TobinLeff
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WHITE PAPER

10 Things I Wish I Knew Before I Sold My Business

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I am a 75-year-old retired owner of a mid-size PR agency which was the top agency in our market when I sold my firm.

I am also the co-founder of TobinLeff—some 13 years ago.

I am financially independent today.

At the time, way before I had the pleasure and good fortune of meeting David Tobin, I retained an exit planning consultant who convinced me that if I put a plan in place at least ***seven years before my planned exit,*** I could receive top dollar for the equity in my firm and achieve my long-term financial objectives.

The plan worked.

Sort of.

In spite of the fact that the economy took a nose dive at the very time I sold my firm, I was able to resort to the built-in Plan B of my exit plan and claim a corporate asset we established—a form of a cash-value insurance policy to ensure there was a hard asset available down the road to pay me off and allow me to “sell” my business to a key employee.

A great plan, right?

Well, yes and no.

Yes—in that it demonstrated the wisdom of creating an exit plan ***five to seven years*** before I planned to move on to my next chapter of life.

If you are in your late fifties or sixties, given all the years, sweat and blood, and time away from your families, in my humble experience, ***you are making a huge mistake that could cost you EVERYTHING if you do not have an exit plan in place NOW!***

I know too many owners who waited way too long. They were convinced they could walk away with a few cool millions when they decided to retire—only to get a rude awakening and get pennies on the dollar when they eventually hung up their spurs. This is especially true of agencies that are overly dependent on their founders, ***who did not have exit plans, and more importantly, did not <u>prepare their business for sale</u> at least three to five years out!***

So what am I bitching about, you are probably asking?

I did well. But I could have done better.

Not complaining at all. I achieved my financial goals. And, frankly, at the time I was more interested in making a lifestyle change (spending more time with my family, teaching as an adjunct at a local university, pursuing some hobbies) than I was in getting top dollar for my firm.

But, looking back, I now realize (a), I really didn't understand what my business was actually worth, (b), I did not fully understand what my other options were, and (c), and most importantly, ***I had not properly prepared my business for a potential sale*** to a third party, which at the time was under my radar.

The plan I put in place was based on my company setting aside profits to purchase a cash-value insurance policy, using money that I, as the sole owner, was entitled to claim each year--to pay myself down the road, should Plan A go south. (Plan A called for my buyer, a key employee, to pay me from future profits, which as it turns out, he was unable to do).

In other words, I had planned on using my own money to pay myself down the road.

But having said that, I doubt if the business would have had as much money to set aside had I not locked in my key employee, with the opportunity to obtain equity, and financially incentivized my management team to perform well. We had a good thing going. I wanted to keep my money machine churning. I could have drained our corporate treasury. But I was at least smart enough to realize that I needed to "share the wealth" in order to enhance the overall value of our firm and secure a decent payout for me down the road.

The plan had the added prospect of enabling my key guy to take over the business and significantly increase his own net worth when I moved on to my next chapter in life.

I would describe my plan as a highly conservative strategy that worked. It enabled me to achieve my long-term goals.

Admittedly, I was also fortunate enough to be aided by a strong equity market which I invested my lump-sum payment in under Plan B.

If you don't have a good financial advisor, get one today! Someone who has the bandwidth to provide a holistic view of your total future financial requirements—the supplemental monthly retirement income you need (in addition to your 401K, IRA and SS) to allow you and your family to maintain your lifestyle, plus everything on your bucket list—that boat or sports car you have been salivating about, a vacation home on the beach, future travel plans, your spouse's vision of his or her dream kitchen, the money you hope to leave to your grandchildren or your alma mater or your favorite charity. Your legacy.

I know. You think you are too young to worry about such things.

But if you are in your fifties or sixties, you are not! It's time to think about your future, and decide why you are working so hard, and what you hope to accomplish and achieve—beyond winning more clients and shiny awards that will just collect dust on your shelves.

What I learned from my experience is that you can do far better than I did ***if you plan early and educate yourself on your many options for MONETIZING YOUR BUSINESS.***

If you get smart today about your options, get your financial house in order, and keep your eye on the potential prize—in return for all those years you invested in growing your business—you can achieve all of your future financial and lifestyle objectives!

Here are ten key things I wish I knew before I sold my business (and what I would do differently if I knew then what I know today).

1. Value, value, value!

When you started your business, your primary focus no doubt was on just making ends meet—earning enough to provide for your family, keeping the doors open, and burning the proverbial candle at both ends to keep clients happy. You became a respectable established business. You were well known in your market. You became a member of all the right clubs and boards, were on the short-list of A list clients in search of top agencies. You may have even gained a national reputation for your craft. Life was good. You became convinced your business was worth millions. Then you began thinking about moving on to your next chapter... And got a wake-up call. You mentioned to your accountant, business coach, or your Uncle Mike (who tried to sell his carwash business last year) that you wanted to sell your business, and they brought you down a peg or two. Sure, you were bringing in the big bucks (gross income), but your profits and EBITDA were marginal, and you discovered your business was only worth a fraction of what you thought it would be (see below).

