Janice Hostager: 0:04

I'm Janice Hostager. After three decades in the marketing business and many years of being an entrepreneur, I've learned a thing or two about marketing. Join me as we talk about marketing, small business and life in between. Welcome to My Weekly Marketing.

Janice Hostager: 0:35

A few years ago, as many of you already know, I had a design agency. It wasn't a huge or hugely profitable design agency, but I worked hard to build it. I had amazing clients and a small but mighty team of freelancers who worked with me in the college town of Eau Claire, Wisconsin. My husband was a tenured professor, so I thought we would be there forever. But he got an unexpected job offer in Minneapolis, which is the city that we both grew up in and it was home to us, and the offer was way too good to pass up. So in a whirlwind, we put our house on the market and sold it. For my business, I reached out to a few people who I thought might be interested in taking on some of my clients because, honestly, I felt really bad about leaving them high and dry. But I had no takers.

Janice Hostager: 1:22

Now I realize I could have continued working remotely with my existing clientele, but frankly, I was burned out with doing design work at that point. So I thought it was a good time to start fresh, but I really had never thought about an exit strategy. After all, day after day, I was in growth mode every single day. That's why I wanted to bring Jonathan Baker on my podcast today. Many of us are so focused on our growth that we don't even think about our business as an asset. But in fact, our businesses are huge assets for us and someday we may want to cash in. So let's hear what Jonathan has to say about where to start to make our business attractive to buyers or to create an exit plan for our business in the future. Here's my conversation with Jonathan. Well, hey, Jonathan, welcome to My Weekly Marketing.

Jonathan Baker: 2:17

Hey, it's good to be here. Thanks for having me.

Janice Hostager: 2:20

So, like a lot of small business owners, I really struggle to think about selling my business. But when I had to close a business, this is several years ago because we suddenly decided to make a move, I was not prepared and so I ended up just closing down and I know I left a lot of money on the table. It was a design agency, I had great clients and I've made that mistake once, so I don't want to make it again. So I really want to talk to you a little about how we can, as small business owners, start planning for the end of their business.

Janice Hostager: 2:58

Basically.

Jonathan Baker: 2:59

Let's do it.

Janice Hostager: 3:00

All right. So first off and we'll get to your story a little bit later too but so why is it important for even solopreneurs to think about selling their business, even if it feels far off? Or and I think there's a little cognitive dissonance associated with it too we spend so much time and energy to build our business that the thought of selling it makes us back up a little bit. You know what I mean.

Jonathan Baker: 3:25

Yeah, and I wouldn't necessarily even think of it in terms of you know to sell or not to sell, but how do I get maximum value out of my business after I'm done working or after

Jonathan Baker: 3:36

I lose interest, right? and so, you know, sometimes we'll coach clients that, like, selling might not be the best route for you, cause usually in a sale, um, there's some percentage of money that you'll get up front, but, uh, oftentimes there's a large percentage that you're kind of waiting on and have to earn via an earn out, and so in that scenario you're, you have a boss again, and for some folks who have been working for themselves for a really long time, that's just like kind of an untenable situation. But so there are, you know, there are scenarios in which we might say, actually what you should do is maximize what you're able to take out of the business over the next three years, you know, and that will actually get you close to what you would have gotten if you sold it. But you can also pursue more of a traditional sale. You know, I would say if you're doing that, the larger you are kind of, the easier that becomes and the more standardized the process looks, and then there are non-traditional ways to at least get something out of your business. So you mentioned you had a lot of great clients. Well, you know, in theory you could have kind of sold those clients to another firm, not for any upfront money, but maybe for a percentage of revenues over the next three years. Right, and so there are still ways to monetize the assets you have outside of what you might consider a traditional sale.

Janice Hostager: 5:09

Okay, okay, that's genius. I wish I would have thought of that back then. So let's not, I just want to clarify some terms here, because this is kind of not my wheelhouse at all and I don't know about my listeners either. So, um, I am taking notes here, but what's an earn out?

Jonathan Baker: 5:29

Yeah, so an earn out, all right. So let me back up. Um, when you're selling a firm, there's usually three kind of main mechanisms that you would do that with, and you can use these in different ways and to varying degrees. But the thing about selling a firm that's different from selling something, like, you know, a manufacturing facility is there's really no hard assets, it's relationships, right, it's relationships with your team, it's relationships with clients, and so any sale involves a fair amount of risk for a buyer. So the buyer is looking for ways to mitigate that risk, and an earn out is one of the main ways that they do that. So they'll be, you know, again, I mentioned a cash at close.

