

# Putting Together the Entrepreneurial Puzzle:

The Ten Pieces Every Business Needs to Succeed



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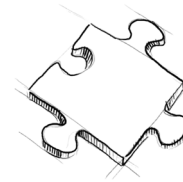
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# Puzzle Piece Ten Exit Strategy



If you don't start with the end in mind, the end usually comes as a big surprise and, generally speaking, it *won't* be what you had in mind. The first question a venture capitalist will ask when evaluating a potential business or idea is, "What's the end game?" What they're really looking for is a significant opportunity to leverage capital to maximize the return on their money, building shareholder value for themselves and their investors. They're looking for the greatest return on their investment dollars in the shortest amount of time.

Why should you be any different? Presumably, you're investing startup capital in your business that could be used for a different investment vehicle, so evaluate this investment as you would any holding in your portfolio. Yes, it offers benefits such as allowing you to be your own boss and launch your own ideas, but it is, at its most basic, an investment, so treat it as one.

## When Do You Want To Be Done Working?

Creating an exit strategy starts with answering a simple question: when do you want to be done? I've heard many responses to this and one of the most common is: "Well, if the price were right, I could be done tomorrow." Clearly that's not a realistic answer for planning purposes. Another common response people give is that they'll stop working when they reach a particular age, usually sixty or sixty-five. But again, that doesn't address the issue of what *you* will do to create your retirement circumstances. What will your life and business look like when you're ready to leave? The

reality is, most of the time, what people really mean is that they don't really know. For some entrepreneurs, talking about retirement is about as comfortable as talking about death.

Nonetheless, what you want your retirement to look like is an important topic because it will guide the decisions you make for your business. If you start your business at forty-five and want to work until you're sixty (and you mean it), you have fifteen years to maximize the investment in your business. On the other hand, if you start at thirty with the same retirement goal, thirty years probably allows you to take more risks and possibly move the business in a different direction than you would with a shorter time frame.

Maybe your exit plan is to leave *this* business, but not to retire. Serial entrepreneurs just keep creating new businesses because they can't help themselves. One very smart CEO I work with is on his tenth or eleventh business. He keeps saying he'll retire someday, but we both know he won't. Whether you want to retire or move onto another business, however, you still need an exit plan.

## What Would You Be Doing if You Didn't Have Your Business?

Take some time to think about when you no longer wish to be working in *any* business. Make a list of all the things you want to do when you're no longer working. If it's not a very long list, you probably want to be "working" a lot longer than you think, maybe just in a different capacity. If you're really struggling with this exercise, I suggest taking a retreat by yourself or with your partner and spend several days just thinking about it. Commit to having an answer by the end of your retreat. Without all the clutter of your daily life, you should be able to picture your future more clearly.

I often work with CEOs who want to stop working or are ready to sell, but they don't know what they'll do when that happens. So they just keep doing what they know how to do, sometimes missing the best opportunity to sell the company. Selling your company is an *emotional* decision, not just a financial one. A software company CEO knew intellectually that it was the right time to sell. He'd had several inquiries from large companies, but couldn't seem to sign the papers for the investment firm to represent him. After a lot of hard, very emotional questions, we discovered that he had no idea what to do with himself if and when his company did sell. This frightened him to the point of inaction—so much so that he was potentially missing an opportunity to cash in on what he'd built. We explored the options he had and decided that he would take about a year off and start another company. Doing this gave him peace of mind and a sense of purpose, and allowed him to let go of the current business.

Sometimes the answer to the above question is, "I'd have another business that didn't have all these issues." I have news for you: all businesses have issues. So you can work to solve the problems at yours and capitalize on your investment or sell it and start over. Either is a good option, just know what you want and why you're doing it as that will color your choices. You can't hide from yourself, so be honest.

There are no right or wrong answers here, just the ones that are right for you. The point is to be intentional so you can plan for your own future in the process of running your business. And be sure to revisit your retirement plan every few years, as your thinking is likely to change.

