

The One Thing You Need to Know

What's the one thing that most closely determines success or failure of a business? Marcus Buckingham sought to figure this out.

He went to a prominent venture capital firm that had made hundreds of investments. The firm provided names of 140 ventures it had invested in—70 that went on to considerable success and 70 that failed. Buckingham contacted the CEOs of each and asked them to answer 25 carefully developed questions. He then analyzed the answers and found that the answer to a single question was the most reliable predictor of success.



That's right. One of Buckingham's questions was, "If a business is to succeed, what is the most essential characteristic?" Answers varied and included the likely candidates: focus, passion, persistence, innovation, creativity, thrift, productivity, teamwork and timing. But the one that correlated most positively with actual success was customer focus.

Interestingly, Peter Drucker — the leading business mind of the 20th century — held that the first and foremost purpose of every business must be to create and serve customers in meaningful ways.

This may seem like common sense to you, but before you dismiss it, keep in mind that common sense is not necessarily common knowledge or common practice. We tend to get sidetracked with all sorts of nonessential activities that don't get us where we want to go.

Who is Marcus Buckingham? He may be the most influential corporate consultant today. I spent part of a day with him recently. He had just come from a presentation to a large group of State Farm Insurance managers and was scheduled for Oprah and Microsoft the following week. His best-selling books include *First — Break All the Rules*, *The One Thing You Need to Know* and *Now, Go Find Your Strengths*.

So what is the one thing you should do during this broad economic downturn? Eliminate the time, energy and resources you waste on nonessentials. Focus squarely on getting to know your core target customer groups and improving the value they derive from your products and services. □

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From the Editor

One of my editors sent me a note saying, "I think our readers are going to be looking for ways to survive the current economic crisis. I would focus on what the heck we are going to do to survive this mess."


Though I appreciate her perspective, I don't share her degree of alarm. Granted, she's in California – an area pretty hard hit by the real estate slump – but panic is neither merited nor useful, and drastic measures are not necessary.

All economies are cyclical. Always have been. During the good times, we (individuals, companies, countries) need to reinvest profits in improving durability, productivity, sustainability and ability to survive slow times. During slow times:

- Cut back and conserve capital.
- Try to take advantage of the downturn by picking up valuable assets at bargain prices, borrowing or refinancing at lower rates (interest rates decline during slow times) and obtaining key talent that might be let go by competitors.
- Maintain confidence that good times will return soon (and they will).
- Know that slow times serve to weed out the weak so that when good times return, the market will be more hospitable for your products and services.

Inherent in the miracle of capitalism is that failure happens and must be allowed to happen. People and assets that were part of the failure are set free to migrate to organizations that are more competitive and more valuable to society.

Sincerely,



David L. Perkins, Jr.
Publisher and Editor



David L. Perkins, Jr.

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PROFIT ENHANCEMENT

Generate Higher Profit, Fast

Is there any endeavor more exciting than a business turnaround? Who are these all-powerful business types who can walk into a joint and whip it into shape in a few months? And why don't these people stick around and keep the darn thing profitable? Where do they go when the job is done? Across the street to clean up a mess made by another mere mortal?

One of these turnaround pros is Gary Sutton, who wrote a book called *The Six Month Fix*. I read the book and am convinced that it offers lessons every business owner can use. Here are a few things you should know:

Identify What You Do Best. What meaningful customer benefit do you provide better than anyone else? Your ability to do so is the only way you can keep customers, earn a profit and stay in business. If you don't do anything better than the rest, you're on borrowed time. Not sure what you do best? You better find out quick.

To begin, ask your customers why they do business with you and what you do better than anyone else. Write it down. Share it with others. Hone it and revise it until you get it right. Don't worry if there isn't conclusive evidence that you do it "better than anyone else," just get it down. More important than what it says about you today is that it should become the vision for your company and the heart of your mission statement. It should be achievable and sustainable. It will be how and why you compete effectively in the future, keep existing customers, gain new clients and succeed.

Focus. Once you determine what you do best, stick to it. Don't create confusion among your customers and employees by offering products or services not in your core area of expertise. Fuzzy direction kills more businesses than competition and dying markets. Specialize and be best at something that's of value to your customers.

Domino's Pizza is a great example. They deliver fast. They don't sell quality or price but "delivery in 30 minutes or less." Home Depot is another great example. They could sell anything in their huge, well-located warehouses. But they sell only home and garden supplies. When you need home and garden supplies, you know exactly where to go, don't you? On the other hand, Sears tries to be everything to everybody, an approach that simply does not work today when consumers are demanding excellence. Stake your claim on a niche, stick to it and focus on getting better at it every day.

Know What Your Customers Really Want. Get close to your customers. Really close. If you have closer relationships with your vendors than your customers, you have a problem. To get feedback, organize periodic gatherings with your customers. Find out why they buy, what they really want and what your competitors offer. Get below the surface and down to the emotional level.

**What meaningful
customer benefit
do you provide
better than
anyone else?**

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Generate Higher Profit, Fast, continued from page 3

Make What Sells. Don't Sell What You Make. When you get close to your customers and learn what they really want and need, give it to them. Your entire organization should serve the wants and needs of your customers — not all customers, but a select group of customers who have certain wants or needs you are more capable of fulfilling than anyone else. If you make products and then try hard to find someone to buy them, you have it backward. Start by asking yourself which customers you are uniquely suited to serve with your products and/or services, then fill those wants and needs.

Find the Profit. Identify products and services that make money and stop doing the rest. Reinforce profitable business and forget money-losing and breakeven products. If a product or service is losing money, try to make it profitable by raising prices. If that does not work, lower prices and see if volume picks up to achieve profitability. If neither works, discontinue the product altogether. Resist the temptation to add products or services that are not competitive or profitable.

Build Your Brand. Once you identify what you do best and commit yourself to total focus, tell the world. Turn your focus into your mantra. Be specific. Instead of using generic words such as “fast” or “quality,” say “in 30 minutes or it's free” or “only NASA-certified parts.” Put your identifying mantra on everything you distribute. Educate your employees, vendors and customers so that they can spot ideal customers for you. This is called branding — creating an identity. Great companies are great marketers that do a tremendous job of branding their image, such as Microsoft, Intuit and AOL.