Moral of the story: If you hope to sell your business in the next three to five years, you have to begin to focus today not just on the top line, but on ***the real VALUE of your business!*** If you don't know what ***EBIDTA*** is, you are way behind the 8-ball and need to get up to speed on that fundamental concept that is crucial to evaluating the real worth of any business.

I admittedly got a bit over-psyched when my firm continued to blow out our competitors and we won tons of new clients and continued to feast on banquet chicken at numerous award ceremonies (including, would you believe, one at the United Nations).

I felt fat and happy, and continued to hire more and more employees. We were on fire. We were on a high-growth curve. I was measuring our success by our top-lines: gross income and number of employees. Until my astute CPA pointed out that while our AGI was at a record high, our labor and related costs increased at a higher rate, and the total value of our business actually declined!

Then a very seasoned industry consultant I retained pointed out to me that while I had a good business, my firm was very vanilla. We just provided all the general services that any PR agency back then could provide in our market. So if I wanted to sell, I would get a fairly low multiple.

In other words, I was way too focused on the top line. And I measured our success by the size of our firm—the number of employees—versus our real ***VALUE!***

Here's one thing I learned that I wish I knew before I sold my business:

An exit plan is a strategic business plan with the specific goal of enhancing the overall VALUE of your business based on five years prior to your planned exit.

Why five years? Because most business valuations are based on either straight or weighted averages over your previous five years, often calculated on a multiple of your EBITDA, discounted future cash flow, or other methodology. (If you are new to the concept of business valuations, be prepared for a wild ride with confusing explanations by CPAs and consultants on both sides of the M&A table).

Buyers want to see EBITDAs north of 20%, ideally. After all, they are not buying the history of your firm. Who cares if you did $10 million in AGI and won an Emmy and seven Addies in 2021? ***They are buying the future potential of your firm!*** They could just as well invest their money in bonds (and yield 2% to 4%), equities (perhaps get 8% to 10% in return), or other small businesses. Marketing firms by their very nature are highly risky investments. Buyers expect to receive a minimum of 15% return on their investment over the next five years. So your number one task is to get your house in order and do what you need to do increase the ***VALUE*** of your firm.

You also need to understand the concept of ***MULTIPLES*** and where your firm is on the multiple scale. If you are a generic PR, advertising, or digital media firm, your multiple could be in the 3.0 to 4.0 range. But if you truly have something special to offer and are what the major national firms and deep-pocket private investment or family offices are looking for, your multiple could be north of 6.0 or more!

I knew nothing about the concept of multiples when I sold my firm. You will do well if you bring yourself up to speed on the concept and manage your firm accordingly.

2. Don't play it too conservatively.

I did.

It felt great when I walked back into our CFO's office one day and she showed me a bank statement with seven figures in available cash. A wonderful thing.

I took our management team out for a great lunch.

But there is only so much shrimp cocktail you can enjoy.

Our employees received very generous year-end bonuses that year.

However, if I were able to do it over again, I should have taken that money and invested it in a new differentiating capability—probably something in the digital marketing space (this was in the halcyon days of e-marketing). I was too focused on the monthly bottom line and, admittedly, lacked the forward vision to understand how the future value of my business would be significantly increased had I been willing to invest in the people and technologies that all indicators suggested were the future of the business, rather than gloating on our past accomplishments.

3. Specialization.

Don't be too vanilla.

While we purported that we focused on B2B marketing (at least eight of our clients were in the *Fortune 500*, with a heavy emphasis on high-tech and industrial companies), we weren't specialized enough. At many a cocktail hour with fellow agency owners at conferences in Hawaii, Paris, and Puerto Rico (around the pool with copious amounts of appetizers and alcohol flowing), I learned that the owners getting the big bucks for their businesses were ***super-duper specialized***.

A firm that had exclusive in-roads to product placements in Hollywood films. Another that focused on franchises for the DIY market. An agency that focused on financial investor relations for health care firms.

Tightly focused, highly specialized businesses, not easy to replicate by other agencies.

Then there was a woman I met who was a true giant in the PR industry. She single-handedly pioneered the field of cause marketing. She built and eventually sold a multi-million dollar enterprise that convinced corporate leaders of top *Fortune 500* companies that they should invest in social responsibility. She was a bold visionary.

By contrast, I was too focused on our local market for general PR services, and lacked and was probably too timid to invest in disruptive, cutting-edge capabilities.