Jonathan Baker: 6:25

It's called so the percent of money you get up front, and then an earn out would be, um, uh, financial, usually financial goals that you would need to hit over the next two to three years, uh, in order to get more chunks of money.

Jonathan Baker: 6:42

So if you're, you know, if you're selling your business for a million dollars and let's, we're going to keep it easy. Maybe you get 500,000 upfront, the other 500,000, you can earn out over the next two years and 250,000 degree chunks, as long as you keep, you know, your growth rate at 10%, or you keep your profitability at 25% or you, you know, are able to retain these three key clients. So all of those terms are negotiable, but that's generally what an earn out is. And then the third mechanism that is used is called a seller note and that's effectively you are financing the sale of the business. You know you'll usually get interest on that. But that's another lower risk. It's kind of between an earn out and the cash up front in terms of risk to the buyer.

Janice Hostager: 7:33

Risk to the buyer, but not risk to the seller.

Jonathan Baker: 7:36

Well, risk to the seller as well in that scenario, because, uh, anytime you're financing something, there's a, there's a chance that you don't get the money back.

Janice Hostager: 7:46

Right, right, right. So what you brought up was really interesting to me. You said you know so many of our businesses are built on relationships and so many of us have personal brands. Do you feel like that gets in the way when it comes time to sell? Because I always had that impression that if you had a personal brand, when you're done, the business is done. But then I look at someone like Martha Stewart, whose personal brand has gone through hell and back and she survived it and her brand is still growing. And so what about personal brands when you're looking at this sort of thing?

Jonathan Baker: 8:25

Yeah, I mean, it depends on how you handle your personal brand.

Jonathan Baker: 8:28

So I would say there's, you know, one scenario in which if you have a trademark process or something that's tied to your brand, you could give a non-exclusive but perpetual license of that away to someone buying your company but still retain the rights to it, so that you, they get the benefit of it, but you also benefit from it.

Jonathan Baker: 8:48

There are other scenarios in which you might become more of a thought leader or business development, you know, machine during an earn out. So if that's something that's interesting to you like I don't want to do operations anymore, but I'm happy to go on a speaking tour then that's a way to leverage your personal brand but also help the buyer. Right, you get your earn out and then, after the earn out's done, you still have your personal brand. It's just not helping the buyer financially anymore. So, yeah, it does make it a little trickier, right, because it's tied to you as a person and not like the business or a brand as an entity. But there is still value there and you just have to come up with creative ways to kind of transfer or share some of that value.

Janice Hostager: 9:32

Gotcha, what about, like mergers and acquisitions? Is that a whole different conversation that we should be having right here? Or is that sort of another way to kind of, I don't know the term for getting out of your business or to moving on?

Jonathan Baker: 9:46

Yeah, yeah, I mean mergers and acquisitions is really kind of just the shorthand for what we're talking about now. Mergers actually happen pretty rarely. Acquisitions do happen a lot, but they can take a lot of different forms and some of the things we're talking about now are technically acquisitions.

Janice Hostager: 10:02

Okay, that makes sense. Okay, so what is, what you're saying is it's important for all of us to have an exit plan at least somewhere down the road, right? So,

Janice Hostager: 10:34

how important is it to start thinking now about where you're heading in the future, or is it something that we can kind of put off and think about later? Or what are your thoughts on that? Is it too early to plan for something like that if you're just building your business?

Jonathan Baker: 10:41

I like to build with an end in mind and I don't think it's ever too early to plan. Now, plans are going to change, right, circumstances are going to change. You're going to have to shift, but at least have a goal so that you can work towards it.

Jonathan Baker: 10:50

And if you think about your personal net worth, you know, maybe you have a house, maybe you have some investments, but this thing you are building and putting all of your time into, in theory, theory is going to be one of the biggest assets that you own, um and so you know, knowing what it's worth and what it could be worth with maybe a little bit more work or if you redirect it a little bit, I think it's a really important thing to think about and a smart thing to think about earlier rather than later, because you're, I mean, you're right, you're not in the minority, the majority of uh business owners in this space end up just shutting their businesses down um and you, you kind of just reach the end of the road, but if you're planning for it, there is more value to capture, um, and if you're building it the right way, you could get you know even more.