Cut Costs. Above all, the customer wants lower prices. The lower the better. The company that can afford to offer it the cheapest will win. Who can offer it the cheapest? The company with the lowest operating costs. In a competitive environment and during difficult economic times, the most

In a competitive environment and during difficult economic times, the most important competitive dimension may be low operating costs.

important competitive dimension may be operating costs. The company with the lower cost structure can charge market prices and gain financially compared to the competition, or it can use its cost advantage to undercut prices offered by the competitor and gain market share.

Don't buy anything that does not enhance the customer relationship in a meaningful way. Don't buy anything new unless it is more productive per dollar spent than the used alternative.

Moreover, don't make any product or service in-house that can be purchased elsewhere for less. Beware of **any** urge to spend money on nonessentials. Take a lesson from *The Millionaire Next Door*: “The bottom line is the only place to flaunt your wealth.”

Pay for Performance. Hire proven winners. Within your company, track performance and make the results open to all.

Make continued employment contingent on production. Pay commissions based on customer satisfaction survey results as well as sales. Track results from every marketing and advertising effort, product, employee, vendor and business unit. Incentivize everyone, including your lawyer, accountant, and ad agency. Hold family members to the same standards as non-family members.

Remove Politics, Fighting, Secrets, Lies, Sex, Alcohol, Drugs and Gambling from the Workplace. Demand integrity and make swift examples out of those who do not follow your lead. Encourage straight talk, questions, ideas and constructive criticism. Discourage adulation and yea-sayers. Get real people with the guts to express their real opinions, even when they disagree with yours. Treat people fairly. Do what is right and demand the same of others.

“The bottom line is the only place to flaunt your wealth.”

Don't Bet on the Breakthrough Order. Serve your core customers profitably and add more just like them. When you have the luxury to spend some time and money on new products or markets, do so. But don't bet your business on breakthrough products or customers. Too often, they never come through. Close is not good enough.

Keep It Simple. Track the key results. Manage from one piece of paper, literally. Track customers won and lost, shipments, back orders, cancellations, returns, payroll expenses, advertising responses, number of inbound calls, product development status, cash balance, cash flow and asset balances. Highlight deviations and take swift action when trends are in the wrong direction.

Reassess Your Do-Good Attitude. When their businesses are struggling, too many owners spend time giving speeches, volunteering at the Chamber of Commerce, cutting ribbons and sitting on nonprofit boards. You, as the owner of a tax-paying business, are a rare commodity. By being successful and earning a profit, you employ others, provide for families and pay taxes that fund schools, roads, police, politicians and social services. The most important thing you can do for your community is to keep your business running.

If your bottom line isn't above the industry average and growing, eliminate all nonessential activities that take up your time.

Cash Is King. What you want is cash flow and cash in the bank. Nothing else can buy groceries. Don't look at anything but cash and things that lead to cash. Balance sheet assets are evil. They take up cash, so be relentless in lowering their values. Increasing non-cash assets spells trouble unless your cash flow is growing along with it.

Sell Harder. Sales calls lead to sales. Get your sales force cracking and personally show them the way. As the owner, you should be selling more than anyone else. Track the number of calls, letters, emails, meetings and results.

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Before You Borrow from (or Lend to) Your Company

Steer clear of the IRS! If you have borrowed or will be borrowing money from your company, or lending to it, here is what you need to know. First, make sure that any loans to the business are not reclassified as equity capital by the IRS because that would create taxable income to you as the loan is repaid. You also don't want borrowings from the company to be reclassified as compensation or dividends and thereby become subject to taxation.

And be sure to do the following:

- Formally execute a promissory note and provide for loan repayment dates (monthly, quarterly, or annually).
- Pay a fair rate of interest, preferably what your company pays its lenders but at least the IRS-prescribed interest rate — currently about 5%.
- Try to give the company some collateral, particularly if this is the standard practice with other company loan agreements.
- Have the company's board of directors approve the loan **and** its terms in a corporate resolution that specifically defines it as a loan, and record that action in the company's minutes. You should try to abstain from voting because the transaction involves your self-interest and could be questioned by the IRS.
- If there are minority owners in the business and the loan from the company is substantial, get their approval in advance.
- Check state laws. Some states prohibit or restrict lending company funds to owners, officers and directors.
- Record the loan on the company's books as an asset or liability of the company.

You don't want borrowings from the company to be reclassified as compensation or dividends and thereby become subject to taxation.

In general, the loan should be made on an arm's-length basis, as if an outsider were borrowing from or lending money to the company. In addition, if you or other stockholders have personally loaned money to the company, talk to your accountant about IRS rules on thinly capitalized businesses. Under such rules, IRS could reclassify your loan as an equity investment and any interest paid to you, and possibly loan repayments, could be treated as a dividend. Dividends are not tax deductible by the company.

In addition, you could raise IRS questions on stockholder/officer loans if there is a possibility of unreasonable compensation or excess accumulated earnings retained in the business.

Best advice: Before making any loans to or borrowing from your company, review the items above with your accountant. If you're doing business as an S-Corporation, whereby stockholder loans to the corporation can increase your cost basis, check out your personal tax write-offs before making the loan. The same applies to owners of limited-liability companies and partnerships.

Don't commingle funds: If the IRS finds that you deposited business receipts in your personal account (and they frequently check this area on closely held and family businesses), you could be looking at comprehensive personal and business tax audits, possible fraud charges and heavy penalties. You also could lose the corporate veil that protects you from personal liability. Sole proprietorships make this mistake more than any other type of company. Make sure all receipts are deposited in and all business expenses written on a separate business checking account. □

You also could lose the corporate veil that protects you from personal liability.

“There are times in everyone's life when something constructive is born out of adversity... when things seem so bad that you've got to grab your fate by the shoulders and shake it.”

— Anonymous

PROFIT ENHANCEMENT

Generate Higher Profit, Fast, continued from previous page

Focus on Getting Better, Not Bigger. Bigger will come when you get better. Raise quality and two great things will happen: Your costs will fall with lower waste, fewer returns and cancelled orders. And revenues will rise through lower customer attrition and more customer referrals.