I once asked this amazing woman to come to our town to speak at a Public Relations Society Association luncheon. She agreed—but only on the condition that I could get her a meeting with the EVP of marketing with a major *Fortune 500* in our city. It was a major corporation which, I must admit, I never had the courage to approach. I got her the meeting. Within a 30-minute discussion, she bagged a six-figure deal. Because (a), she had a highly specialized offering no other PR agency on the planet could offer, (b), she thought BIG!, and (c), she had the moxie to go for the jugular in the first meeting (which included an aggressive fact-based put-down of their agency of record).

4. Hire people smarter than you.

The great David Olgivy said it best: *"If each of us hires people who are smaller than we are, we shall become a company of dwarfs. But if each of us hires people who are bigger than we are, we shall become a company of giants."* If you think you are the end-all and be-all of your business, good luck. Your business will likely be worth zip when you move on. But if you have the foresight to identify and hire the best people for each segment of your business and lock them in with incentives—both monetary and quality-of-work/life—chances are your business will be more sustainable and far more attractive to a potential buyer. I know an owner who way back in the 1980's decided to build his firm around a classic law firm model. He identified, hired and incentivized the best people he could find in key vertical sectors—technology, health care, financial services, commercial real estate, etc., and put them in charge of their own fiefdoms within his firm.

And by smarter, I mean smarter. Specific industry and agency experience is great. But three of my top employees had zero experience in digital marketing, advertising, or public relations. They were just smart! I once hired a former high school English teacher as a proofreader. Zero business experience. In three months, I promoted her to our top market researcher. A few months later, she was wowing clients like IBM as an account exec with her grasp of a highly complex technical market segment, plus her presentation and writing skills.

If I had to build a marketing firm today, I would just find the smartest people regardless of their previous professional experience.

5. Get out of your bubble.

You are the top dog in your market. A mover and shaker in your community. But if you have never attended a national conference or have attempted to benchmark your firm against the best practices of the leading firms in your industry, you are living in LaLaLand. Whether you are operating a firm in Peoria or Pittsburgh, you need to get out there and discover the secret sauce of the top firms in your sector. Potential buyers know who the hot firms are in your industry segment. Are you one of the major teams, or still playing Class B ball? You won't know until you get out there and strut your stuff against the top players. A national association conference (too many to name here) is a good place to start. You will learn more chumming it at cocktail hour at a national conference than you will reading an on-line industry rag.

6. Get smart, financially.

We all got into this crazy business because we thought we were pretty good at words, drawing pictures, coming up with creative ideas, writing clever lyrics, conceiving PR stunts that would go viral, or more recently, convincing clients that you understood Google algorithms and could develop an inbound marketing program that would yield 3.5% on click-throughs.

But few of us really knew anything about the numbers side of the game.

You are making payroll? Great!

Your accounts receivables are under 60 days? What a wonderful thing.

But I will guarantee you that the majority of agency owners, let alone their CFO and top officers, don't really know how to read a P&L statement or balance sheet, and certainly weren't managing their businesses to make their financial statements look better.

In my time as a consultant with TobinLeff, I analyzed the financial statements of well over one hundred marketing businesses. Here is what I discovered:

The overall values of the firms we were trying to sell were much lower than what the owners hoped to reap, because in many cases, the owners did not understand their true costs of doing business, or even their own business models.

They typically showed adjusted gross income (AGI) south of 10%. And often their assessments did not even include the fair market salaries of the owners. (Typical response: An owner would tell us that based on his or her firm's financial statement, they were 15% profitable. But after I demonstrated to them that their salaries should be included in their business costs, they were in fact unprofitable).

Other take-aways:

Many firms, including those that employ "value billing," don't understand how to apply their true overhead costs to what it takes to service a client. Many firms I analyzed did not know how to account for top VP (highly paid) management level "touches" to client service. As a result, they were underbilling clients for services and talent rendered.

Actually, it is not rocket science.

It comes down to a simple formula.

There are only three cash buckets you need to monitor. Weekly. Monthly. Annually.

Labor costs, including health benefits.

Non-labor overhead costs. Rent, office supplies, utilities, travel expenses, IT, marketing, that sort of thing.

Profit. What's left over, hopefully at least 20% of your AGI.

Here is a simple formula I encouraged clients to strive for:

Labor: 60%
Overhead: 20%
Profit: 20%

But in today's "I'd rather work at home" world, I would revise that to:

Labor: 60%
Overhead: 10-15%
Profit: 25-30%

7. A little knowledge is a dangerous thing.

I spent nearly 40 years in the business. I had friends all over the country who had bigger firms than mine who shared with me their experiences trying to sell their businesses.

I attended dozens of conference presentations on exit planning, business valuations, M&A transactions. I thought I knew the game.

I knew zilch.

