Sound Financial Bites 041: Andrew Cross and Damon Pistulka

Episode Transcription

"Do you own a business or do you own a job?"

Hello, Paul Adams here. Welcome to Sound Financial Bites, where we help you with bite-sized pieces of financial and life knowledge to help you design and build a good life.

Hello, and welcome to Sound Financial Bites. My name is Paul Adams, president and CEO of Sound Financial Group, and your host of today's podcast. Today, we've got a real treat. We've got two experts on the call with us today, partners in a firm called Cross Northwest. Cross Northwest is a mergers and acquisitions firm helping broker business deals, sales and purchases of businesses, as well as doing things like certified valuations and consulting to help companies be ready to sell, or for owners to be able to buy.

I'm excited about them being on the podcast today. But, before introducing our guests, let me share with you, if you're new to the podcast, what it is we work to do. We have four different types of podcasts that we do. One is the financial philosophy. Next, for our analytical friends, we do some deep-in-the-numbers analytical podcast. We have one like today that has to do with career or being an entrepreneur or business owner. We also have these podcasts that are about just really designing and building a good life where we might have somebody who's a marriage counselor, or a biohacker, or a physician on a call that's more about how we parent our kids better, or how do we live our lives better. Because, what we're committed to at Sound Financial Group is helping you design and build a good life. That designing and building a good life, part of it is money. That's what we help people with. But, these podcasts are meant to help you with the financial knowledge and a lot of everything else so that you can build your version of a good life. We're glad to have you with us, and as always, we want to invest back in you, so if something resonates with you from our conversation today, reach out to our guests. You're going to have their information both in the podcast details, and I'm going to give it during the podcasts. And reach out to me directly. You can reach us at info@sfgwa.com. Put in the subject line, "I want to talk." Happy to spend a little bit of time with any of our listeners who are willing to invest in themselves enough to be on and listen to our podcast.

Let me share with you who we have on the call today. We have Andrew Cross and Damon Pistulka, which I think I've pronounced properly, Damon, but you'll have to call me out if I got it wrong. They're partners in Cross Northwest. Now, Cross Northwest is this firm that works with companies all over the country, and even some international, but primarily in the Pacific Northwest and Mountain West part of the United States helping businesses transition to new owners, finding buyers, and getting the greatest amount of value for those businesses. Andrew, Damon, welcome.

Hello!

Paul, thank you for having us.

Yeah, you're welcome. I'm glad to have you here. Now, this is the first time we've done an around-the-table where we had multiple people from across diverse locations all coming together to record today's podcast. Let me start by saying that we may step on each other as we go today, but I don't think it's going to get too much in the way. Can I start by asking you gentlemen, what do you think the biggest mistake that's made? I want to start with, because there's two different people that I think could be listening today. One is those people that are business owners that are, one day, going to no longer own that business. Now, they might sell it or maybe some other outcomes that aren't as favorable as selling it the way they want to. There's that person in the audience, and then there's the person that may be in corporate that's at top 1% earning, executive that maybe doesn't want to be in corporate forever, and what happens to them. So, the first question I want to ask is what do you see is the biggest mistake that occurs for those people that are currently business owners?

Well, Paul, I think most business owners, everybody's going to have to exit a business or there's going to be a transition in the business life cycle. For people that we encounter, most of the time, they have spent, if any time at all, understanding what that process is that inevitably is going to occur. So, we end up doing a lot of backtracking to try and redo the work to do that. And if you're coming from the other end where you're transitioning into becoming an entrepreneur buying a business, again, it's educating yourself on that acquisition process or that transition for the exit as well as you're missing, potentially, on understanding the value that acquiring businesses could be to your business.

"At a corporate job where you're making 300k a year, you've got low risk. That's not the life of a business owner."

Let me ask. There was something that we talked about earlier ahead of our recording that had to do with whether or not people are actually planning for their exit or when they do their business plan. Can you speak to that a little bit about they build their business plan, one day they're going to exit the business, because you can't own a business forever. Yet, what do you usually see when you see people's business plan around the exit?