Jonathan Baker: 11:44

So I don't think it's ever too early and I like to advise folks to start with evaluation, just so you kind of know where you are and what the big levers are that move your value up and down, so that you can, you know, at least match that up with your personal goals and say, okay, well, I am willing to do this, I'm not really interested in growing the value this way and that's fine.

Janice Hostager: 12:12

That's interesting. That's a really good point, because oftentimes we put a lot of energy into something. We do that anyway with our businesses. We can get into what I call like cul-de-sacs, where we put a lot of time and energy into one aspect of our business and it really doesn't move the needle at all. But what you're saying is reach out to someone like you, get a valuation, understand what it is that really has monetary value in your future, and then you can go ahead and they can kind of direct you from there.

Jonathan Baker: 12:47

Right right.

Janice Hostager: 12:49

So tell us a little bit about your business and how you work and who you work with.

Jonathan Baker: 12:55

Yeah, so I am one half of Punctuation punctuation. com. We are advisors to the marketing services industry. The other half is my father, coincidentally, who started the firm in the late 90s after owning his own ad agency. And we help marketing services firms usually on the smaller side, always independent um with their own positioning, lead generation, um, service offering design roles, uh and responsibilities. And then I add up the M&A practice. So after you've built something you know worth selling, um, I'll help you find a buyer. Uh, we also help buyers find sellers and we do valuations.

Jonathan Baker: 13:46

So that's a little bit about us.

Janice Hostager: 13:48

And M&A is mergers and acquisitions.

Jonathan Baker: 13:50

Yes, sorry, mergers and acquisitions. Yep.

Janice Hostager: 13:53

Yeah.

Janice Hostager: 13:55

So if you're not, if I have a business that's not in the marketing world, you're probably not going to be who I would see. But who would I reach out to?

Jonathan Baker: 14:04

I think you'd want to talk to someone who, uh, at least specialized in professional services or you know the industry that you are in. Um, frankly, there's a there's a lot of overlap between, uh, different types of professional services and the way that the firms are valued. So we've actually worked with architects, we've worked with tattoo shops. If your business model is similar, the precepts hold true, but there are plenty of folks that do specialize in industries, and the advantage of working with someone like that is you're going to get access to their network and their buyer list, and so it might kind of shortcut some of the search process.

Janice Hostager: 14:51

Gotcha.

Janice Hostager: 14:52

Gotcha. So a lot of small businesses don't have elaborate financial systems in place, so what's the minimum they need to have in place to make a business appealing to a buyer?

Jonathan Baker: 15:05

Yeah, you don't need to be elaborate, and in some ways elaborate is more complicated.

Jonathan Baker: 15:11

You do need to have clean financials, and so know there are tax advantages to running personal expenses through the business, and so I'm not going to say don't do it, but at least keep good documentation of what is personal and what is not, so that you can strip those out when you are, when it comes time to sell, um. The other thing is I would imagine a lot of your folks are running their books on a cash basis accounting and, um, most sales are going to require you to kind of go back and convert that to accrual, and so, um, we recommend that you just go ahead and, if that's in your in your future at all, go ahead and switch to accrual, because there are other benefits in terms of just managing your business, um correctly, and you can still use cash basis for tax purposes. So it's not like it's neither or. Yes, accrual adds a little bit more complexity, maybe a little bit more cost, but generally I think the cost is worth the trade-off.

Janice Hostager: 16:17

So I have to interrupt you here. You said that there's, I didn't ever know that there was a tax advantage of running personal expenses through your business. It's like, I have had my hand slapped so many times pulling like a personal expense and putting it on my business credit card or something like that from my accountant. You're saying that that's actually something that's okay to do.

Jonathan Baker: 16:38

I'm not saying that. You have a by-the-book accountant. There are a lot of accountants out there who operate a little bit, maybe more, in a gray area when it comes to personal expenses. So you know, the IRS is going to say something different from say. I say. But I am just acknowledging that it happens a lot.

Janice Hostager: 17:02

Okay, oh, that's good to know. I'm not the only one. Well, I guess you know, for me it's just an owner draw, you know? So I just I call it that, and sometimes I just have my business card with me, for example, and I run through it, or something like that. That you know wasn't business related or whatever. Um, but anyway, uh, what is it that? What kind of business structure should be in place for, uh, a company that's looking at selling? Is it okay to have an LLC, or should it be an S corp, or doesn't it matter?

