Jack HM Wong: 00:00

Welcome to this episode of Cracking the Entrepreneurial Code and I'm your host, Jack Wong, and I have the privilege and honour to have a very successful serial entrepreneur who is also an author and speaker. His name is David Barnett. Just give you a little of who David is. He's been working with small and medium enterprises for over 20 years. He has been an advertising consultant, a finance broker, a business broker, and currently he is helping people buy and sell around the world as a private transaction advisor. And David has written 7 books about small business and local investing. 3 of which have been Amazon best-sellers; Invest Local, Franchise Warnings and How To Sell My Own Business. How are you, David? Thanks for being a guest on this show.

David Barnett: 01:35

I'm doing great, Jack. Thank you so much for inviting me.

Jack HM Wong: 01:39

Yes, first of all, I want to say that when I received the bio from David, I will say, "OMG". I have no reason how or earth I can attract David to be on the show and it's always been our privilege to have people like David who has successful in what you do, and it's actually my own agenda. I want my audiences to learn how you are so successful. So I would like to start by asking a very simple question. It might be simple to me, but I do not know how you handled that. That is how do you start your business?

David Barnett: 02:20

Well, it's interesting because when I look back over my past, I can see different points where I felt that I was more successful and there were different points where I didn't feel as though I was very successful at all. And so what I'm doing today in helping people buy and sell businesses, it actually you can turn the clock back to when I was a finance broker because I was arranging commercial debt and other financing vehicles such as factoring facilities in commercial mortgages for businesses and the financial crisis of 2008 occurred. And what happened was a lot of the companies that I was going to get money for my clients, they went out of business during the financial crisis. And I realised that I had to make a change. And one of the things that I had seen so often when I was doing finance brokerage is people were looking for money to purchase businesses and the deals were not being put together in a proper way. And the people who were trying to broker the deals didn't know what they were doing. So we had people like, real estate agents trying to put together deals to buy a business. And they didn't understand how to put it together properly. That they didn't understand the financing. They didn't understand operating capital or how to treat things like no outstanding liabilities with respect to gift cards or gift certificates or how to treat inventory, that kind of thing and so deals are being put together improperly and people were ending up with bad deals and so seeing that need in the market, I decided I would become a business broker and I joined up with an international business brokerage company and the reason I chose them is because they gave me access to training and so I'm on the east coast of Canada in a province called New Brunswick and I was the first person ever in New Brunswick to be certified as a business broker and so I was able to bring a higher level of professionalism to the trade here in New Brunswick and in my business brokerage, I did that for three years. I sold 36 companies for other people and so I was very successful as a business broker. But what the story doesn't tell you is that the cash flow of that business is terrible. When I was a business broker, I was basically earning a commission from the business seller when the business was sold and even though I sold 36 companies in three years, there were three different periods, some of them up to nine months long with no closings, so imagine for nine months you're spending money on rent your office, staff advertising the budget at home and no money is coming in at the top and so it was very stressful and if you look at my photo online, you'll see that I have grey hair on the side of my head and all of this grey hair comes from that time of my life.

Jack HM Wong:	05:23	I see. Thank you for being honest because there is always the other side of the coin. Some entrepreneurs like to just show the good side and never revealed the site and thank you for being honest to me. That is a true character of a successful entrepreneur - being able to stay vulnerable and tell the truth, so thank you for that.
David Barnett:	05:40	It all culminated it actually in a very stressful time. At the end of 2011, I had 6 deals lined up that we're going to close and they were going to bring me a quarter of a million dollars in commissions and by the time the year ended one of those deals fell apart because a bank rescinded a funding letter, so they had promised to make a loan and then they pulled back. A second deal fell apart because a franchisor treated the buyer disrespectfully and the buyer back to the deal and a third deal fell apart because it was a regulated industry and the government agency which regulated that industry wouldn't issue a license to the buyer. And so three of my six deals fell apart and it had nothing to do with the buyer, the seller or me, and that's when I realised I cannot plan a future in an industry with all of these forces that can create problems for me. And so that's when I got out of business brokerage. It was almost a year later, my phone kept ringing. Jack. People were calling me

because I had built a reputation for helping people buy and sell businesses and my phone kept ringing and finally I said to someone, "look, you know, I'm not a broker anymore, but I can help you." I'll have to act like a consultant, and so and that's how I eventually started working as a consultant. It began as a side hustle and then within a year became a full time thing and now I've been doing it for almost three years and I work with largely people in North America, UK, Australia, and a lot of that is driven by my YouTube Channel and some of the things that I do online.