Well, frankly, and this is true in a lot of cases, business owners don't have a business plan, and that's another topic. They have an idea what they're doing and they're doing it. A lot of them are doers, and that's fine. Whether a business plan is down on paper written or organized, but fundamentally, any time you're in business school, one of the major sections of a business plan that's in there is the exit strategy, and what is that going to be. Time and time again, usually, we see that, even from early-stage companies who are just getting started to the ones who are very well-developed in getting towards an exit or a transition, there's maybe one paragraph dedicated to that, if that, and it's we're either going to sell out or go and get an IPO, and that's the extent of it.

Now, when you say that, I know I've seen that on business plans where it is a single line like we are doing all this to idea.

I need two words: "I'm going public."

Not that that couldn't be a great destination, but it certainly is incomplete.

Very incomplete.

When you say, Andrew, about these businesses not having a -- like that most businesses out there that we see operating that we may walk into and be customers of every day that somebody is, one day, going to sell, is the reason many of them don't have business plans simply because the person that's going to sell it has just been doing it a while, and now, just sort of takes for granted how to run the business and is not in some of those practices?

Yeah, I think that's part of it. Writing a business plan in itself is a difficult exercise. It seems like it shouldn't be, but business owners, I think, too, it's the mindset of an entrepreneur. They tend to be people who will jump in and do it. Many of them are successful, and the most highly successful business owners don't even have any formal education and any kind of business training. That's okay too. They're learning trial and error usually. So, a great resource for future entrepreneurs is, currently, entrepreneurs who are doing it. Learn from their mistakes because that's the best schooling you can get.

So, Damon, when you're looking at businesses and trying to help them prepare for sale -- unfortunately, I think many people end up engaging you guys when they need to sell like, "Oh, I need to sell now or yesterday." But, how long do you think a business should be thinking about sale? If they said, "We're real serious now today," how long should they really have prepared for sale? I think you put it to me, the best way to prepare for sale is to think of it as making the most money go from your business balance sheet to your personal balance sheet.

"There's data out there that buying a business has less of a failure rate than startups."

Yeah, and that's really what I think about when I'm talking with business owners and looking at -- we're usually involved at the very end, as Andrew said, or close to the end. They're ready to sell their business, they would like to sell it in three to six months. Even on a good day, the process is much longer than that. But, really, they should be thinking about this thing 5 years, maybe even 10 years ahead of time. Because, the value of the business is not significant enough to help their personal balance sheet get to where they want it to be. They need to go back into this business and really concentrate on value, the overall value of the business, and increase it to a point so they're going to be happy when they sell that business with the returns they get from it.

That's what we see more than anything is when a business owner is near the end and they want to exit or transition, they come and talk to us about their business value. Oftentimes, it's 60 to 70 percent of what they thought it was, and that's a significant change to find out when you're only a couple years from retirement. Whereas if they would do this 10 years earlier, even 5 years earlier, if you look at the way a modest growth for those five years, and your business value, you can make a 50 to 75 percent difference in the value of your business over five years with a modest increase. That's really what they lose when they lose that time and they also lose the opportunity to build their business, and oftentimes, they're forced into some pretty difficult decisions.

Could I ask you guys, you mentioned not many business owners end up with a business plan when you first start talking to them. Although it seemed like it should be there, have you ever seen a business owner yet have, in their business plan, goals that don't just revolve around, "Here's how I want sales to be," or, "Here's what I want profit to be," but goals that actually reflect, "Here's what I want my balance sheet to look like."?

Rarely.

Rarely. I have, but it's a professional investor that owned the company, Then you do. I mean, a private equity, you do see that.

I was going to say, that would make sense that somebody who professionally invests in small companies would have an objective around it, but those of us in kind of that entrepreneurial brotherhood, it is a matter of we will throw ourselves at it and make it happen this year, and it's not necessarily going to have to do with the bottom line with what the balance sheet should look like. But, rather, it would be, "I just want a certain amount of profit or a certain amount of revenue."

For professionally-run groups like that too, you really aren't a business owner or an entrepreneur then. You really have a job. You just don't know it.

Yeah, and nobody wants to buy your job.

That's exactly, yeah.

