by Dyanne Ross-Hanson

Upsize Minnesota

Lifestyle or transferable: which business are you building, and why it matters

STATISTICS SURROUNDING the impending tsunami of private businesses changing hands in the next decade has been well documented.

One estimate suggests as many as 72 percent of privately held business owners anticipate a "monetization" event, and 62 percent of those indicate a time frame of five to six years.

Momentum can be attributable to two primary factors. First, baby boomer business owners, those born between 1946 and 1964, are marching into retirement in unparalleled numbers. Second, the Great Recession put many owners' transition plans on hold while they focused on navigating through an economic crisis.

Having survived, many of those companies have emerged stronger, more efficient and well capitalized. Merger and acquisition activity has intensified. Investment capital is abundant. One recent statistic stated private equity groups have an estimated $500- to $750 billion waiting to be deployed.

Companies, individual investors, financial and strategic buyers are all clamoring to find the "right" company to acquire. The question to ask yourself, is yours one of them?

Time for a gut check

Ideally, you and your advisory team have evaluated those aspects of your business that an experienced buyer will carefully scrutinize, well in advance of handing over the keys. How much in advance? Experts suggest three to five years prior to an anticipated sale.

At the same time, this evaluation may uncover an entirely different reality—that your business resembles more of a "lifestyle" than a "transferable" organization. The former term is not meant to be derogatory. Rather, it helps put perspective on whether the commitment of resources, both time and money, are consistent with your goals for the business.

There is no right or wrong answer to this contemplation. Instead, it simply requires the proverbial gut check to determine if you aspire to a big paycheck at the end of the rainbow or if you're content to "lock the door on your way out."

Many owners experience a sense of relief to learn that a lifestyle business can be commendable, as long as they recognize it for what it is. Still, evaluating performance and identifying objectives long before a transition increases the likelihood you'll get what you want.

So how does an owner identify whether a business is transferable/sellable? Here are some common, measurable metrics:

Operating systems that support sustainable cash flow: Buyers want to know company cash flow is likely to continue, independent of the current owner's hand on the wheel. Contractually recurring revenue is much more valuable than what might be called historically recurring revenue. And revenue generation, independent of the owner, is vital. Here's more:

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- Operating margins at or above industry standards.
- Solid, diversified customer/client base: Customer/client concentration poses a high risk for a new owner, because the loss of one or two accounts could turn the buyer's investment sour in a big hurry.
- Realistic growth strategy and/or competitive edge: A commodity product or service is difficult to defend and margin/profits are often at risk. In addition, a broad market segment with identifiable growth potential is far more appealing to most buyers.

These metrics are measurable with the help of a trained eye. More difficult to measure but equally important are:

- A stable, motivated, secondary management team. For most buyers, even strategic ones, knowing that a few experienced, key personnel will remain through ownership transition, and potentially beyond, is extremely important. Developing and motivating a "second bench" should be a priority for every owner who wants to maximize price (and cash) upon sale.

Subjective test

This final metric is subjective and often the most elusive for most owners to master. To test your assumptions, ask yourself when was the last time you took more than two weeks' vacation (in a row) without checking in on a regular basis? And did the business function as profitably in your absence?

Would the answer be similar if you were to take a month, two months or even spend winters in a more reasonable climate?

Operational independence, without the owner's direct involvement, should ultimately be the goal of every business owner, because the more dependent the company is on that owner, the less value it has in the marketplace. What's more, proceeds from a sale are much more likely to resemble future payments, dependent on future profitability (meaning earn-outs, rather than cash, at closing.)

I advise owners that one of their most important tasks, when thinking of preparing for transition, is to work themselves out of a job, ideally well in advance of going to market.

Mastery of the metrics discussed improves the likelihood that you are indeed building a transferable/sellable business. If your dream of the ultimate exit plan has you riding off into the sunset, with bank accounts newly flush, consider taking a hard look in the mirror, and at your business operation, to determine if there's a match.

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