This is something you should not try at home, or rely on your home team of accountants and lawyers to figure out for you.

My accountant, lawyer, and exit planning consultant, as it turns out, were very myopic. They all had limited knowledge and axes to grind in terms of their recommendations.

You will be making a huge mistake if you think you know all the answers because you spent two hours at a Tiki Bar in Hawaii with the owner of a PR firm who got a multiple of 6.0 and just inked a deal for her agency that focused on promoting organic vegan products to Gen Z-ers through social media influencers (yes, it has become that specialized).

8. Know thy value!

Thou should not undersell or oversell thyself. I did not understand what my business was actually worth when I sold my business via an employee-based buyout. In discussions with agency owners I met at industry events, I sensed few seemed to have a grasp of how marketing firms are valuated.

When the time comes for you to sell and move on, you would be foolish to hang on to an overly inflated valuation of your business, and just as foolish to accept a lower than deserved valuation.

So what's the secret? Get smart about the whole business of business valuations. Learn the lingo. And the four or five methodologies commonly employed to value a business like yours. Most importantly, what is the methodology that your potential buyer will be utilizing to place a value on your business? And what are the terms of your buy-out deal? You absolutely must know the terms and all the fine print of their offer to ensure that you can live up to them. Most deals, but not all, include a clause that will require an earn-out, meaning that your company or profit center will need to achieve certain financial benchmarks in order for you to receive full value for your business.

Once again, it all comes down to ***VALUE***. Your number one focus, three to five years out, is to enhance the value of your business, and know what that value is when you are ready to sell.

9. Hire the right consultant.

I learned way too long after the fact that the consultant I hired, who billed herself as an exit planning consultant, ***offered only one solution***—an employee-based buy-out, and was incentivized by whether or not she was able to make a HUGE commission by selling us a large whole-life insurance policy to prefund part of my future payout. She was a one-trick pony. She offered a valid strategy that might make sense for some owners. But she did not show us the pros, cons and mechanics of ***other options*** that would enable me to monetize my business.

You need to hire a consultant (don't even think of trying to doing this at home with you own chummy team of advisors) that has done many deals, a firm that has seen and done it all, with no incentive or axe to grind based upon how they are compensated. You have multiple options. A leveraged buy-out to sell to your top management team? A merger with a cross-town rival? Selling to one of your competitors? Or to one of those mega multi-nationals? Or how about selling to a private equity firm or family office? You need a consulting firm that can educate you and walk you through the pros and cons of ALL of your options.

10. Stay in your comfort lane.

It's your business. You built it from scratch. You know your business better than anyone. I once had an offer to sell out to one of the top PR firms in the world. We were close to inking a deal. Their top brass and legal team flew in from New York. We met at the swankiest private club in the city. We had a wonderful meal. They shoved their legal documents in front of me and handed me a Mont Blanc pen. I set the pen down. It just didn't feel right. In addition to questioning the terms of the deal (one-third in cash—which Uncle Sam was going to take a chunk of, one third in their stock, and one-third if the profit center I brought to their firm performed at 20% plus, which assumed that all of my clients and employees would transfer and be happy with the deal, which was unlikely) there were cultural issues. It just didn't feel right. Chemistry and culture are very important. You have to trust your instinct and gut when dealing with a potential buyer. It's not that different from marriage. Do you feel good about the prospect of spending the rest of your professional career with this potential investor, buyer or partner? Do they share your values and goals? Are they in your comfort zone?

Study carefully the letter of intent and all the fine print. Scrutinize with a magnifying glass the financial aspects of the deal. Listen carefully to all of your advisors.
Then take a deep breath and then trust your gut.

Does the deal feel good? Could you live comfortably under the culture and dictates of the new regime (whether it is a private equity firm, one of the mega multi-nationals, or your senior management team you bought you out under a leveraged buy-out scheme)?

Selling your business will likely be the single most important financial transaction of your career.

I was somewhat prepared, and thought I had the right team of advisors, and had done adequate research and "due diligence" before I inked my deal.

Looking back, I would give myself a B+. I did okay. I achieved my goals. But if you begin to focus on enhancing the real value of your business today, understand all of your options, and, most importantly, hire the right advisory team, you can do better. Much better.

Given all the sweat equity you have invested in building your business over all the years, you deserve top dollar, and should not expect anything less.

About TobinLeff, LLC

TobinLeff is a leading M&A advisory and exit planning consulting firm, helping owners sell to strategic buyers and private equity groups. With 13 years of service, TobinLeff's team of senior advisors brings a wealth of Mergers & Acquisitions experience as former business owners, accountants, attorneys, and bankers dedicated to the mission of helping their clients maximize and monetize their life's work. TobinLeff is the go-to resource for business owners looking for true partners in their exit planning journey.