Stop Flattering Yourself. You are only as good as the satisfaction of the last customer served. Your customers and your bottom line don't care how long you have been in business or what your grandfather went through to get you where you are today.

I guess these turnaround experts have to be pretty tough. But each lesson above seems to ring true to me. For more, pick up a copy of Gary Sutton's *The Six Month Fix*. □

Alan Greenspan: The Age of Turbulence

Reviewed by David L. Perkins

It has been said that knowledge is power. If so, it would seem Alan Greenspan would convincingly prove the theory. Pure, untethered and incorruptible knowledge, and the ability to reason, begat great power and influence in the life of Alan Greenspan.

How did he do it? First, he lived his life — beginning at a very early age — in constant thought, study and practice. The pursuit of knowledge was his hobby and his occupation. He sought to gain useful and enjoyable skills, knowledge and answers to the world around him.

Second, he followed his heart and interests rather than money.

Third, he dreamed of a better life — one that would extend far beyond his neighborhood — and actively pursued it.

Greenspan was blessed with a sharp mind, innate curiosity, natural work ethic and a non-threatening manner. He was rewarded with opportunities that offered exposure, resources and — more opportunities to learn. People began to recognize his skill, knowledge and — just as important — his unyielding allegiance to the truth. A truth derived solely from the disciplined study of facts. Of great fortune for all of us, he was eventually elevated to positions where his wisdom, intellect and incorruptibility could enhance the prosperity of a great many people.

Alan Greenspan was born on the west side of Manhattan in 1926. His mother's family had emigrated from Hungary; his father's from Romania. Of lower-middle-class means, Greenspan's parents divorced a few years after his birth. Alan was raised by his mother as an only child but enjoyed a large and close extended family. He frequently visited his father, who worked on Wall Street but was by no means wealthy.

His early interest was baseball. He listened to games and kept detailed box scores. He learned fractions by calculating batting averages. He played ball himself and dreamed of becoming a professional but didn't quite have the talent. Other early interests were Morse Code, photography and trains. As a youngster he memorized the train schedules for the entire United States. At 13 he discovered music. He took up clarinet and practiced several hours a day.

He entered high school in 1940 when the rooms were bulging with immigrants from Europe because the Nazis had just conquered Western Europe. London was soon under siege. Alan made decent grades, but his interest remained with music and baseball, and he earned side money playing in a band.

He was practicing clarinet when Pearl Harbor was bombed. He graduated from high school in 1943 and began taking

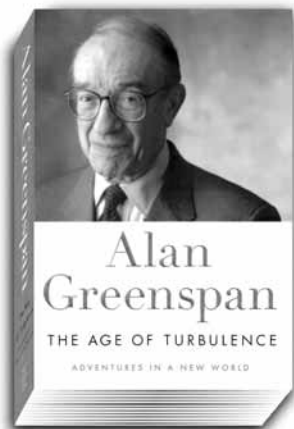
courses at Juilliard in clarinet, piano and composition as he awaited receipt of his draft card. To his great disappointment, he failed his military physical. Lacking direction, he accepted an invitation to join a successful jazz band. For the next two years he played up and down the East Coast to sizeable crowds. Each night during session breaks Greenspan would read books while the other band members smoked and drank in the lounge.

He read nonfiction: books about the London and U.S. stock markets, and then scores of books on JP Morgan. Alan was fascinated with Morgan's

wealth and reach. Morgan financed the formation of U.S. Steel, consolidated the railroads, contributed to the forming of General Electric, and was the main stabilizing force in the U.S. financial system before the creation of the Federal Reserve. Greenspan was equally as impressed by Morgan's character. During this time, Greenspan realized that Wall Street was an interesting, exciting place, and he wanted to go work there.

Alan enrolled at New York University for a degree in finance. Concerned about his prospects, he read all of his 1st semester textbooks in advance. He was an A student and gained considerable confidence in his intellect. It was also a time when everyone was interested in economics. The Great Depression was generally accepted as the reason World War II began; the economic engine of the U.S. was widely credited with winning the war; and the appropriate means for economic reconstruction of the U.S. and Europe was the debate of the day.

Greenspan twice read Maynard Keynes' lengthy and highly technical breakthrough macroeconomics book — *The General Theory of Employment, Interest and Money* — in great detail. Economics intrigued Alan, but where he really excelled was math. His professors took note, and Alan began working part time crunching numbers for Wall Street firms.



Pure, untethered and incorruptible knowledge, and the ability to reason, begat great power and influence in the life of Alan Greenspan.

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After graduating from college, he took the lower paying of two job offers and joined what was considered the world's foremost private economic research organization, the National Industrial Conference Board. Alan was most impressed with the extensive library of information on every statistical, economic and industrial topic conceivable. Alan made it his mission to "memorize all the data in the library." He gained considerable renown as "the guy with the answers."

In addition to basic research assignments, Greenspan began writing articles for *Business Record*, the Conference Board's monthly publication. Meanwhile, he completed a master's degree at NYU and enrolled in the Ph.D. economics program at Columbia. One of the courses he took was mathematical statistics, which dealt with the fledgling field of study that became known as econometrics, that is, the forecasting of the economy. During this class Greenspan says he found a growing field he could excel in.

In the early 50s he became acquainted with, and considerably influenced by, novelist Ayn Rand and her philosophy of "Objectivism," which holds, among other things, that human beings gain objective knowledge from perception by measurement; that the proper moral purpose of one's life is the pursuit of one's own happiness or "rational self-interest," and that the only social system consistent with this morality is full respect for individual rights, embodied in pure, consensual laissez-faire capitalism.

In 1954 Greenspan partnered with bond trader William Townsend to form Townsend-Greenspan and Company, an economic consulting firm. He was its chairman and president until 1974 when he joined Richard Nixon's administration as director of domestic policy research and then as chairman of the president's Council of Economic Advisers. He then returned to Townsend-Greenspan in 1977 and also completed a Ph.D. at NYU.

From 1981 to 1983, he served as chairman of the National Commission on Social Security Reform, working to save the Social Security system from bankruptcy. When the chairman of the Federal Reserve Board retired in June 1987, Alan was nominated as his replacement and accepted. Alan Greenspan was chairman of the Federal Reserve Board for five straight terms and was not eligible for a sixth term.