Jack HM Wong: 07:29 So you do have a very interesting story to share. At the same time, I realise that how you started your consulting business and what you're doing right now is the result of demand coming in because you have built a few over the years, the reputation and people understand you. People know your capability and that's how you do what you're doing right now.

David Barnett: 07:52 So I was gonna say that the other interesting thing is that when I was a business broker, my business model was based on me earning commissions when I sold a business for someone and the whole time I had that office, there were people that would come and talk to me and they would learn about buying and selling businesses and then they wouldn't do a deal with me and so I wasn't able to earn money from those people. And what I realised later is that was the market trying to speak to me. These were people who were trying to learn and it was only later after I got out of business brokerage when my mind was opened to understanding a different way that I realised that people don't necessarily want someone in the middle who takes a piece of the deal. People want guidance and advice and they're willing to pay for it. In much the same way that you go to an accountant for help with your tax forms or you go to a lawyer for help with a contract. People will pay for competent advice. And so my business today is simply based upon people coming to me to help them through the process of either buying or selling their businesses.

Jack HM Wong: 09:14 That is why I said in my consulting business and I can totally relate to this because you just hit the nail of the thread where I'm actually doing tax consulting and if I want to just provide tax filing services to my clients, the proposition doesn't last long for one reason because any CPA can do the job easily and with less cost. So why do they need me? So for us as consultants, one of the challenges I am facing in the early part of my consulting business is how I stand out, how I add value so that my clients appreciated with what I did so that they would be willing to work with me at the very trustworthy level. And that's how I can command a much higher consulting fee as compared to an ordinary consultant would have charged. So running a consulting business initially wasn't easy. I mean to grow it is already quite difficult, but to stand out in the intense competition because I bet that we have so many people doing similar things in our industry, so the question is how we stand out, how we make ourselves distinguishable, and how to gain the trust and confidence from our clients so that they decide to use us. These are always the challenges. Do you see these kind of things happening in your industry?

David Barnett: 10:30 What I see in consulting in general though is I see a lot of people out there who call themselves consultants, but really what they're doing is they're being freelance workers, so maybe they're in the computer industry where they're doing programming and they're just working for an hourly rate, and so there's not really much there that makes them any different from an employee, just that they're temporary, and so what I've often had to show people, what I implement in my own consulting practice is I create products. And products are treated very differently in the minds of a client. Here's one of the big things. When you hire someone to do a service, typically they do the service and then pay them. Right? But if you go to a shop to buy an item, you pay the shopkeeper, and then you take the item, and so if you can create products that people see value in, they'll buy the products, you end up with no receivables. You end up with being able to specialise to the degree where you can do the same thing over and over again for people very efficiently, and it means that even though you're delivering great value for the customer, it's taking less and less of your time actually deliver the end result.

Jack HM Wong: 11:55 That's right. It's a very interesting concept because in the accounting industry primarily, I don't see a lot of these productisations. I mean happening, at least from my Asian perspective, I didn't see much. It's still a very intangible activity which does require consultants to go to the companies spending that time and charging based on time costs. So I heard you loud and clear that the above, to your definition is not really the consultants that you are talking about.

David Barnett: 12:28 Yes, because once you can create a product, then you can create a procedure. Here's our desired deliverable. And once you get this organised and here's the biggest thing of all, Jack. Once you get all that organised, you can then teach somebody else how to do it and once you can teach somebody else how to do it, now you have scalability in a consultant practice, which is the thing that so many people have trouble getting to, you know, they do work for other people and the only way they can grow is by having other people with the same skills and knowledge come in and do the same work. And then they start working off of a spread. And that business model is the exact same business with the auto mechanic shop where you pay a certain amount for labor and they're paying the mechanic less and the owner of the shop is trying to make his living off the difference. And the problem with that is that you're skilled. People can always just leave at anytime and you end up with turnover problems and your business may have value, but the only value that's there is in the work that you have booked for the future and if you were to sell a business like that, the buyer is to insist that you stay on to realize all of those contracts, when they're going to tie and they're going to tie the value of the business to that effort.

