday in early December. Our plan was to have Erik fly in for a last round of face-to-face talks and dinner on Thursday, after which we would officially ink the contract the next morning.

Sasha and Ace arrived at my office after lunch on Thursday and informed me of their decision not to sell Struktoor for anything less than $42 million. This year would beat profit expectations and they had the biggest-ever backlog for the following year, and so on and so forth.

My stomach sank. MB Partners' fee would be close to a million dollars and I was desperate not to lose this deal in the eleventh hour, but I doubted Gaffkont would renegotiate once again and just hours before the closing. What could I do to save the transaction?

Soon, Erik and his entourage from Gaffkont arrived, and I broke the news of my clients' new demands. They just about had had it and were ready to head back to the airport, but it turned out there were no more flights back to Hamburg that night.

Trying to break the icy atmosphere, I offered to take them for a drink. Dinner followed at an exclusive restaurant in the suburbs of Budapest, and then gypsy music and more drinks. At two in the morning, on the back of a napkin I suggested a compromise deal, and to my amazement, everyone agreed to it. I got home in the wee hours, feeling triumphant.

The signing would take place at nine the next morning, as planned, at the offices of Gaffkont's law firm. I arrived to find half a dozen copies of the updated sale and purchase agreement arranged around a vast mahogany table, with an army of attorneys and Erik's team in attendance. Sasha would be representing the sellers at signing, but he was not to be found.

He finally arrived 40 minutes late only to tell us he had one last condition on the sale: Gaffkont should give him a 50 percent raise in his role as the CEO of the jointly owned company. This was a shocking move, but Gaffkont was desperate not to leave empty-handed. They agreed to fund their share of the raise, corresponding to their initial ownership of 51 percent of the company. The rest, they said, should come from Sasha and Ace, as the 49 percent owners.

Sasha refused, arguing that he could not commit Ace to this deal and that Gaffkont should pay for his full raise. Discussions froze, then Erik and his team left in a huff.

The turn of events absolutely devastated me. How could this deal blow up after nearly 12 months of efforts round the clock to secure it? How would I get over losing a million-dollar fee, the highest ever for my firm?

I could not sleep for three nights, wracking my brain for ideas on how to resuscitate the transaction. Finally, at three in the morning on Monday, an idea struck me: What if I paid for Sasha's raise? It would cost half a million dollars over the next three years until the sellers were fully bought out. I could afford to pay for it from my fee, and our firm would still make $500,000. We would be good with that.

I called Erik the next morning and found him to have cooled down after spending a relaxing weekend at his château. He was open to doing the deal if I could fund the sellers' share of Sasha's raise. I was on my way.

My next call went to Ace and Sasha, who were driving together in Ace's Ferrari. I quickly explained my idea of how I would waive half my fee to pay for Sasha's salary. After a few seconds' pause, which felt like an eternity, Ace started laughing uncontrollably.

"What is funny about that?" I asked in desperation.

"Steve, you didn't seriously think we would pay your fee, did you? Ha ha!"

Epilogue to this story: Four years later, Struktoor ran out of cash and went into administration. Sasha and Ace were convicted for bankruptcy fraud, although the judgment got eventually overturned on appeal in controversial circumstances.

The owners of Struktoor were driven entrepreneurs, but they had no apparent vision of what they wanted to build and why. They were attracted by opportunities and were always chasing the deal that looked most promising in the moment. Over time they lost their sense of proportion and started to believe in their invincibility. That blinded them and prevented them from seizing the opportunity to take their profits when they broke through the multiple business value targets they had set for our project. Sasha and Ace ended up losing their company and brushed close to losing their freedom, too.

Now let me share with you a very different story, one in which the owners of a business took a strategic approach to selling their company.

Strategic Sellers

Gulliver was a toy wholesale and retail business with annual sales of about $45 million and a healthy profit, founded by two best friends and Hall of Fame hockey players, Csaba and Péter. That is, Hall of Fame of Hungary, not the NHL, but they are two of the 10 "living legend" members of all time.