Greenspan is a staunch believer in the power of capitalism and free markets. He believes government should stay out of the free markets except as needed to maintain stability (i.e., the warding off of economic depressions and bubbles) by using

macroeconomic means such as varying the money supply and interest rates.

Although he is a lifelong Republican, he praises Bill Clinton for doing what Alan counseled was most prudent for the nation's long-term economic health — even when it wasn't popular. He does not seem to be a fan of President George W. Bush.

Greenspan devotes a considerable part of his book to the difficulty that free-market capitalism is clearly the economic model that generates the greatest prosperity for all, but that inherent in it is that there will always be both a great discrepancy between the rich and poor and, at times, people "getting hurt" economically. Unfortunately, attempts to intervene and protect — or take from the haves and give to the have-nots — causes a breakdown in the system itself. Furthermore, attempts to protect "here and there" results in unhealthy imbalances that end up simply shifting the pain from one group to another. More systemic efforts to reduce the discrepancy between the haves and have-nots, such as socialism and communism, simply do not work.

Alan Greenspan fears for the size of the U.S. deficit. He also warns that protectionism and limits to free trade will result in damage to the global economy and less prosperity, not more.

The Age of Turbulence is an incredibly interesting read and a nine-course meal on economic theory, history and politics. I highly recommend it. □

Greenspan is a staunch believer in the power of capitalism and free markets. He believes government should stay out of the free markets except as needed to maintain stability.

5 Tips from John Chidsey (Burger King CEO) for Reviving a Struggling Company



1. Focus on two or three major drivers that will make the biggest impact on the business.
2. Create and maintain a sense of urgency and risk-taking.
3. Know your customers.
4. Put the right employees in the right places.
5. Know your operators and regain their trust. Great relationships are key (in the business of Burger King).

Source: Wall Street Journal, April 2, 2008

How to Value an Intangible Asset

Appraisal methods that value the entire enterprise will yield a value that includes **all** of the assets of the business, both tangible and intangible. When this is the case, there may be no need to separately value individual intangible assets. But in two cases, valuation of a specific intangible asset may be merited:

- A specific intangible asset is being bought or sold separately and apart from the sale of an entire enterprise.
- The seller of an enterprise wishes to make a case for a higher value of the entire company by highlighting the value of a specific intangible asset that will be sold as part of the entire enterprise.

When the decision is made to isolate and value a particular intangible asset, many methods can be used. Every method falls into one of three approaches to value: cost, market or income. This article introduces two of the easier methods to apply:

- Cost approach: replacement value method
- Income approach: direct capitalization method

Let's first review the definition of intangible asset. Valuation experts know that defining intangible assets can be difficult. But for our purposes, an intangible asset is something of value that does not have a physical presence. Examples are royalty rights, customer lists, expertise, recipes, processes, brand awareness and reputation. Some of these have a physical representation, such as a customer list, but the information, not the paper it is printed on, has the value.

Cost approach: replacement value method

When we apply the cost approach, we answer the question: **What would it cost to create or construct, at current prices, an intangible asset with equivalent utility?** The methodology used is represented by the equation:

$$\text{Value} = \text{replacement cost new} - \text{functional obsolescence}$$

Calculating replacement cost new (RCN) requires identification of all costs that might be incurred in re-creating an intangible asset that is functionally identical to what is being valued. All costs fall into one of the following categories:

Material: expenditures related to tangible elements of the intangible asset development process

Labor: expenditures related to human capital efforts necessary to develop the intangible asset

Overhead: expenditures necessary to oversee the project, including management, supervision, support and clerical labor, necessary payroll taxes, perquisites and benefits, utilities, and operating expenses

Developer's profit: required by the person charged with creating or developing the intangible asset

If the intangible asset that is being valued is not new, it is possible that the newly created asset is of greater utility than the one being duplicated (the "old" one). If this is the case, then the old may have functional obsolescence, which is defined as the reduction in value of an intangible asset due to its inability to perform the function it was originally designed for. An adjustment must be made to the RCN value, as the formula above represents.

Income approach: direct capitalization method

All income approaches estimate value by calculating the present value of future income streams expected to be generated by the asset. The direct capitalization method (DCM) is an income approach to valuation and thus uses the same methodology. DCM is easier than other income methods to apply, but the annual future income stream to be generated by the asset must have the following characteristics:

- Constant future income, or income growing at a constant rate (i.e., same dollar value each year or constant growth rate)
- Perpetuity (i.e., income stream to be received each year, indefinitely)

If the intangible asset being valued generates (or will generate) for the buyer an income stream that has the above two characteristics, then the DCM method can be used. The next task is to determine the following:

- Income to be received beginning in Year 1
- Growth rate annually for the income stream
- Discount rate or required rate of return

Identifying a discount rate can be tricky and confusing to the untrained. There isn't sufficient room here for a complete description of how discount rates are calculated. To summarize, the discount rate is referred to as the required rate of return. In other words, it is the return an investor would require to make the investment and forego alternative investments. Once a discount rate is selected, the capitalization rate can be computed as follows:

$$\text{Capitalization rate} = \text{discount rate} - \text{growth rate}$$

Once the capitalization rate is calculated, the following formula can be applied to determine the value conclusion:

$$\text{Value} = \text{income} / \text{capitalization rate}$$

Example: XYZ Company wants to buy the royalty rights to a book titled *Making Money in America*. It is estimated that this book will generate \$95,000 in after-tax royalty income per year in the first year, and this income stream should increase 10% per year for a very long time. A discount rate of 18% was determined after considering the expected rate of inflation, lack of marketability (liquidity) of the investment and the risk characteristics. By simply plugging our inputs into the formula, we calculate the value as follows:

$$\begin{aligned} \text{Value} &= \text{income} / (\text{discount rate} - \text{growth rate}) \\ &= \$95,000 / (.18 - .10) \\ &= \$95,000 / .08 \\ &= \$1,187,500 \end{aligned}$$

The above discussion is meant to provide the business owner, investor, executive or advisor a general understanding of the subject. A working knowledge will help you make better decisions. When material dollars are at stake, skilled professionals should be considered before any conclusions are drawn or investments made. □

Quick, Effective Business Writing

Do business letters take too much time to write? Are you uncomfortable with writing? Do you avoid it? Do typos plague you and damage your credibility?