## How Much Do You Want In the Bank After the Sale?

Let me just preface this discussion by stressing that you should really use a financial advisor to help you determine this number. This is the number that will allow you to start a new business, or maintain the lifestyle of your choice while never working again. In all likelihood not all of your retirement money will come from selling your business—you probably have other assets or investments—but certainly you are expecting some end profit from this investment, the ROI on your business. How much you need to sell your business for can be complicated to figure out because what you walk away with depends so much on things like your tax structure and the estate planning you do prior to selling.

You'll want to spend some time contemplating what you want life after *this* business to look like (whether that's starting another business or retiring), and what you need to do now to make that happen. Include your spouse or partner. Talk to your financial advisor. Then, as I said before, reevaluate your plan regularly to make sure it still accurately reflects your lifestyle goals as well the inevitable surprises that come up.

## Current Assessment of Business Value

You really do need an expert to help you determine the value of your company and, as a rule, I recommend an evaluation at least every three years, if not every other year. When I worked in mergers and acquisitions for smaller firms, the business owner was almost always surprised by the valuation. The value was never *more* than they expected. Although I've just said that selling your business is an emotional decision, try to be as objective as you can. Potential buyers don't share your emotional investment. You won't get paid back for all the blood, sweat, and tears you put in over the years. You won't get paid back for your anguish over all the risks you took. You *will* get paid for value: the financial value the business has to investors to operate as a sustainable enterprise, or the strategic value it brings to another firm.

Following is a quick breakdown of the various valuation methodologies in the most basic terms.

### Balance Sheet Based

- Book Value = Balance sheet assets – liabilities
- Liquidation Value = Discounted balance sheet assets – liabilities
- Fair Market Value = Fair market value of your assets – liabilities

### Earnings Based

- **EBIT and EBITDA Multiples** = Multiples-based net earnings + addbacks for owner salaries, taxes, interest, and any other benefits defined as tied to current owners or ownership structure (EBIT). EBITDA simply adds depreciation and amortization to that calculation.
- **Discounted Cash Flow** is a valuation based on cash flow, discounted for a variety of factors.
- **Capitalization of Earnings** (earnings cap method): According to Wikipedia this is “an income-valuation approach that determines the value of a business by looking at the current benefit of realizing a cash flow now, rather than in the future.”

### Market Based

- **Earnings Multiple:** Some multiple of earnings, for example two times revenue or five times EBITDA.
- **Industry Rule of Thumb:** Whatever the standard is for your industry: e.g., financial services firms typically go for three to five times earnings over a certain level.

### Buyer's Feasibility

- **Cash Flow Adequacy:** Can the business pay for itself? Is there sufficient cash flow to cover the debt service of the purchase?
- **Payback Period:** How long it will take to pay off the purchase price from earnings.
- **Return on Investment (ROI):** The rate of return for the capital investment someone would be making in the business.

Which method you use is really dependent on the reason for the evaluation. For instance, when I bought into a company I was working for, we had a shareholder evaluation done, which is typically lower than a market-based evaluation. A shareholder evaluation is done when you're giving or selling shares to family members or internal employees you might want to incentivize with future earning potential.

When selling to outside investors, you'll most likely have a combination of earnings-based and market-based methods. A savvy investment banker will have a good idea of what the multiple is for your industry. And that person should also be able to tell you what that number would be if your company were X size. It's often advantageous to keep your business and grow it just a little more to capitalize on your investment.

### Current S.W.O.T.

What are your company's Strengths, Weaknesses, Opportunities, and Threats? Although you should be doing this annually to take advantage of or protect market positions, when doing this with a sale in mind, you'll know what your ideal ROI is (I'll call this your "number"). This will advance different conversations based on your number and time frame. What will best maximize what you currently have? What does this tell you about when to sell? Is that sooner or later than you had planned?

Examine your strategic position in the marketplace. This will tell you a lot about who might want to buy your company, and what you could do to enhance its value. This might include making a purchase yourself to create a succession plan for the business, or to enhance its value to get you closer to your number.