What do you see as some of the biggest or leverage points? If we've got somebody who's listening right now who has a small business, or even a larger business, but they're finding that they're still stuck. I don't know about stuck, but they got to show up. If somebody buys the business, somebody's going to be a hawk as a certain way they are. Is there something you'd recommend to them immediately to say, "You should look at one or two leverage points to begin to extract yourself from the business so that you can take care of this business beyond you."? Because, if the business doesn't survive, all those employees are out of work, customers are left stranded.

Well, I think, for most business owners, they tend to get into business because they have some sort of expertise, some sort of background, and it's a matter of leveraging. When they jump into business, a lot of them, at first, by becoming a business owner are somewhat of a general contractor or general manager starting to get people to work for them, but they're more actively involved in the business.

The real thing is to take that next step where you get off of the business and not work in the business, putting the right people in place and having that management still set, and that's where a lot of entrepreneurs struggle to get into that level of management that runs a company more professionally, so that the business can run without you. Because, that is a problem we run into where the business owners are the business.

When that happens, is that just -- I'm assuming it just limits the population of who they could sell to as they need to sell to a bigger version of them that has the professional team that knows that industry, or they got to find that other person that's PhD in Metallurgy because that's what they are, and now their whole scope of who they could sell it to is going to be right down to that.

It really does. And limiting to the point that they've got a chance their business won't sell.

Yeah, these are value points that we're looking at. These are what buyers look for. If they don't have that PhD, they can't buy that business. If they can't be you, they can't buy that business. But, a professionally-managed business, whether the work requires PhDs or not, if you got hit by a bus, heaven forbid, the next day, the business will continue. That's when you've really established value.

It really begs the question, as people are listening, is do you own a business, or do you own a job?

Yeah, that's the step you have to take.

Yeah, I get that. I think that's a confronting one that many business owners don't want to be fully -- that's a tough one. Do I have a professionally-managed business that somebody else would want to buy today? That is a hard question to be with, especially when it's your baby. You go into a business, you're helping them look at selling, preparing, becoming aware of some of these things. It can take years. Correct me if I'm wrong, it's not years to prepare a business sale. All we're doing is preparing it to sell for two years, or three years, but rather, we need to move the needle in some ways over a three-year period of time. It's like collective, right? It's not like three years of, "I need to stop worrying about growing my business." It's three years of little habits and practices that have to change in the business over three years.

Exactly. It's a combination of things. Growth is just one of the things that has to happen if you really want to prepare for a successful sale. Buyers want to see a path forward. Growth is always a very helpful, very promising indicator for buyers. It can help get the deal done. But, you're right. You have to make sure things like down to you've got proper HR practices in place. As we were just discussing, you can take a vacation without the business falling apart. That's a great way to measure how well you've successfully made a transition into some sort of management that can maintain the business while you're gone.

There's a series of other things that you have to come around: customer satisfaction and just different things to make sure your business is set up along with the normal things of, "I'm doing my financial statements right, I'm closing every month, I've got all my documents prepared so that when somebody's ready to look at them, it doesn't take me two months to get these things pulled together."

Well, that they're prepared in a way that's recognizable too.

Yes.

Not napkins?

Yes, exactly.

I've dealt with companies that are in the 40-million-dollar annual sales range that pay their bills, basically, out of a jar of money and just take what's left at the end. Just because you're big and successful doesn't necessarily translate.

I have heard stories of businesses being acquired, and I've been very close to some of these where the business is getting acquired and it is an absolute madhouse inside of the business. I mean, people who were the top sales folks that are absolutely crazy human beings that are driving the sales ship of this business, and owner is an unbelievable personal practices, and the buyer had to come in and, over a year's time, the owner had to no longer work there, and they had the institute drug testing. For the state of Washington, I'm not talking just marijuana. They had to clean house and recruit all new people, but took a business that was selling like 8 million dollars a year and took it to 40 million in a relatively short period of time by taking care of all those things.

The thing that kind of hurts, when you talk about that damage, one of the things to do is grow the business on its path to sales that what sits with me is get a business who has a bit of a bag of cats, but if the prior owners would have been more diligent in many ways in the way they grew the business or the rigor, "Do I have a professionally-managed business?" They would have seen those gains, and maybe they couldn't have grown it to 40 like the new owner did, but they probably could have grown it to 20 before they sold it and gotten a lot more money.