The two friends had married two sisters, Ildikó and Krisztina, and the four of them founded the company in the late 1980s. Over time, they became the management team of the business, and it was virtually impossible for an outsider to penetrate to the top tier of leadership. In the mid-2000s, they decided to sell the business and pursue their other passions.

The business was well organized with processes and ran on a sophisticated IT system. They led the market and were highly profitable; however, they made the most money selling Chinese imports to big-box retailers, which meant high receivables and inventory and minimal payables to fund it. A risky combination, as we discussed earlier.

But the sale of the business went like clockwork. MB Partners put on an auction and received half a dozen competitive offers. We sold the business by the end of the next year at full price. Péter stayed on the management team as Chief Operating Officer, but the private equity buyer still considered the company self-managed. Gulliver's team was perceived to be so well organized that they could hand over the keys, take full payout, and leave with minimal indemnities. The sellers even negotiated a long-term lease for the properties they kept ownership of.

But here is the best part: Csaba, after resigning as CEO of Gulliver, was elected as the president of the Ice Hockey Federation and helped the national team reach its best-ever ranking and remain at that level ever since. Another founder, Krisztina, was the first woman of her country to reach both the Arctic and the Antarctic and became a minor celebrity. Ildikó retired to spend more time with her grandchildren, and Péter stayed on at the company, which remained his passion, for several years longer.

The Gulliver team accomplished the transition in a way few business owners manage. They had a plan for the next stage of their lives, they knew what they had to achieve to get there, and they executed the plan. It required making their business buyable, and they sold Gulliver at the right time to the highest bidder.

They were strategic about their personal futures and leveraged their business to achieve their vision. The way to be strategic is to visualize your future and then to be proactive in taking the right steps to create it.

ARE YOU REACTIVE OR PROACTIVE?

The Default Setting

Unless you have a plan and execute on that plan, you are being reactive. Most entrepreneurs are reactive, even when they have mission statements and perform strategic planning.

Michael Gerber in his seminal book *The E-Myth: Why Most Small Businesses Don't Work and What to Do About It* speaks about the root of the problem.[6] The great majority of founders fall into entrepreneurship by being great at their profession and building a business around their own technical expertise. He calls these quasi entrepreneurs "technicians."

Unless these technicians work on their business as much as in their business they will remain stuck, limited by their personal technical capabilities. Gerber describes that the way to break through the ceiling is to transition to a "manager" role, delegating and getting things done through others, and eventually to "entrepreneur" status. The entrepreneur's primary role is to set the direction, find and exploit opportunities, and steer the ship.

Ascending to the entrepreneur role is a necessary but not sufficient condition, however, to make your business buyable. One reason entrepreneurial people start companies is for the freedom to experiment with whatever fascinates them. This tendency frequently leads the entrepreneur to chase "shiny objects" and jerk employees from one priority to the next, confusing and demotivating them.

I fell into the shiny object trap myself while running MB Partners. After the investment banking business took off, I launched a business brokerage operation to help smaller companies that could not afford our VIP service. I promoted one of my best employees to be the managing director of that venture.

While trying to get that brokerage business off the ground, I read *The E-Myth* and got excited about systemizing businesses into well-oiled machines. Soon I had a second shiny object to chase after and hired a senior executive to run that business.

By that point, I was devoting 60 percent of my time to these new businesses, and MB Partners started slowing down. In the meantime, the brokerage and systemizing businesses did not receive enough of my attention, either, and went nowhere. Instead of one growing and profitable business, now I had three failing ventures on my hands, with a bloated payroll and unhappy clients.

Six months later, I swallowed my pride and wound down both the brokerage and the systemization businesses. Painfully, I had to let go of my senior colleague, who was also a friend. My rising executive in charge of the brokerage got burned out by the experience and left our company. I learned a costly lesson about what happens when I react to exciting opportunities that don't organically fit into the core focus of my business. More on that later.

Let's review how being reactive can force you into an exit that does not serve your best interests, or one that unfolds with suboptimal results.

Reactive Exits

Whether you are proactive or reactive, at some point you will exit your business. Here are some scenarios in which reactive business owners leave their companies.