It doesn't have to be that way. If you follow this advice, you can begin using

The key is to write as you speak and stop trying to "sound smart."

your writing as an asset, not a curse. The key is to write as you speak and stop trying to "sound smart." Look at

the example (below right) of a nice, crisp business letter.

Stop worrying about silly rules. Many of the rules drilled into your head in school do more harm than good, e.g., "never end a sentence with a preposition." That rule is now out-of-date anyway. Just focus on making your point as clearly as possible. The recipient will appreciate that your letter is clear and to the point.

Use punctuation to show readers how you intend your sentence to read, e.g., I get *The Business Owner* for one reason: to enhance my skill as a business owner.

Format your letters so they are pleasing to the eye and do not detract from information in the letter. Use a conservative, easy-to-read font such as Ariel, Calibri or Times Roman in 12-point size, and block everything flush left

One key to reducing time wasted on worrying about your business letters is to write fewer of them. But avoiding them when a letter is more appropriate or effective is not the answer either.

as we do here on this page.

Structure the information to help readers quickly understand your points. If you have lists, make key points easy to see using bullets, dashes, numbers, letters or other marks for emphasis.

Reread and proofread every word. You can't afford typographical errors in your letters. If your proofreader misses typos, find a new one. Email DPerkins@DLPerkins.com and I'll send you the name and email

address of an affordable, quality copy editor and proofreader.

It's a piece of cake. You email your letters, marketing materials, website content, catalog pages, etc. to the editor, who emails you back edited copy, typically the same day or overnight, with an invoice.

Don't write letters if a phone call or short email will do the trick. One key to reducing time wasted on worrying about your business letters is to write fewer of them. But avoiding them when a letter is more appropriate or effective is not the answer, either. Letters are great for documenting an agreement or understanding, providing "official"

notice, taking a stance, and/or showing respect, care or concern.

Letters are NOT good for sharing ideas, discussing issues or airing disputes. The sample landlord letter below was written because the author wanted to get his landlord's attention that he had a problem. The writer does not want to move, and hopes his letter will help negotiate a favorable deal in a timely manner that ensures improvements are finally made.

Writing is an important strategic asset. If you need help, call me at 800-634-0605. Then read this short, clearly written book on business writing: *The Plain English Approach to Business Writing*, by Edward P. Bailey, Jr. □

JIM SMITH COMPANY

May 1, 2008

Mr. John Doe
 Managing Director
 John Doe Company
 123 Elm Street
 Anytown, Any State, 00000

Dear Mr. Doe,

We've been leasing this space from you for four and a half years. Our lease comes up for renewal in six months, but we have serious reservations about renewing. Before we moved in, you promised to paint the building, repave and restripe the parking lot, and replace the roof. These things were never done, even though we inquired about them many times, even in writing.

Because it will take time to find a new location and move, we need to start looking now. So if you want to keep us as tenants, please let us know the terms you'd accept. Of course, any deal would have to include an ironclad obligation on your part to make the above improvements and a provision that, if you don't do this within 120 days, we can get them done ourselves and deduct the cost from our rent.

We hope you understand our position and we would appreciate your timely response.

Sincerely,



Jim Smith

Making Sense of the Sales Multiple

We've all heard that companies are valued by, and sell on, a "multiple." The talk at the club and trade conference quickly moves to "who sold for what multiple." We hear the multiples, but we almost never hear the definition of earnings used or important elements such as deal terms.

There is much confusion about what constitutes earnings. A recent *Wall Street Journal* article said that "there are a host of names for earnings and there is no uniform standard by which to understand them, causing much confusion among investors." So when "multiples of earnings" are mentioned, the types of earnings should always be clarified and defined.

"There are a host of names for earnings and there is no uniform standard by which to understand them, causing much confusion among investors."

Wall Street Journal

This article explains various types of "profits" used and the definitions of each. With an understanding of terms and definitions, we can begin to put any particular business sale multiples in proper perspective.

To begin, review the 2007 income statement for XYZ Company at right. How much profit did XYZ make in 2007? This is a trick question.

Profit comes in many forms: gross profit, operating profit, net profit, taxable profit. Earnings can mean the same as profits. The names and definitions are almost endless. Below is a list of commonly used terms that refer to profitability.

Now, imagine you are at your country club and Jack Taylor tells you for the 10th time this year that he sold his company for 10 times profits. To his surprise, you ask him what he means by profits. After he gives you a flip answer like "You know, the green stuff you put on the table in Vegas," you inquire as to what type of earnings. He probably doesn't even know himself. But you will.

If he sold for 10 times his after-tax profit, then the price was \$600,000. We see on the accompanying table that XYZ Co. reported pretax profit of \$60,000. When we look at the income statement and footnotes, we see that adjusted seller's discretionary cash flow (SDCF) was \$365,000. Consider this number and the definition of SDCF, and you might come to believe that Jack Taylor didn't obtain the premium he boasts of.

We could estimate that this company generates \$300,000 in annual after-tax income to the owner, assuming that 2007 was a typical year, except for the lawsuit expense, and that his company was not a C-corporation and thereby subject to double taxation. This is pre-debt service, so as long as the owner used leverage, his take-home would be less. Again, it does not appear that he sold for a premium.

In summary, next time you hear a sale multiple, you'll know that it tells you almost nothing unless you know the definition of profit used. Similarly, the sale price is almost meaningless unless you know the terms. □

(\$000's)

2007 Income Statement XYZ Company

Revenue.....	\$1,000
Cost of Sales	(\$300)
Gross Profit	\$700
Operating Expenses*	(\$500)
Operating Profit.....	\$200
Non-Operating Expense**	(\$100)
Pretax Profit.....	\$100
Tax.....	(\$40)
After-Tax Profit.....	\$60

* Operating Expenses include \$100,000 of salary to the owner, \$40,000 in owner perquisites and \$25,000 in depreciation.