Jack HM Wong: 13:56

So this is like you cannot leave the business even though the business might have been sold to the other person. You are not replaceable. It is the worst nightmare because when I first started a consulting business, my own definition of consulting business is OK, I provide consulting services to my clients and I always found that at the end of the day, wow, I'm so busy with my work because like you said, it's really like trading time for money is no different from working in a, you know, from as employee versus working as a freelancer and it is only like in the last two, three years. I started realising one thing, i.e. well, I can't keep on doing what I'm doing, so I've started creating templates for my own tax consulting work and these templates are based on my experiences that work and that has proven results and I started actually teaching clients how to implement these templates. So it's kind of like I'm selling a product with my coaching and my training to empower my clients to be able to use them. So to me I do not need to spend a lot of time like before and the clients feel empowered and they feel that Jack is actually doing something unique because other consultants won't do that. So to me, I only came to this realisation in the last two years because it's not an easy thing to do. How on earth where we can create product is I work for that? Are we talking about there wearing your running consulting services. It is not easy.

David Barnett: 15:26

You're talking about creating a system that other companies can apply internally. What was great about that kind of thing is that it becomes a product that you can license to people. You can sell it on for an annual fee for example, and you can show people, if you implement my system, this is the expected outcome for you. The savings and the fee of course is much less than that, so you you get an advantage and if they ever decide the other road and they don't want to do it any more then you can take it away from them and so It creates this long-term relationship. It's not just a relationship with an accountant, it's a relationship with you. Right? And that repeatable subscription revenue, that's what's going to give your business true goodwill value because a buyer who comes along and buys your business, they're going to acquire that intellectual property because of the subscription revenue attached to it.

Jack HM Wong: 16:29 While we are really providing a service, but we still have to understand at the end, the impact on productisation and one thing that just struck my mind was that products can mean something that is an intellectual property, it is a product which you can license for a fee or you can actually start as an asset. Whichever way it will free your time. You don't need to worry about continuing trading time for money like before, so that's really the next phase for every consultant who is listening to this episode right now. You've got to understand that if you don't do what David has mentioned, you are forever working like a slave. It just a matter of you are working in a different environment, but you still own the job. This is a very loud and clear message to those consultants right now. When you're struggling, when you find that you're so busy, you have no time for other things, this tip itself from David is really like a diamond. So thank you for sharing this piece with us. It's really impactful. and honestly for me, I can speak from my own experience. I didn't really know this kind of productisation. It's just like by chance that in the Singapore culture, the people here in Singapore for some reasons are very systemised. It's partly because this is how the country is built by our late Founding Father, Mr Lee Kuan Yew. And he likes systems. He likes people to follow certain rituals or paths so people are so used to this thing about systemisation, about following step-by-step processes, so I just say, Hey, if you talk about system you people like system, people like to follow certain steps, would it be possible to implement some of these things in my consulting business and that's how I got this "AHA" moment two years ago and I've found that people are very receptive to this and that's how I started doing more and more of this. Without that realisation, I will probably be doing like how i first started in this business, i.e. trading time for money. It doesn't work that way. So this is how my story goes as to how I come up with all these templates as products. I want to talk about the key theme of this interview - because you talk about helping consultants to sell their business, so in the first place when you helped clients to sell their business, why exactly are the buyers looking for in the businesses?

