I Wish I Had …

Lessons from those who have sold their dealerships

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Having participated in hundreds of business sales and purchase transactions, I have had the unique opportunity to gain experience, as an insider, from what dealers think as they reflect on the sales of their dealerships. Human nature often compels you to doubt yourself and look back at the things that you think you could or should have done differently.

In this article, I am going to outline 10 things dealers have told me they wish they had done differently with their transactions. My hope in sharing this information is that those of you who are considering a future sale of your dealership will be able to avoid these missteps whether your sale is today or more than 10 years from now.

Here are the top 10 "I wish I had … " regrets I have learned from dealers:

… Made Difficult Employee Decisions

One of the most difficult things a business owner can face is having one or more employees who are not cutting it. I have seen too many situations where a long-term, key employee is retained longer than he (or she) should have been. An employee can be kept even when he is no longer a good fit for the company or not producing at the level he should be. Often this is done out of loyalty or sympathy for the employee.

These issues come to light very quickly in the discovery process. Buyers figure it out quickly, leaving the dealership owner to tap dance around why he has this less-than-ideal employee. In retrospect, most dealers who have faced this say they wish they had done something about it earlier, either by holding the employee accountable and repairing the situation or letting the employee go. They often realize that it would have been best for all concerned — the employee included — to simply part ways.

… Paid Down the Debt

No one incurs debt with the idea of damaging his company. It is always a means of capitalizing on an opportunity or solving a problem. At face value, debt is not a bad thing. However, when it comes time to sell the business, many dealership owners are not prepared for the effect it will have on the final value received. Business sales are almost always done on a cash-free, debt-free basis. This means the seller retains whatever cash he has on hand at closing and pays the liabilities that exist at closing, including lines of credit, business loans, vehicle loans, inventory floor-planning loans, etc. As such, every dollar of debt acts to reduce the net value received by the seller. In addition, any debt that is secured by a lien and a UCC filing will need to be paid off at the closing, if not before. So, the effects are felt immediately. Owners we have worked with who had a bunch of debt have, one for one, wished it had been paid off earlier.

Regarding liabilities, there is a subsection to consider. By definition, deferred service revenue is a liability to the business for service contracts that have been billed and/or paid for that have a term longer than one month. Because you have the money (or the A/R if it is invoiced) there is an obligation to service that customer for the prepaid period. When most of your service contracts are collected by the leasing company and passed through to the dealership monthly, the liability is minimal. However, some dealerships have chosen to bill the service contract for the full term of the lease up front. In this case, the dealership is funded for the full term of the lease by the leasing company in advance.

Unfortunately, in most cases, the money is then spent, leaving the liability to deliver service, parts and supplies for the next 36 to 60 months with no money on hand to cover the costs. It is important to understand that buyers will look to deduct the liability for prepaid/deferred service from the purchase price. I have seen cases where this is hundreds of thousands of dollars. In extreme cases, it has created a situation where the business value is negative. Though it seems like a great cash flow move, taking multiple years of service payments up front is a slippery slope that can and will come back to hurt you later.

… Built a Strong Sales Team

This seems like an obvious one, but it is often overlooked. When looking at a business, acquirers regularly consider how they will be able to maintain or (more likely) grow the business going forward. The easiest way to do this is to take over a well-producing sales team. As such, the lack of a strong sales team can hurt a potential sale. This is especially true when most of the sales are done by one or more of the business owners. In this case, the buyer usually requires the owner to stay on for a longer period of time after closing than he might want to in order to transition customers to the buyer.

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… Trained My Replacement

Many of the dealership owners we work with have the goal of selling their businesses and handing over the keys at the closing. I can tell you that this is very rare. The buyer will want the owner(s) to stay on for a transition period. However, this transition period can vary depending on the circumstances. The best way to minimize this time is to have someone in the business already who can take over the ownership role. It is even better if he has already done so to a certain extent.

When your contribution to the business is in the form of high-level vision and leadership with little to no day-to-day transactional responsibility, you are easy to replace. At the other end of the spectrum, if everything in the business runs through you, it is almost impossible to replace you quickly. In these cases, buyers will often require the owner to stay on for a few years. This may not be good news if you are looking for a quick exit.

… Paid Myself More

As the owner of a dealership, it can seem that everyone else is in line to be paid before you — employees, manufacturers, vendors, the government, etc. In the day-to-day cash-flow struggles, many dealership owners have cut or forgone their own pay to make ends meet. This often becomes very real when negotiating with a buyer. If you have underpaid yourself, the buyer will point out that he will need to pay someone more to do the job. In modeling this out, the buyer reduces the profit you have been showing and, thus, reduces the purchase price for the business.

I have learned that in order to best secure your own financial future (as well as your present), you need to pay yourself at least a fair market wage for the role you play in the business. This forces the business to create the money needed. If you put yourself at the end of the line, the money will often run out before you get paid.

If you own the building you are operating from, this would also include rent. I have seen too many businesses that pay themselves below market rent or no rent for their facilities. This creates the same effect as paying yourself below market compensation. Not only will you make less money as you go along, you will end up with a business that is worth less than you thought it was.