** Non-Operating Expense is \$50,000 in interest and a \$50,000 legal bill to settle a dispute.

Miscellaneous Profit Calculations¹ (From the above income statement)

Operating Profit.....	\$200
Pretax Profit.....	\$100
After-Tax Profit.....	\$60
EBIT	\$150
Adjusted EBIT ²	\$200
EBITDA.....	\$175
Adjusted EBITDA ²	\$225
SDCF ²	\$365

¹ For additional profit calculations, see each "profit" line on the accompanying XYZ income statement.

² Nonrecurring expenses added back.

Various Types of Profit

Gross profit: revenues minus direct expenses (often referred to as cost of goods sold)

Operating profit: gross profit minus operating expenses (often referred to as sales, general and administrative expenses, or net operating profit)

Pretax profit: operating profit minus all expenses (except taxes)

After-tax profit: profit after all expenses have been deducted, including taxes

Net profit: see After-tax profit

Profit: general term for profitability, e.g., gross profit, net profit

Earnings: profit, generally net profit

EBIT: earnings before interest and taxes

EBITDA: earnings before interest, taxes, depreciation and amortization

Seller's discretionary cash flow (SDCF): EBITDA plus owner compensation

and all non-recurring expenses and those unnecessary for ongoing business operations

Owner earnings: see SDCF

Taxable income: see Pretax profit

Normalized earnings: adding back to profit all excess owner compensation (salaries that are not "fair market") plus all non-recurring expenses and those unnecessary for ongoing business operations

Where to Keep Important Documents

When you die, the bank that has your safe deposit box may “seal” it until sometimes-lengthy legal procedures end. This can occur even if a second registered holder of the box is still alive. Only government and court-appointed representatives have access to the box during those procedures. Here are suggestions for using a safe deposit box wisely.

Keep in your safe deposit box

- birth and death certificates (original)
- divorce certificates/decrees (original)
- adoption papers (original)
- marriage licenses (original)
- military service papers (original)
- real estate deeds (original)
- title insurance (original)
- mortgage papers (original)
- savings bonds and certificates (original)
- rare stamps and coins
- copy of your will (your law firm keeps original)
- copy of cemetery deed (your law firm keeps original)
- copy of burial instructions (your law firm keeps original)

- copy of life insurance policies (your law firm keeps original)
- video of all your personal property, periodically updated for casualty loss purposes (fire, flood, tornado, theft, etc.)

Your law firm keeps*

- will (original)
 - cemetery deed (original)
 - burial instructions (original)
 - life insurance policies (original)
 - important business records, such as articles of incorporation, bylaws, stock certificates, stockholder agreements, buy-sell agreements, deferred-compensation agreements, etc. (original; keep copies in your office)
- * If you change lawyers, get old documents from your old lawyer and have your new lawyer keep them.*

Keep in your fireproof home safe*

- power of attorney
- living will
- health care proxy
- location of safety deposit box

- location of key to safety deposit box
- name and contact information for the law firm that keeps important documents for you
- tax records
- list of all your assets and liabilities
- retirement plan documents
- Social Security records

** Make your heirs aware of the safe, its contents and the key's location. They need ready access to the contents of the box when you die.*

Do not keep in your safe deposit box

- Cash. Could generate suspicion, tax liability questions, etc.
- Property belonging to someone else. Heirs could have a hard time proving ownership (or non-ownership) of jewelry or other valuables.
- Originals of documents that govern how your estate will be handled after your death, such as power of attorney, will, living will, health care proxy, burial instructions, burial plot deed, etc. ❑

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Password: Profit (good until release of July/August issue)

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International Profit Associates (IPA) International Tax Associates (ITA)

I received a call the other day from a representative of International Profit Associates (IPA). I visited with the representative for a minute and, sure enough, they're still "doing their thing." I also occasionally hear of IPA's sister company, International Tax Associates (ITA). I have never heard

If you have any experience at all with IPA or ITA, we'd greatly appreciate it if you'd share your experience with us.

anyone say anything positive about these guys. To the contrary, I've heard many horror stories.

I first alerted you to IPA in our September/October 2003 issue. At a business presentation, I had heard a businessman named Elvis Davis tell how IPA convinced him that it could improve his business' profitability and lower his tax bill. Davis hired IPA on an hourly basis but with a

total cost estimate of \$11,000. But the bill grew to \$35,000 and the results were far worse than useless. Damage to his company's morale, productivity and bank account took years to correct. In hindsight, he thinks it was a scam.

Inc. magazine featured IPA in its January 2000 issue. The writer, Joe Rosenbloom, said he wrote the article after receiving complaints from *Inc.* readers about IPA and its tactics. The article reported that a disbarred lawyer named John Burgess, a former George S. May employee with a conviction for attempted grand larceny, owns IPA. His two founding partners also had criminal records.

According to the article, IPA was founded in 1991 and posted 2001 revenue of \$105 million. With an average client fee of \$18,000, it served approximately 6,000 small-business clients that year. Although IPA purports to be a consulting company, only 20% of its employees are consultants. The majority of its employees are telemarketers and sales people. In researching the story, Rosenbloom had no trouble finding disgruntled clients through Better Business Bureau complaint filings.

According to the article, IPA relies heavily on:

- Massive telemarketing force and very aggressive sales tactics
- Use of credibility-garnering "signals" such as paying for high-profile spokespersons and IPA's inclusion in *Inc.*'s list of fast-growing companies
- Avoiding the need to provide referrals by explaining that its clients want their names kept confidential

Inc. readers wrote to the magazine's website about IPA:

"Having worked there (IPA) for 60 days and participating in the unethical hard core sales pitch, my only remorse is for the two clients whom I convinced to part with a lot of money for no value."

Walt Marino,
Orlando, Florida

"I signed their pressured deal. At the time it all made sense. Now I realize the huge mistake I made."

Tim Shea,
Escondido, California

"I recently spent one week in Chicago training to be an IPA senior advisor. After seeing firsthand their sales tactics (very heavy handed, strong arm, aggressive techniques), coupled with the old bait & switch approach, I have decided to pass on this opportunity."

Bob Thompson,
Detroit, Michigan

"Once the sale was made, a very unqualified person came in to do the work. Nothing went well."