Now, can we talk about the other side for a moment? We have some mutual friends that have written a book together - David Nilssen and Jeff Levy - called "Making the Jump". You guys can find this on Amazon, but it's a book that's about making the jump into small business ownership because you have all these people who might be at some large corporate, are tired of the grind, and want to go out. They might be listening to this podcast right now wondering, "What could I do because I don't want to just be punching the clock anymore?" What would you guys say somebody should do even before -- I think what people think is the first step's going to be go look at a business. What should they be doing before they even think about going to look at a business?

I'm glad you said that in particular too about, "Hey, let's just go and look at a few businesses," because we get that all the time. All the time.

So, somebody who's just making 350 a year, they're working for Amazon, or whatever they're doing, and they say, "Hey, can we just go look at some businesses," and that is their stuff.

And they're in for a bit of a surprise. They feel like, "Oh, there's an open house at the house. I think I'll pop in and have the T sandwiches and look around." Well, it doesn't work that way when you're buying a business. It is a very confidential transaction. We're on the other side of it but we're very, very careful about who we allow into to look at this. So, you can't go kick the tires. It's challenging because there's not a lot of information. There's not a lot of structure. These are closely held businesses, privately held. Unlike publicly-traded companies, there's no disclosure regulations or any of that and you're not going to get it. But, there are ways to educate yourselves, and that's what the business owners, potential ones that want to do it, really need to get into understanding what it's like to be that entrepreneur.

Can you contrast for us and for our listeners the difference between buying a business and the biggest transaction most people are familiar with is buying their home? Can you just kind of put those two side by side here for us to give people a glimpse at how much more complicated buying a business is than the type of transactions they're normally in?

We're business brokers. As opposed to a real estate broker, the industries are similar but dissimilar in many, many ways. But, one of the things, when you're buying a home, it is probably, for most people, it's their largest investment. It's much more money that they're going out and leveraging themselves much further out than most people should or would be feeling comfortable with. But, what makes it happen, it's a much larger market, it is much more organized, it is much more regulated. When you're buying a business, you don't have disclosures, you can't go find good reliable comps on other businesses sold. There's a curtain, and it's not that it's rocket science, but you have to pull the curtain back a little bit and understand how it works.

My biggest recommendation for anybody contemplating buying a business or being a business owner is really get to know that process and get comfortable with it. The people that are are highly successful. That's one thing as a business owner: if you are comfortable making acquisitions and understanding how that whole process works, and most people who are good at doing that or are successful, a lot of it's because they just jumped in and did and they've been through a few deals. You're going to get your bruises along the way. Some work and some don't, but ultimately, that's a great path for growing your business.

The best advice I've ever gotten on real estate acquisition or business acquisition was the idea that there never is a deal. There never is one. There only was one. So, they only exist in past tense because people get -- their stomachs get churning and they were almost there, and it's going to happen. It is never going to happen. It only happened, and that that mindset helps people not get so wound up as they go through the process or look at a potential acquisition, or look at a potential buyer if they're the seller.

If you're an analyst and you have those tendencies, that's great. That's a great strength to have, but in a business transaction too, you could find thousands of reasons not to get into my space. You don't have to look very hard.

I was going to say at one of our prior podcasts, we interviewed Paul Menig, who at the time of recording, had looked at something like 43 businesses, and of them, only 2 or 3 were appropriate businesses for them to look at buying in their price range. Now, you guys have a philosophy that one of the things somebody needs to do if they're a buyer is look at, "How much assets do I have to potentially buy into this business, like cash, or things that could be cash? How much debt do I have to take on?" and then like the Making the Jump book, which is, "Am I mentally ready?"

If somebody's making 300 a year right now at a large corporation and now they want to buy a business that's going to -- they might have to work in it to make it happen. They're not going to maybe be able to go in and only manage. What are they likely going to have to spend? They're going to have to take a lot more financial risk than they did at their old job, but what are they likely going to have to spend and purchase to be able to even potentially make that much money from a business?