Ill Health

No one lives forever, and at some point, you will be forced to hang up your keys. It may be a dramatic event, such as a major illness or operation, like that of Mrs. Juhász, or you could have a heart attack or stroke on the job. Without building a competent team, it is challenging to pull back and dial down the stress of running the company during times of ill health. You need to grow the business so that you can afford a team and then train them so that you build a self-managing organization that can operate without you if necessary or desirable.

Burnout

If illness doesn't throw you off your feet, you may as well burn yourself out. A business is either driven by a compelling vision or by the fear of failure. The latter is the default setting. It is human nature to relax and coast when your bank balance is high.

Predictably, coasting puts the brakes on your momentum, triggering a slide and a crisis. This, in turn, reignites your survival instinct, and you will pull yourself together. The crisis mobilizes all your resources and you run on adrenaline for a while. However, you cannot sustain this level of fear-induced intensity, and you will feel the need to relax again as soon as your business has recovered.

Most companies are living this stop–go cycle, and they stumble from one crisis to another, only making enough money to pay their bills and stay in business. It takes effort, and planning, to leave the gravitational force of the survival zone. However, after take-off, sustained effort creates the momentum to propel you forward, like when a plane becomes airborne. Eventually, you reach cruising altitude and need to put in less effort going forward, which is what happens when you have created a self-managing business.

Indebtedness

Borrowing is a slippery slope for a small business, because banks tend to lend for the wrong reasons. A growing business needs to invest in productive assets, predominantly people, marketing, and product development. (Hard equipment and vehicles can often be leased.) Banks don't like to fund off-balance-sheet assets because these can fast lose their value when a business becomes unable to service its loans.

Therefore banks prefer to push loans secured by the personal property and creditworthiness of the business owner, and they like to lend against assets they can better control and liquidate, such as receivables and inventories. One of my clients, a construction services company, prefers not to collect on receivables early because its bank would reduce its credit line to align with the lower "collateral balance." Similarly, banks incentivize the buildup of inventories by lending against them, whether or not that is in the best interest of the business.

Unfortunately, borrowing against receivables and inventories can be a self-defeating strategy. If you don't generate enough profit margin to finance your growing working capital needs, then your business model is flawed and you should fix it as soon as possible. Solutions include collecting up-front payments and engineering a just-in-time delivery system.

"But what if all my competitors are offering terms and are willing to keep inventories?" you ask. Then you are in a commodity business, which is a dangerous place to be. The users of commodities tend to be price driven and fickle. You need to break out of commodity status by providing more valuable products or services or by tailoring your offerings to a niche market if you want to build a Buyable Business.

Slipping into bank debt and financing growth with credit lines means that you're generating paper profits, much of which is eaten up by your growing working capital needs, which leaves little cash available in the business for dividends or growth. Serving commodity markets is not a scalable business model and you will not accumulate much equity in your company. More on that later. Structurally indebted companies are also unattractive to buyers.

Partnership Dysfunction

A healthy team and working capital profile are important, but not sufficient to make your business viable. The relations between partners and owners also need to be healthy.

Perfect business partnerships are rare. It is the exception, not the rule, for partners to complement each other, grow as leaders at a similar pace, and maintain compatible long-term aspirations. More often than not, one partner ends up playing a bigger part because of their superior drive, energy, or talent to attract and motivate people.

Equal partnerships are risky because they can put a damper on growth when the more active partner becomes bitter about pulling the cart on behalf of their less-driven or less-effective fellow owners. In such situations, partners sometimes agree to adjust their equity holdings to reflect their contributions to the business. But often they cannot find a mutually satisfactory solution and end up dissolving their partnership by splitting the business in the middle or by one partner buying out the other.

In each of these examples, outside circumstances force the business owner into leaving the business. Next we will review how being proactive helps you reach better outcomes.