David Barnett:	19:01	Buyers are only looking for one thing when they buy a business. They are looking for cash flow. They want to pay money to you in order to secure a stream of revenue for themselves, and so what that stream of revenue looks like is different based on different kinds of businesses. So if you're talking about a little corner shop, you know, which has always done the same level of sales for many years and has always produced the same cash flow. People will will agree that the cashflow will likely continue even though you don't necessarily know your customers. They're just people from the neighbourhood that stop in to buy things. When you get into more professional services, then the relationship becomes more important. An extreme would be a construction company where the value of the business at any one time is really based on the book of contracts that they have coming up because if there's no new contracts beyond the next year then no buyer is going to be willing to see that there's any more money coming in. So it all depends on how likely it is for that stream of revenue to carry on into the future. So if you have established clients that are repeat clients, that is the most reliable form of cashflow. So an accounting office that has a book of clients where people have been coming, you know 90 percent of the clients come back every year for tax services and things, this is seen as a very reliable source of revenue, but if you're just working time for money, then there's not a great margin in it. Right? And so, so that magnitude of that cashflow is going to be quite small. And so therefore the value of the business will be quite small. If you can create an advantage, for example, if you license your system that people use internally in their companies and once you teach them how to use it, it takes very little of your time to support, now you're talking about a stream of revenue with very little cost associated to it, so you've got a high gross margin revenue stream or product where people subscribe to it. Now you're talking about both are secure revenue going into the future, which is also a high margin revenue and that is very attractive to a business buyer and it's going to earn you not only a bigger price but a higher multiple of the cash flow because the more secure the cash flow seems to be, the less risky it is, the higher the multiple is going to be when somebody puts a price on that business.
Jack HM Wong:	21:39	That's very interesting. It's all depending on what type of business as we are talking about. Like I am familiar with the accounting and the tax services. This is where I came from. We always like to put a lot of values on this thing called the client's database, If you have a very huge database and that produces revenues consistently, that in Singapore terms, can come command a decent valuation to start with, so this is something that I can attest to. So talking about the other part of the

transaction which is the seller, I mean at what point the seller will consider that the business is ready to be sold. What are the steps for the seller if let's say the owner of the business right now is thinking of letting go of the business one day. At what stage of the business can the owner say, OK, "I'm now ready for this business to be sold." Like at what point can the seller think that way?

David Barnett: [22:33]

Well here's the interesting thing - people think about retirement and people also think about maybe making a change. When I owned my business brokerage though, the top reasons that people came in looking to sell their business were these. The number one was burnout. So someone's overwork themselves. They become bored of what they do. And if a person had a job that they no longer liked, what they would do is they would go find a new job and then they would quit their job they didn't like and they would move on. But when you own it, you can't do that. You need to sell it because a lot of your family's wealth is going to be tied up in that business. After that came poor health. So a disappointing visit to the doctor who tells you that you need to move on or become less active or maybe you have an illness, then comes divorce. Then comes relocation.   And so we're seeing more and more in North America is we're seeing a successful entrepreneur who's married to another person who maybe is a very successful employed person, so maybe they're a military officer or a doctor or something like this. And if that successful employed person gets transferred than the business would be putting up for for sale because the couple wants to stay together. And so we've got poor health, we've got burnout, we've got divorced, we've got relocation and the last one was retirement. So out of the top five reasons that people ended up wanting to sell a business or needing to sell a business, only one of the five is planned for. The other 80 percent of the time, people were not planning with their business. And so that's why it's so very important when you are building your business, you need to get these things in place. Systems, processes, procedures, products in place, as soon as you can because you need to be running your business at all times as though it might go up for sale because the things that can push you to need to sell your business are sometimes things that you never expected.

Jack HM Wong: [24:54]

This is a very important point. As one of my coaches actually talk about one time. I remember that was in 2012, about six years ago. He said that the reason why I start my business is to sell it at certain point in time if I choose to. So that means your business must be structured in such a way that it can be sold one day. So, how do you do it? Systemisation and putting all processes in place is important. It doesn't matter what business we are talking about. All businesses are a result of people and systems. So systemisation is very important.

David Barnett: 25:30 Yeah, it's critical and people, customers put value in systems. And the one thing that I point out all the time is the fact that, you know, McDonald's does not produce the best hamburger. Everybody knows this, but what they produce is the same hamburger over and over again. And so when you're traveling to a new town and you're not familiar with the restaurants and you want something to eat, people will choose the expected over the unknown. And that's why they walk into a place like McDonald's because they know what it's going to taste like even though it's not the best.