It's going to be somewhere around a million dollars, probably, depending on the kind of business just to replace that kind of income. But, you got to look at the one thing that you mentioned that is drastically different is the risk. At a corporate job where you're making the 300k a year and happy, you've got relatively low risk.

You can quit any day. You could say, "Here's the keys to my desk. I'm out. Here's my little card."

Yeah, you can go home at night.

You don't have to think about it until the next day. That's not the life of a business owner.

I was going to say I think a lot of our folks that are at that top 1%, 350, 375 income level and above, they never really get to shut it down. When you're making that level of comp, people are able to invade your evening periodically. That stuff is there, but at the end of the day, they don't have the financial risk. They could walk away and get another job. But, when you've got a -- because I think about you might have a million-dollar purchase of a business, but you might be re-signing a lease that's another half a million coming up. So, you have a million, 5, of liability just with one lease and the purchase of the business. Not to mention liability with staff and all that.

That lease is a 20-year liability, 10 or a 15-year liability.

What do you think the likelihood of success of somebody starting with, "Hey guys, I want to go look at a couple of businesses and see if I like it," is where they start. Just call that step 1. How many out of 20 make it to the other end of that and actually buy a business?

One.

One?

Yeah.

And they may not make it? I kind of hear you say it.

Yeah.

Yeah? You have that much confidence that that one then makes it?

It's that in itself too. Yeah, there's a lot of factors, but --

It's a low, low percent.

There's still a failure rate that's pretty high. However, buying a business, people understand you have an option for if you want to become a business owner, you can buy a business or you can start one. I do think that the numbers do and there is data out there that it is buying a business, there's less of a failure rate than there are for startups. But, that is what you're dealing with. It's highly competitive, you need to be well capitalized, you have to be well-rounded through all the disciplines, which is something that doesn't necessarily come out of the corporate world. But, there are plenty of people who have done the transition quite successfully.

You've got these people out here that have businesses, know, one day, they're going to no longer be a business owner. I think that, sometimes, that can be a little confronting for many people because they don't really -- which doesn't mean you don't have a right to get to sell your business. It's not just because you started a business doesn't mean, one day, you get to sell it. But, I hear people speak about it sometimes like they're correlated. Like, "Oh, one day I'll sell my business and then I'll retire." But, you guys alluded to it earlier, they don't even all get to be actually sold. Like some businesses just don't get sold. What happens then?

Well, it's a very low percentage. I mean, there's a lot of ways, but some people wait until it's too late and they end up having to liquidate a business, or worse. And the other thing that happens is for every hundred businesses that are on the market for sale, that only about 30% of them actually do sell. At that point then, the 70 owners that didn't sell their business get to back and figure out what they're going to do now. It can be make changes and go back on the market, obviously, but it's not a high percentage when people say that, "I'm just going to sell my business." It's not like selling your house. It doesn't have to sell and it can sit there way longer than you want it to if you're not preparing to get rid of it.

It isn't a tangible asset in that regard.

If you guys could, and maybe this would be a good kind of closing comment for me. There's a great book and I cannot think of the author. I'm going to look it up here in a moment, called "Built to Sell", and in that book, one of the things that --

John Warrillow.

John Warrillow? Yeah, that's it. So, what I thought was so interesting about that book is that if you had a company, which is why I liked that you guys have this consulting offer of helping people, is that if you built a business that is actually one that could be sellable for a decent multiple, it's the business that you might be least likely to actually want to sell unless life forces it. Damon, you first just kind of speak that, and then, Andrew, I'll let you kind of close us out on that.

Well, the things that you're going to look for in a business that is easy to sell are the same things that make a business run well. We've talked about it. It's good management, good records, growth, all the kind of things that is going to make a business owner very happy and profitable, and they're going to be making good money. What we like to say is we want these business owners to be able to go out their way on a high note rather than a lot of businesses we see that just kind of drift off into Never Never Land and then they try to sell them after that. But, these businesses that are actually ran as they could be sold any time are profitable with good management, and are growing and thriving.

That's great.