### Exit Options

You always have multiple options for exit, they're just valued differently, so your decisions will be different based on your number and the legacy you want for your business. As you think about all this, also keep in mind that a business should be sold when it's doing well, not when it's on the down slope of the business cycle. That's where your exit plan will serve you well. And don't forget that it's also an option not to exit.

## **Strategic Buyer vs. Traditional Buyer**

You won't have much argument that in most cases a strategic sale is worth more to you than a traditional buyer. Strategic buyers are those who can exponentially increase the value of their company by purchasing yours. Rollups were popular in the nineties as a way of maximizing value for all parties involved. A manufacturer would buy up the distributors in the industry or the logistics handler to control all aspects of the business and have an edge over the competition. A strategic buyer will often pay a premium for your business because it's worth it to them. Microsoft has made hundreds of "strategic buys" in the tech world because, in some cases, it's cheaper to buy a product than create it. In most cases a strategic buyer is also purchasing your market share.

## **Family Sale**

Keeping the business in the family or selling to family members can be a good option. At least for a while. Think about the generational businesses you know. Often, the first generation is entrepreneurial: they have big ideas, they're engaging, and they get something started that didn't exist before. The second generation comes along and sometimes there's a good manager in the bunch. That person has had good training by the founder, and there's a solid succession plan in place. However, by the third generation, a sense of entitlement may have crept in, eroding the founder's work ethic. Think about Nordstrom or Walmart. By the third generation, Nordstrom's second generation had to come out of retirement to set things right again. Sam Walton is probably turning in his grave at some of the waste his heirs have created.

If you're going to keep the business in the family and sell it to children or other family members, you should work with a family business specialist who can help you through the exit planning with all the complexities families create. They can help you plan, train for, and execute a transition strategy that can save the business for your family and generations to come, and that leaves you with what you need. Even though you're dealing with family, think of this like any other business transaction and don't compromise to accommodate a family member's shortcomings. If you wouldn't concede something for an outside investor, you probably shouldn't do it for an inside investor, even your kids. Most importantly, make everything visible, talk about expectations, and have a plan for what to do if things don't go as intended.

## **Employee Stock Ownership Plan (ESOP)**

An ESOP is a sale to your employees. You arrange a stock value and sell shares to your employees or a group of employees, or they can earn shares as part of their compensation. I've seen as many unsuccessful ESOPs as successful ones. One owner sold a portion of his business to his employees in an ESOP transaction. The owner still had a significant stake in the business (sixty percent) as the transaction was playing out. At that point a strategic buyer made an offer that was approximately four times the ESOP valuation. Although the employees would all have made a significant return on their investment (the owner had kept share values low, gifted shares, and allowed employees to earn shares as bonuses), they refused to approve the outside sale, which was their right according to the ESOP rules. The owner was furious, but there was nothing he could do because the new leadership felt they didn't want or need to sell. Conse-

quently, the owner spent the next two years and several hundred thousand dollars in attorney's fees rescinding the ESOP. He finally won, but the end result was the departure of many key employees, lost business, bitter feelings, and no interest from buyers. (ESOPs can also be risky for employees, especially if they're buying in with their 401K or retirement. If the company folds, they're left with nothing and they're out of a job.)

But I have seen successful ESOPs as well, where the employees took ownership, felt empowered, and increased the value of the company. The lesson here is to be very careful, specific, and clear about all eventualities with an ESOP. Be sure to get the best legal and accounting advice you can find.

### Potential Suitors

As you're thinking about your exit from your business, it's good to start and keep a list of potential suitors. These are individuals who have expressed interest in the past, as well as potential strategic buyers for whom your business would be a jewel. Once you have the list, check in with these people to keep your company on their radar. The best business deals are not made when the owner decides to sell; they are made long before by cultivating partnerships and relationships that might one day bear fruit. This does not mean you have a perpetual "for sale" sign up for your business. Rather, it means that you are always ready for an opportunity should one present at the right time and for the right price.

## Transition Team

Your team will include a group of professionals who know exactly what to do when a change happens, be it planned or unplanned. The team members should include your accounting firm, business attorney, estate attorney, board members or advisors, insurance advisor, mentor, investment analyst/advisor or broker, and any high-level members of the management team. The reason to include most of these professionals might be obvious, but I'll discuss them anyway because this aspect of planning is so important.