… Managed Inventory Better

The effects of poorly managed inventory are far reaching. One impact that many owners do not consider is the involvement of carrying too much inventory — especially equipment. Acquirers do not like to "buy" a lot of equipment in an acquisition. First, it adds to the money needed to buy the company. Second, they will have quotas to attain post-closing and starting with a lot of equipment (usually purchased so you could make your quota or earn a rebate in an earlier period) puts them behind. Of course, no dealer wants to lose what they paid for the inventory on hand at the time of closing. The best solution here is to keep inventory levels moderate in the months leading up to closing a sale.

The other aspect of inventory that has been a tough pill for business owners to swallow is the handling of obsolete products. No buyer wants to pay for something and then throw it into a dumpster. As such, buyers will look closely at inventory and will only accept what is truly sellable or usable in the near future. If you have obsolete inventory, it is best to move it out or write it off prior to taking your company to market. More importantly, I have had quite a few clients tell me they wish they had managed inventory better. While getting a tax write-off for disposing obsolete inventory helps the tax burden, it comes at a very high cost — 100% of the price you paid for the product.

… Known My People Were Backlogged

Business valuations are based, in large part, on historical financial performance. As such, the accuracy of your financial reports is critical. I have seen too many situations where financial reports are not accurate because there is backlogged data entry. For example, when an outside payroll company does payroll, the basic requirement is that you have money in the account to cover paychecks and various payroll tax payments. When dealership personnel are busy, it is easy to put payroll entry aside as a way to cope with other tasks. However, if it is not done on a timely basis, you now have an income statement that shows more profit than what was really created.

I have seen the same situation with credit card expenses, cash application, closing service calls, customer billing and more. During due diligence, the buyer will be digging into the financials of the business in detail. When you have issues with backlogged work, they almost jump off the screen. Not only does this lead to embarrassment for you as a business owner, but it also creates doubt and uncertainty in buyers. They start to wonder what else they cannot trust in your data. I have seen problems like this lead to a deal falling apart.

The beauty of working on the items listed is that the side effect is a better-run and more profitable business today — not just when you look to sell it.

… Tracked the Add Backs Better

Every deal we have participated in had some level of profit "add backs." These range from the personal expenses of the owners (i.e., entertainment, personal travel, country club memberships, boats, cars, etc.) to business expenses or one-time expenses that will not be incurred by the new owners going forward (i.e., accounting fees, legal fees, certain donations and sponsorships, extraordinary training, leasehold improvements, etc.). Of course, the nature of these add backs can sometimes lead one to intentionally not leave a paper trail. While that makes sense for obvious reasons, it can create a situation where you do not get proper credit for add backs because they cannot be proven. In addition, it leaves you without knowing how much profit you are actually making. It is quite common for business owners to underestimate their add backs when I ask for a ballpark estimate.

… Handled the Tax Process Better

Paying taxes is something none of us is fond of. Most would rather get a root canal done than work on and pay taxes. Because of this, the process does not get the attention it should. The first regret I have heard on many occasions is that dealership owners wish they had not always filed for extensions.

Reviewing tax returns is an important piece of the due diligence process. When the most recent year is not available for nine months after closing, it creates problems. Along with this, most owners have their accountants prepare their tax returns from documents provided from their internal accounting systems, yet many do not go back and make the accountants' tax adjustments in those systems. This leads to a situation where the internal financial reports may be dramatically different from the tax returns. When buyers see this, it raises questions.

The final tax issue I want to cover relates to having regular audits. This is particularly important for larger dealerships that make more than $10 million in annual revenue. Having your books formally audited on an annual basis will not only provide tremendous insight into what is happening in your company, but also shows how well you comply with generally accepted accounting principles (GAAP). This will make the due diligence process much easier.

In larger transactions and any done by private-equity buyers, an outside accounting firm will be brought in to complete a "quality of earnings assessment." This is an audit of the books to prove out the net income and earnings before interest, taxes, depreciation and amortization (EBITDA). When the books have been regularly audited by an accounting firm, things go more smoothly and the final numbers usually end up where we thought they would be. When the books have not been audited, we have seen some big swings in the final numbers.

… Looked at My Dealership Through the Eyes of an Acquirer

We can all get caught up in the day to day and sometimes find it difficult to step back from the business and look at it from the outside. I have had many clients tell me they learned a lot through the sale process and wish they had known more about it earlier. When you look at your business through the eyes of an acquirer, you often see things you never noticed before. This is an exercise anyone can do at any time. All it takes is the willingness to look at the business differently and accept guidance. One of the reasons we offer a dealership valuation program is to provide the road map for this type of business review. Those who have completed the process come away with a list of items to address and a road map that leads them in a better direction.

Final Thoughts

Looking back at a significant business and/or life event always gives one pause to consider what could have been done better. The beauty of being part of a tight-knit industry is the ability to learn from those who have already been where you are heading. My hope is that you have found a few nuggets of useful information in the items above and can use them to improve your dealership and set yourself up for a successful future. The beauty of working on the items listed is that the side effect is a better-run and more profitable business today — not just when you look to sell it. ■

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