John's book too, another good read for any entrepreneur, and I think he deals a lot in that book about business owners who tend to be the business. Whether they have the relationships or the goodwill, or the technology, or the technological skill. We deal with that a lot because it just makes a buyer nervous going into a business and having to replace the owner. Do they have the ability to do that? I think what makes us a little different is we do enjoy this. We enjoy what we do working with our clients and we like to talk to them as early as possible. Even if they're in startup stage and have no concept of exiting, let's talk about being prepared to sell if someone walked in the door today and say, "I want to make an offer on your business." If you ask yourself that, honestly, are you really -- if you're like that every day, you're running your business at its optimal efficiency.

So, we look for that and we've got programs where we come with the clients and they want to exit. They may not be able to do it as quickly as they want, but progressively. Still, it's a boot camp to get them ready to sell, and we like to see that entrepreneurs put these aspects of what a buyer is looking for into their business much, much earlier than that. Again, what's different about us is that we don't just specialize in the selling of the business. That's a big part of what we do, but we also do valuations and we work with clients, and many of them do not know what their companies are worth.

And if they don't figure out what your company's worth or find out a way so you know where you're at and what you're working towards, as former business owners ourselves and managers of companies, Damon and I, we work with clients on our consulting side of the business too to maybe put in the missing pieces that these companies have to get them ready to sell and optimize them. I laugh a little bit because sometimes if we do a really, really good job, ultimately, we want to sell *your company but they might just say, "I don't want to sell now. We're doing great.*

Yeah, now I like owning this thing. I didn't like it before. You guys have mentioned before that one of the things any buyer is going to ask is why are you selling it, and what you don't want to say, I suppose, is because this is terrible. I don't like coming in every day. My life is miserable. Whatever it is you don't like about the business --

I can't sleep.

Yeah, and I want you to have that. I don't want to have that problem anymore. One thing, and this is kind of a recommendation to our audience, and I think this equally applies for you to think about is that, one, I think, also, business owners get a little bit older and a little bit older and they're not talking about selling the business, and yet, being in an active conversation with your team about we are going to build a business that's going to last and will be valuable to a buyer one day, and it's why we're going to do things differently going forward can bring a lot of peace and certainty to many of your employees if that's done as a joint effort together. Because then, they have an active part in participation and not just like, "Gosh, Tom seems to be getting older every year and he's never talked about this. One of these days, I'm going to still need a job, and so I want to encourage that."

Second, is a tip that I got from a friend that built a company now to about 36 million in total value, and one of the biggest shifts they had was beginning as an edict from their board is that they needed to get a valuation every year on the business, and they paid to get that valuation. By going through the rigor required every year -- because just calling a firm like Cross Northwest and saying, "We want to get a valuation and actually know what our business is worth," takes a degree of accounting and systems' rigor just to answer that question every year. And by merely answering that question, you can have a business that runs more efficiently and effectively. So, if you're one of the key people in a good-sized privately held business, that might be the kind of value, or refer this podcast to the owner of your company saying, "I think there's some things here we may want to look at," to just make sure that the legacy that you've built lasts.

Andrew, Damon, let me thank you guys for being here today. This was great. I think our audience should be able to take away more than a few things today in being able to think about their business a little bit differently. And for those folks looking at thinking about stepping out into business, I would say having them take it with an appropriate amount of respect, what it means to step into the owner role, and risk and awareness, not so much to scare anybody away, but to have people be sure that as they step out onto that thin limb, they know how thin it is, and they can go into it with the right mindset and with preparedness. So, thanks for being here, guys.

Paul, thank you very much.

Yeah, you're welcome. Well, great to have everybody on the podcast today. We look forward to having you back. This was unique because today is podcast number 40, so we keep crossing thresholds. We're on the iTunes New and Noteworthy now. And if you need anything, you want to get connected with one of our speakers, whether that's Cross Northwest, which you can get to at www.crossnw.com, you can reach them by phone at 866-428-1921, 866-428-1921, this will all be in the show notes, or you can get ahold of them at info@crossnw.com, and if you need anything from our guests, our past guests, you can always reach out to us directly info@sfgwa.com. Have a great rest of your week, and we look forward to seeing you on the next episode.

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