Jack HM Wong: 26:19 This is a very interesting because in America, whenever I go to America and the time is 10:00 PM, there's no where else I can find food. The only two places I always go to are McDonald's and Dennys because I know how it tastes like. This is confirmed and I will not be very surprised. And yes, the food quality is OK but at least I know how it tastes like. I'm totally with you. And the questions that I have in my mind is that like for the buyers when they look for buying a consulting company, and you mentioned that the buyers are looking for a cash cow, I mean looking for income stream, have you got any experience in your assignments in the past like the buyers were able to raise capital because recently I'm a big fan. I wanted to study more on this thing about raising capital is like I want to buy a business. I don't want to fork out my own cash. I want to raise capital first to fund the purchase of the business. Like what can the buyers do to raise their finances so that they are able to pay for the business.

David Barnett: 27:30 When you buy a business, money always comes from two places - from you and from the seller. And in some instances it comes from a third place which would be a bank or you could also put other investors into that category. So this is one of the big things that a lot of people aren't familiar with - because a successful business will have a certain component of its price being goodwill. This is the value of that cash flow. It's not tied to tangible assets, which means that a bank is not going to make a loan unless there's some sort of government guarantee program. So in the United States they have something called the small business administration which guarantees these loans and so in that country people can actually borrow against goodwill. But here where I am in Canada, it's not the case and in most of the world it's not the case. So if you buy a business and there's some equipment and machinery, a bank might lend you a certain percentage of the value of that machinery, maybe 50 or 60 percent of the machinery. So as a buyer you put some money down and the bank will maybe advance a little bit of money and then the seller is asked to finance the balance, which means that the seller has a vested interest in the success of the business. And this is really critical because the buyer often wants or needs the seller support through training and transition, and so now the buyer and seller, after the deal closes, they both have an interest in the success of the business. If you buy a business and you pay all cash, this seller now has no interest in helping you as he's already got his money and he's going to walk away. So I have a little bit of experience through stories. I met a business broker from Hong Kong once and he was telling me that in Hong Kong, very few of the sellers are willing to do vendor financing. And as a result, what happens is that the buyers will only agree to a price that takes into account all possible risks, which means that the businesses are sold with a risk discount. What the sellers don't understand is that by not financing part of the deal, they're eroding the value of their own business. The value of anything is underpinned by the availability of financing. I always say, you know how many $40,000 cars will be driving around if there was no such thing as a car loan and the answer, it's far fewer because very few people will save for much time and then write a big check for a car. It's much easier for a person to say, OK, I'll pay $500 a month versus saving money and writing a check. People value the money more when they save it up. Right? And a lot of people don't have the ability to save it up. They need those financing terms. So if you can't borrow money to buy a business, then the value of the businesses themselves will start to decline because no one buys and sellers will often say, you know, if they're going to sell 100,000 dollar business and the buyer wants them to finance, the seller will say, well, we just need a buyer with more money. It doesn't work that way because the people who are trying to buy 100,000 dollar business are people that have $25,000 and they're trying to use that leverage to buy the hundred thousand dollar business. People with $100,000 don't want the hundred thousand dollar business. They're trying to buy the $500,000 business, right? Everyone wants to use leverage to get something more. It's the same reason why people use mortgages when they buy a house. They put a down payment and get a much bigger house and they'll use the bank's money as leverage to get the nicer home. So the vendor financing component is critical because it also provides a method or for guaranteeing that the buyer can trust the seller in all of his disclosures before the sale, because of vendor financing often includes a clause which says that the note or the debt is subject to offset in the case of a material misrepresentation or undisclosed lien. So if the seller is lying to the buyer about important information and the deal goes through, then the buyer has recourse because they can then go after the seller for damages and guess what? They can offset the amount that they owe them in the future, which creates an incentive for the seller to be honest and trustworthy.