- **Accounting Firm** Your accountant should have an up-to-date picture of all the company's financial and tax information, as well as the current business valuation. Your accountant will be counted on for tax advice as it relates to the transition or sale and as well as for maximizing value for owners, heirs, or employees.
- **Business Attorney** The company's business attorney should have a copy of the transition plan, and assist with execution in the event of a founder death or incapacity. This person should have a list of the team and be able to act as executor if needed.
- **Estate Attorney** The estate attorney will be the one who has set things up in advance in trusts or other vehicles so that, again, no undo tax is paid or owed as a result of poor planning. This person should be directed by the founders as to specific requests in the event of any type of liquidity event or unforeseen occurrence.
- **Board Members or Advisors** This group needs to be involved if they are stepping in for a departed founder or leader, or if they are advising on a sale.



- **Mentor** This person usually will have had the ear of the owner/founder/CEO and can help execute any plan that's put into place. This person can sometimes act as an interim, depending on qualifications.
- **Insurance Advisor** This person will need to be brought in if any key man insurance was purchased and needs to be exercised.
- **Investment Analyst/Advisor** This advisor will be brought in to do the valuation or update an existing one, and to find or negotiate with the buyer or buyers.
- **Management Team** Only senior executives need to be a part of this team as it relates to what roles they play in any transition. However, they should all be aware of what the plan is for any event.

## The Succession Plan

Just in case you're still wondering if you need one, let me give you an example of what can happen if you don't think this through now. A manufacturing business I worked with was a family company that had a proprietary product in the construction industry. Although the revenues were upwards of \$150 million, the founder's eighty-year-old wife did the books by hand. And I do mean by hand—she refused to use a computer and actually still used the old ledger books instead. Over sixty years of operating the business they had had multiple offers to buy, but never gave them any attention. The founder refused to give his son any real control and never cultivated a management team. One day on the job the eighty-five year-old founder dropped dead of a heart attack. A week later his wife died. The son had no idea what to do and, although the business had no debt, it quickly went down hill without the father to guide things. No one had done any planning for what would happen after the founders were gone, and the son was completely unprepared. Although the books were accurate, because they were done by hand, no buyer would believe it, much less pay top dollar for the business. The company was eventually sold at a discount for its asset value and one patent. The family received pennies on the dollar for a formerly prosperous business. The plant was shuttered and 150 employees lost their jobs. Although this is an extreme story, I've experienced many others just as sad for the founders, family, or employees. All for lack of a real succession plan.

Now that you have all of the elements and I've convinced you that it's really necessary, it's time to put together your plan. Just as you would have an outside facilitator help you formulate a strategic plan, you should also consider an outside person to help with your succession plan. After all, this is also a strategic plan, just for a different purpose. Make sure you've involved all the appropriate people (see above), and have the plan in writing.

Your plan doesn't need to be long or complicated (although some of the legal and tax implications can be), and you should be able to have it outlined in two to three pages. Each of the team members will likely have a more detailed plan for their roles, but the overall strategy need not be complicated. Your plan might be a fairly simple statement like this: "The business will grow to X dollars, and then we will sell to one of three strategic buyers for X dollars. The following people will make up the transition team." And then you'd go in more detail from there. Be sure to involve your

business partners, management team, and family members in the decisions so they know exactly what to do if you're not around to direct the show.

As you are putting together your succession plan, you should put together what I call a Business Plan B Notebook in case something happens to you before you plan to leave. Your Plan B Notebook contains all the key information about the business including accounts, insurance, family contacts, locations of key items and documents, etc. See the Plan B Notebook worksheet at the end of this chapter. Make sure someone knows where your notebook is and keep it updated.

Revisit your succession plan every few years or so to make sure you're still comfortable with it. It's perfectly okay to change your mind, because of course you will depending on what life throws your way. Be flexible, but feel secure knowing that you actually have a plan to keep your most important investment safe.