Elvis Davis,
Memphis, Tennessee

From what I've heard of International Tax Associates (ITA), its business model is basically the same as International Profit Associates (IPA). It has terrific salespeople who are highly skilled at dealing with your concerns about their credibility, including helping you get past negative postings that you may find on the Internet. They'll argue things like:

"Any large company will, over time, have some bad customer experiences. Toyota at times will have unhappy customers, but you wouldn't say that they're a scam, would you?"

Granted, you would not. But that does not address whether IPA or ITA is a scam or not.

If you have any experience at all with IPA or ITA, we'd greatly appreciate it if you'd share your experience with us. Ditto if you have paid a "business brokerage" firm or "investment bank" a large, non-refundable up-front fee but received very little of what you really wanted — buyers that were willing and able to buy your business for the prices or "multiples" that the

firm led you to believe were possible. Unfortunately, people who fall victim to scams, or think they may have been scammed, rarely tell anyone about it. But this only benefits the scammers. Please resist the urge to protect yourself and help us protect other business owners like you. Call me on my cell (918-760-2715) or send me an email (David@TheBusinessOwner). □

Unfortunately, people who fall victim to scams, or think they may have been scammed, rarely tell anyone about it.

About the Publisher



David L. Perkins, Jr. owns, writes, edits and publishes *The Business Owner*, the

newsletter of choice for more than 35,000 business owners who are serious about building wealth through successful private business ownership.

Perkins draws editorial ideas and inspiration from his own life as a business owner and investor, and his daily work as a mergers & acquisitions consultant, where he has advised on more than 100 purchase/sale transactions involving both private and public companies. His M&A consulting firm is Acquisition Advisors, which he founded in 1997 and which specializes in transactions valued between \$5 million and \$75 million. Visit AcquisitionAdvisors.com to learn more.

Perkins holds a bachelor of arts degree in psychology from the University of Oklahoma and an MBA from the University of Notre Dame, and has completed the executive education course titled "Mergers and Acquisitions" at The Wharton School, University of Pennsylvania. He also pulls editorially from prior experience in commercial real estate leasing and brokerage, commercial bank lending and private company financial management.

Perkins is the author of *A Concise Overview of Business Valuation* and co-author of *The Business Sale, An Owner's Most Perilous Expedition*. You can buy the former at www.TheBusinessOwner.com.

Contact him at 800-634-0605 or DPerkins@AcquisitionAdvisors.com.

Ask the Editor: How to Evaluate a Business Investment Opportunity

Question: I have the opportunity to become an equity partner in a 12-year-old company that owns four pizza restaurants. The company has been earning \$350,000 per year, on average. The current owners are raising \$600,000 by selling a 25% equity interest. They are willing to repay the investment over five years, level principal and interest paid quarterly at a 5.5% annual interest rate. At the end of the five years, the new investors will continue as 25% owners and begin getting 25% of all profits. This sounds like a pretty good deal to me. I get all my money back and keep the equity interest. Am I missing anything?

Answer: To assess this opportunity, we need to look at several issues before drawing a conclusion:

- What kind of profit does the \$350,000 represent? Operating profit? Net profit? Adjusted profit? EBIT? EBITDA? (See "Making Sense of the Sales Multiple" on page 10.) If this is an equity investment and we are talking about after-tax profit, then valuation of the company at \$1.4 million may be reasonable.
- How will the five-year repayment obligation be structured? Will the company sign a note that obligates it to specific repayment terms?
- How will the repayment obligation be secured? What if the company can't repay the capital as stipulated? Can you take control of the company? Will any current owners guarantee the obligation?
- What does the company's balance sheet look like? How much debt does it have? How valuable and liquid are the assets? If outside borrowing exists, which obligations will be senior and junior? How easily will current and projected cash flow cover existing debt and the new obligation?
- What is a fair rate of return for money you invest in opportunities like this? Assuming 10% return is fair for your money, why accept 5.5% as with this opportunity? You would not, of course, unless there were a very good probability you would enjoy nice returns after the first five years. How sure are you that this will occur? Remember, a lot can happen in five years. Be sure to run the numbers.
- As a minority owner, you likely have almost no say in what controlling shareholders do with the company or its profits. What prevents controlling parties from raising their salaries and perquisites to the detriment of your return?
- If you ever want out, who is going to buy your minority shares? This is called lack of marketability. Unlike publicly traded stock, you're probably stuck unless you have a good buy-sell agreement.

In summary, you should work out many of the protections discussed above before you take this opportunity seriously. Move cautiously, get all the facts and use common sense. Keep in mind that private businesses are risky and investments in them merit annual rates of return well in excess of what you can get from the public equity market (i.e., average annual return around 12%). □

More Questions, Fewer Statements Key to Effective Communication

Knowledge is power. With knowledge, you can govern your actions and better control your environment. That's why you read *The Business Owner*. But no matter how much you read, the amount of information you take in is dwarfed by the amount you get by talking with people. So what's the key to maximizing knowledge you gain from interactions with others? Ask a lot of good questions.

Good questions are powerful. They uncover facts, put you in control, provoke thought and convey points. But nobody wants to be interrogated. So the skilled conversationalist simply fills casual conversation with questions that show keen interest in what the other person has to say.

Business researcher, author and strategist Peter Drucker says, "My greatest strength as a consultant is to be ignorant and ask a few questions." You can make it your strength, too.

Nearly all the problems people have come from foolish statements. Questions, on the other hand, are pretty darn safe. They allow you to gather information. Questions have no downside.

Ever assume you knew where someone stood and ended up making a fool of yourself? If you want to be a better conversationalist and also keep your "boot out of the bucket," spend more time asking questions and less time making statements.

In our society, most people talk but few listen. Studies show that many people who talk a lot do so in an effort to appear "smart" and/or cover up their insecurity or ignorance. But studies also show that people tend to perceive those who ask a lot of questions as more intelligent.

If you're addressing an issue or problem, continually refine your questions until you understand both the big picture and any personal issues that bear on its resolution. The key is to remain objective and focused so you can get to the heart of the issue or root of the problem.

Resist pressure to offer swift comment or judgment. Yes, our culture lacks patience and generally desires the excitement of hardened positions and controversial statements, but you don't have to give 'em what they want. After all, it's not always in your best interest. If you are not ready or willing to share your thoughts, don't. Leaving others to wonder puts you in a position of power that has little downside.