Jack HM Wong:	[32:28]()	I enjoyed this conversation because to me I can say this, - Jack fully understands what David is talking about because from my background, I understand all these lingos. In my old firm, I was involved in millions of dollars of M&A deals so I fully understand that. I'm just wondering like for the SME business owners, do they really understand this kind of conversation? I don't know. How do you feel?
David Barnett:	[32:54]()	I think that they do because when they come across this information, it makes a lot of sense and they understand me really why it makes sense for them as a buyer to set up a deal in this way and the sellers also understand because you know at first glance the sellers often say, well, it's risky for me to lend money to a buyer, but when they realize the position that they're in, then I'll give an example of what can happen if a buyer is not successful and make the payments to the bank or to the vendor, what that means is that the vendor can then foreclose on them and take the business and you don't forget the seller receives all the money from the down payment and all the money from the bank loans. So the seller has received, in most cases a big portion of the overall amount of money and it usually takes a few years before things go bad. So they've also received payments on their note and if they want to, it's not an obligation. It's an option to seller. The seller can foreclose on the buyer and take the business back. What that means they get to take the business back and they can build the business backup again and sell it again. So in a worst case scenario for the seller, which is a default of the buyer on his note, who the seller can actually come out further ahead being able to scale the business twice. And so when buyers and sellers are both brought up to speed on the reasons why we structured this way and what the advantages and disadvantages are for both, it makes sense. And so in all the deals that I've ever worked on, there only ever been one cash deal ever. It was, there's only been one and it was because the business was marginal, it wasn't very profitable and the purchase price was basically an amount of money for the machinery and the inventory. So there was no goodwill or just anything like that. So that was a cash deal. Every other deal I have ever worked on, has had the vendor financing some part of the deal and it's to give security to the buyer that they're not being lied to. And I often say to

people that if a vendor refuses to do any kind of financing, it means one of three things that either means that the seller simply ignorant of how businesses are sold, which they may be right, because people don't sell businesses everyday. Or number two, it means that the seller has no confidence in the buyer. They they don't leave the buyer's capable of running the business or working for three. It means that they know that they are being misleading and that they're giving incorrect or the remitting something important in your disclosures and reason to or reason. [inaudible] are both very good reasons not to buy a business, and so I tell people, if the vendor is not willing to finance some part of it, it's the biggest red flag you can ever notice out of business.

Jack HM Wong:	36:01	It's very useful tips and information and thank you for sharing. So, towards the end of the show, I always ask my guest to share with our audiences the most favourite quote. So David gave me this one and he said, "You can ignore reality, but you can't ignore the consequences of ignoring reality!" So how does this quote apply to you?
David Barnett:	36:29	I see it all the time when I look at the financial statements of businesses, people will be in a business and they will ignore certain indicators that show that they're not doing well. From your accounting background, Jack, you've probably seen some of this before. So they will pretend everything's going OK. You know, they'll continue to take the same salary and what you look at as you look at a series of balance sheets, for example, where the long-term debts are going down because you know, the bank has been amortising that. But the short term liabilities are increasing over the same period over a period of time. The person keeps taking the same salary. They keep treating the business as though everything is OK and one day, so they're ignoring reality and then one day all of a sudden you know the credit card is declined and this is the consequence of ignoring rally and you can no longer ignore it at that point because the consequence now is real and a crisis is usually what ends up happening because somebody has been ignoring the facts
Jack HM Wong:	37:33	Yes, and sometimes it may be just too late to salvage the situation.
David Barnett:	37:33	Unfortunately, sometimes. Yeah.
Jack HM Wong:	37:47	Thank you for sharing your insights. I have learned something about the true consulting business and this thing called "vendor financing concept". Yes, I was aware but I could not explain the way you did. Thank you for enlightening me. For people who are

interested in knowing a bit more about your services and yourself, where can they go to check this out?

David Barnett: 38:07 Well, the number one place on the web to learn more from me is that

http://www.DavidCBarnett.com. My blog site, and from there they can find hundreds of articles and videos and links to my youtube channel and links to the sites where I talk specifically about buying or selling businesses or the work I do. I do help people systematised businesses as well, and then I have an online course that speaks specifically to that challenge.

Jack HM Wong: 38:40 I am sure that my audiences would love the systematisation part because most of them actually know the concept, but if you ask them to implement, they get stuck. They do not know how to do that. It's very typical and that's why guys like you are here for a good reason. So I truly want to thank David Barnett once again for sharing with us his insight and experience on this show, and that concludes this episode of the Cracking the Entrepreneur Code podcast show. I will continue doing my best to bring to you another successful entrepreneur who would share with you his insights, his wisdom and his experiences to enable you to take your business to the next level. So thank you very much for listening and your host, Jack Wong, is signing off now.