Jonathan Baker: 17:36

Doesn't matter.

Janice Hostager: 17:36

Okay. Okay, well, that's easy. Yep. Okay. Well, that's easy, yep.. Okay, so what are some common mistakes solopreneurs make when negotiating a sale of their business.

Jonathan Baker: 17:52

Well, I think trying to negotiate by yourself is probably a common mistake, because you're usually negotiating against someone bigger and more sophisticated than you and so trying to do it alone, you're almost always going to miss something.

Jonathan Baker: 18:05

Um, so I would bring in an advisor at some point just to help with that piece. I think one of the common things folks don't understand going in is really just how these deals are normally structured, and so you might go in with unreasonable expectations which can send the wrong signal to a buyer, right? And they might back out thinking oh, this is kind of like working with someone who's trying to sell their house without a realtor, certainly not having clean books. Being too involved in the day-to-day can really hurt you. So you have to have some processes and systems in place, unless you're willing to keep working kind of indefinitely which in theory you're not um, but you know think about you, you, your replacement cost and what um, what it's going to take to do the job you do, and try to put together a plan to kind of take all the critical stuff off of your plate over time.

Janice Hostager: 19:20

Interesting. So the buyers? Tell me a little more about the buyers that typically look to purchase existing businesses.

Jonathan Baker: 19:30

Yeah, they, you know they vary. There's strategic buyers, which can be larger consulting firms or other professional service businesses. If you're big enough, you might get some smaller private equity interest. There are also family offices buying firms. There are individuals buying firms who want to run something but not build something. Um, you know, they know that they're an entrepreneur, but they're not good at the beginning stages of business. Um. And then there's other folks looking for, uh, you know, ways to scale by combining businesses together, and so there are options where maybe you don't sell the full business, you sell a piece of it and then you retain equity and as, or you roll that equity into this larger entity and so, as it grows, you can still benefit from it.

Janice Hostager: 20:32

Hmm, super interesting. Wow, I am learning a lot. Thankfully, I'm taking notes. So do you have some tools or resources that you recommend? So where do we start? Let's say, today I'm going to take a look at my business and say, is it ready in 10 years? If I decide to sell at that point, or whatever, what process should I be following? Is there a checklist that you know about? Or what should I be doing today?

Jonathan Baker: 21:00

Yeah, I mean, look, we put out a lot of free resources on our site. So the first thing I would do is probably just go to our website and go to our insights page and you'll be able to find tons of stuff on M&A and transfers and internal sales and you know all evaluations, all that stuff. We also just put out a book called Selling your Professional Service Firm, which you can find on Amazon, but very helpful kind of no-nonsense, written-in-layman's-term type of book, because the reality is one, most folks don't end up selling a business. Two, the ones that do only end up doing it once, and so you know you're not an expert in it, right, like you're not expected to be, and so we try to come in and at least make it less intimidating and more approachable.

Jonathan Baker: 22:00

I think some buyers actually try to make it more intimidating, to try to kind of scare you into thinking your firm is worth less or not worth anything, um, and give you some imposter syndrome and you just have to recognize that you're not an imposter like you have built this business that's worth something, right? Um, and they wouldn't be approaching you unless that were true. So, um, we're just trying to give you tools to kind of empower you to to think about options and, um, think about exits, in the right way.

Janice Hostager: 22:34

Okay, that's perfect. Now I'll put the links to all that in the show notes. But where can people find out more about you or follow you or connect with you in some way?

Jonathan Baker: 22:48

Punctuation. com, or you can find me on LinkedIn. Jonathan David Baker is my handle, and we try to make it as easy as possible to connect, so if you want to chat, just let me know.

Janice Hostager: 23:01

Lovely. Thank you so much, Jonathan. This has been very eye-opening and I will be getting your book.

Jonathan Baker: 23:08

Sounds good, thanks.

Janice Hostager: 23:09

All right, thanks.

Janice Hostager: 23:11

So I hope this episode had you thinking ahead a little bit, if you haven't already about an exit strategy for your business. I know for me I've already ordered his book and I was taking notes. So you can find the show notes for this episode at myweeklymarketingcom, forward slash 87. If this episode has helped you nail or think about your exit strategy, let me know with a five-star review. Think of it like tipping your barista, but it won't cost you a dime and it would mean so much to me. Thanks so much for joining me today. See you next time. Bye for now.