## Additional Resources

### Business Plan B Notebook

**Purpose:** In case of a major emergency there is a plan to take care of the business.

#### Information

- Bank (account numbers, passwords, banker)
- Bookkeeper (all contact information)
- Accountant (all contact information)
- Financial Planner/Stockbroker (all contact information)
- Access points
- Cell Phone (account number and password)
- Landline (account number and password)
- Web site (host information, account number, password)
- Web person(s) (all contact information)
- I.T. person (all contact information)
- Lawyer (all contact information)
- Executor for business (all contact information)
- Insurance agent(s) (all contact information)
- Office/Personal assistants (all contact information)
- Family Contact info for office assistants (parents, spouse, in-laws, keyholder for home, pet sitter, baby sitter)
- Safety deposit box location

#### Documents (list locations and relevant information for each)

- Bank accounts
- Business documents (license, corporate shareholders agreements, LLC operating agreement, etc.)
- Insurance
- General Commercial Liability
- Disability
- Health
- Life
- Malpractice/E&O
- Homeowners
- Major client contracts
- List of where to locate physical items like checkbook
- Renewals (domain names, business license, associations)
- Credit cards for business
- Power of attorney
- Business
- Healthcare

- Passwords (computer, applications, etc.): Needs to be in a separate location from this book.
- Property (residential and commercial, including leases)

**Plan B**

Who will do what if:

- Flight delayed many days
- Serious illness or injury
- Natural disaster with disrupted communications

## Exit Strategy Checklist

- Set the date when you want to be done working.
- Describe what you would be doing if you didn't have your business.
- Determine your number: ascertain how much you want in the bank after the sale.
- Current Assessment of Business Value:
  - Who did/will do the assessment?
  - What type of valuation was/will be done?
  - Date of valuation:
  - Amount assessed:
- Current S.W.O.T.:
  - Strengths
  - Weaknesses
  - Opportunities
  - Threats
- List type of exit option in order preference (Sale to outside, family, ESOP or IPO).
- List potential suitors
- List transition team:
  - Accountant
  - Attorney
  - Board Members/Advisors
  - Mentor
  - Insurance Analyst
  - Broker/Investment Analyst
  - Banker
  - Other
- Construct Business Plan B Notebook

## Recommended Reading

*The Number: What Do You Need for the Rest of Your Life and What Will it Cost?*, Lee Eisenberg, Free Press, 2006.

# Putting Together the Entrepreneurial Puzzle

## *The Ten Pieces Every Business Needs to Succeed*

by Mary E. Marshall

The US has a long history of independent thinking, innovation, and creativity—a culture that is evident in an economy largely driven by small businesses and entrepreneurs. Yet, only about half of new businesses survive five years. Lack of practical knowledge about the basics of running a successful business is key. While entrepreneurs often have a dream for a service or product, many lack a comprehensive picture of what it takes to run a business. Given the precarious state of the economy and the significance of small business success, it's as important as it's ever been to support entrepreneurs in developing their practical business knowledge.

Over the course of a career working and consulting with entrepreneurs, Ms. Marshall has compiled a list of the ten most common problems that hamper small business success. *Putting Together the Entrepreneurial Puzzle* is comprised of ten interconnected but freestanding chapters addressing the fundamental areas of business every successful entrepreneur must be prepared to develop and manage. Each chapter takes a nuts-and-bolts approach and includes practical tools for building a successful business or correcting a struggling one:

- Real-life examples from Ms. Marshall's many years working with real entrepreneurs.
- Additional reading resources to increase breadth and depth of knowledge in specific areas.
- Sample worksheets, scripts, interview questions, etc.
- Checklists to help busy CEOs keep track of and accomplish tasks set out in each chapter.

Whether as a gift or a course text, *Putting Together the Entrepreneurial Puzzle* is a must-have reference for entrepreneurs at all stages of growing their businesses.

*Available now from Amazon.com in print and Kindle formats.*

Find out more about Mary Marshall's services  
and follow her blog on leadership development and entrepreneurship:  
[www.mary-marshall.com](http://www.mary-marshall.com).