When using questions to gain knowledge and control, have some poise and patience. Rapid-fire questions won't do. Use a conversational approach. Questions provoke thought and emotion, and can take a few moments for the recipient to digest. Pace your questions so people have time to ponder and provide well-thought-out responses.

Though you may not be able to tell if someone is lying or is just insecure, you will know when you've triggered an emotion if the person you are questioning:

- Widens or narrows his eyes or looks away
- Talks softer or louder
- Breathes faster or slower
- Folds his arms tightly or gestures openly
- Turns his body away or toward you

Some people will give you more information than you want, or talk about things unrelated to the issue at hand. Take control by saying, "I understand, but for the moment can we focus on this issue?" If they continue to skirt the issue and you're engaged in more than a casual conversation, you can say, "Hey, if I'm going to really understand, I need you to give me a precise answer to this question."

Questions are universally accepted as an absolute key to effective communication. Their highest and best use is to check progress and mutual understanding during, and at the end of, a conversation.

Do you want to show people respect AND understanding? Check and recheck by inquiring. You'll quickly become a master communicator and enjoy stronger relationships and fewer conflicts.

As a business owner, you're in a position of power. People care about — and want to control — what you think. People act in funny ways around you.

You get all kinds of information that's slanted, skewed, carved up and hollowed out. Your job is to uncover the truth. The tool you use is probing questions.

Questions may be the most powerful force in the universe, at least in our earthly universe. Consider harnessing the power of questions. Talk a lot less and query a lot more. Stop trying to be the know-it-all.

Legendary business researcher, author and strategist Peter Drucker says, "My greatest strength as a consultant is to be ignorant and ask a few questions." You can make it your strength, too.

Yes, our culture lacks patience and generally desires the excitement of hardened positions and controversial statements, but you don't have to give 'em what they want.

This piece was inspired by and adapted from an article by James Dawson, managing partner of ADI Performance. □

Eight Tips to Get You to Closing

During my years as a commercial real estate broker, banker and business consultant, I've seen deals and financings fall apart when they shouldn't have. The reasons usually are basic — what legendary football coach Lou Holtz calls “blocking and tackling.” To maximize the odds of getting your deal done:

Don't Try to Teach a Pig to Sing

“You'll only frustrate yourself and irritate the pig,” as my former boss used to say. If you are looking for financing, find a lender that specializes in loans of the type you seek. If you are looking for a buyer, look for persons or entities most likely to make investments of the type you offer. Resist the temptation to try fitting a square peg in a round hole. Hard-selling rarely overcomes a poor fit. And if the deal closes, the odds of it being a mutually successful relationship are diminished.

Be Prepared

If you want to get off to a bad start, show up at the first meeting unprepared. Carelessness communicates that you run your business sloppily. In the case of debt financing, you should have in hand, and be ready to discuss:

- Description of your business, including its history, what you do and how you do it
- Summary of your request and why the money is needed
- Income statements and balance sheets for the past three years, plus year-to-date
- Projections for the next year or two, including cash flow
- How the loan will be repaid — both primary and secondary sources
- Personal financial statement

For owners of closely held businesses, personal guarantees normally are required by lenders. Bring a personal financial statement to the meeting and you'll make a very strong first impression.

Follow Up

If in your initial meeting the lender or investor requests additional information, send it promptly. If it will take you some time to gather the requested data, tell him how long. Confirm in writing what you will do and when you will do it. Then be sure to do as you say. You will establish credibility and communicate that you will be a good customer. Moreover, the parties will be more likely to mirror your professionalism and promptness.

Get Good Advice

We all have heard that lawyers kill deals. They can make them, too. Get good advice and you will maximize the chances that a good deal gets done for you. Good advice primarily comes from experience. Find counsel that is experienced in the type of deal you are working on.

Be Realistic

Before you start spending time and money, be realistic as to whether the deal you are buying or selling has merit. Will the cash flow work with realistic projections of income and expense? Do the equity amount, collateral and cash flow coverage fall within acceptable norms? Don't be overly optimistic because you unwittingly may be sticking a pin in your own balloon. This can be particularly true near the closing date, when the lender asks you for an actual vs. budget comparison, with the figures you provided when talks began.

Move Swiftly

Time kills deals. If you really want to get your deal done, move swiftly. Don't expect that you can take a vacation during negotiations and have everyone still excited when you return. Have you ever heard of the pendulum theory? The pendulum never stands still. It is either moving forward or backward. Your deal is either moving forward or backward. Your time, energy and diligence will keep it moving forward.

Give Them What They Want

No, don't give away the farm. Listen to comments, concerns and requirements of the other party. Ask questions to understand not just what they say but what they really mean. Then address their needs. Whether you seek financing, a buyer or investor, resist the temptation to respond to objections by selling harder. Instead, address the other party's concerns and figure out how your deal can be presented in a way that addresses their needs and concerns.

Negotiate and Compromise

Negotiating any deal is give and take. Don't expect everything to go your way. Know the market, give yourself room, and accept that you have to compromise. An unreasonable request without a valid basis kills deals and destroys your credibility. Also, keep in mind that **your** opportunity will not be their only opportunity. Make sure yours is a win-win.

Adhere to the above and you'll maximize the chance that your next deal will get done. □



“Now remember, let me do all the talking.”

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What Every Business Seller Should Know (Part II)

SELLING A COMPANY

BUYING A COMPANY

BUSINESS VALUATION

Your competitors are **not** the best buyers for your business. Although they're easy to identify, they pose considerable risk and rarely pay the highest price. Risky — because they can and will use the fact that you wish to sell — and the information you share with them — against you. A lower value — because you don't offer as much value to them in terms of industry knowledge, expertise, processes and methods.

It's hard work locating better buyers, but the rewards can be considerable. That's why smart business owners hire Acquisition Advisors. We develop "highest and best buyer profiles" for your business and then use them to sort through a database of every U.S. company, scores of international companies, and our proprietary database of more than 3,000 private equity groups. We then confidentially market your company to the leading candidates. Our goal is to deliver a range of competitive bids and deal structures for you to choose from and then work to complete the deal with your preferred buyer. All of this is done in strict confidence.

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