Proactive Exits

Opening a Compelling Next Chapter

As you recall from the earlier story, the founders of the toy company Gulliver initiated an exit so that they could fulfill their desires. Gulliver was built to be buyable, and selling 100 percent of the company for cash allowed Csaba to pursue his passion for ice hockey, Krisztina to conquer the Arctic and the Antarctic, and Ildikó to lavish time and attention on her family. It is rare for multiple owners to have in mind desirable missions outside the business, especially for them to realize it all at the same time. Businesses that are owned by a sole entrepreneur who engineers an exit and businesses in which one or more incumbents acquire the stake of another founder are more frequent.

I discuss examples of worthwhile postentrepreneurial careers in the next chapter.

Starting Another Business

Certain entrepreneurs realize that they enjoy and have the talent to build a business to a certain size, after which they lose interest. Exiting their current business allows them to become financially independent and creates the starting capital to launch another business that may have more potential.

I know of an engineering company that had grown to more than a hundred people when the owners decided there was limited upside in continuing to build a business that depended on selling consultant hours. They incubated a software services business on the side. Selling the consulting business helped them eliminate their personal debts and financial guarantees, take chips off the table, and capitalize a technology startup they had spun off.

Then they turned their tech spin-off into a Software as a Service (SaaS) company, which is much more scalable than the consulting business ever was.

Also consider the case of Linda Nash, a serial business angel who incubates new businesses to sell them off as soon as they have become viable, with stable revenues and independent management, typically after two or three years. More on her later.

Family and/or Management Succession

Perpetuating family businesses through multiple generations is challenging. According to the Family Business Network, a nonprofit serving the owners and leaders of family-owned businesses, one out of three family companies pull off a successful family succession, and only 3 percent of family companies last for four generations or beyond. The oldest family business is the Hoshi Ryokan Hotel, founded in the year 718 and being run by the 46th generation[7] of the family. Japan hosts 60 percent of the 5,000 family companies worldwide that are more than 200 years old. Most of them survived by adhering to and perpetuating fundamental family values.

One family company that created a proactive succession is Szabadics, a civil engineering company in western Hungary founded by József Szabadics. József built a Buyable Business and facilitated a smooth ownership transition to his two sons, Zoltán and Attila. They did this while creating personal liquidity for the founder and his two sons and expanding the management team with two senior executives, one of whom became the CEO of the company.

In a single transaction, József cashed out 60 percent of the equity of the business and arranged a management transition to an independent CEO, while keeping his two sons engaged in a thus institutionalized business. The Szabadics family retained 90 percent ownership in the business. See more about this transaction in Chapter 10.

Since the transaction, Szabadics grew the number of its employees fourfold, and the small-town company expanded its geographical footprint to cover 50 percent of western Hungary. The company has a multilayer leadership structure and can attract and keep talent by continually growing and offering a career structure to its employees.

Szabadics achieved the family and management transitions at the same time, which is rare. Occasionally, an owner can sell the business to their management team and stay engaged with the business at a strategic level. A tax-effective approach is to use an employee stock ownership program (ESOP), which we will discuss in more detail later.

KEY IDEAS

- A Buyable Business is an asset that others want to have and are willing to pay to obtain, without you having to become their employee. You need to build your business into a Buyable Business—even if you never intend to sell it—so that you have good options if you are called elsewhere, face an emergency, or want or need to dial back your efforts.
- The default position for any business is unbuyability. You have to be intentional about building buyability into your company. Most businesses are started by technicians who initially focus on personally delivering services rather than on building a company. Being strategic and proactive helps you set up your business in a way that yields optimal outcomes.
- Reactive business owners struggle with stop–go businesses that they run on adrenaline from crisis to crisis. This kind of fuel works for a while but is not sustainable and can make owners sick or burned out

in the long term. Lack of focus on the right business model can also trap an owner into a debt spiral, eroding the value of the business. Partnership dysfunction can also force a business owner to exit the company prematurely or see it decline.
- Proactive business owners build Buyable Businesses that allow them to exit and pursue their passions, start another business with bigger potential, arrange a successful family transition, or continue at the helm of a prospering organization run by a succession management team.

TOOL FOR THE CHAPTER

Assess the buyability of your business at: BuyabilityAssessment.com