



Selling Disruption™ Show

With Mark S. A. Smith

*Built to Disrupt:
Designing a Disruptive Business*

John Warrillow

Mark S A Smith: Our guest today is John Warrillow, who wrote the book *Built to Sell: Creating a Business That Can Thrive Without You*, without a doubt, one of the most frequently given-away books that I offer to entrepreneurs. He also wrote the book *The Automatic Customer: Creating a Subscription Business in Any Industry*, and he is the founder of the Value Builder System, just absolutely perfect for creating disruptive companies run by disruptive people. Welcome, John.

John Warrillow: Thanks, Mark. Good to be here.

Mark S A Smith: I'm so delighted to have you on the show. I was introduced to you through a mutual friend, Rob Nixon...

John Warrillow: Oh, sure.

Mark S A Smith: ... who has brought you in, and he says, "You really need to get to know John's stuff." I bought *Built to Sell*, sat down and read it in one sitting on an airplane. Just that easy to read. It really impressed me. I think that you've really outlined what entrepreneurs need to know to create a salable business. Part of being disruptive is creating something that can be sold so that you can cash out and make some money. How did you get into this business of teaching people how to build a business to sell?

John Warrillow: I've been involved, I guess, in four startups. My last one was sold to a public company, so I've sort of been around the selling of companies for a while now. A lot of business owners go through the process of building a company and kind of defer the decision to sell it, thinking, okay, when I'm ready to retire, I'll sell, or when I get to \$10 million in revenue, I'll sell, or when I've got 100 employees, I'll sell. These sort of fake milestones that we put in front of us. Whereas, what I've seen is the most valuable companies, almost from the get-go, are started with the view that they're building value. Whether the owner wants to sell immediately or in 20 years, they're making decisions with the lens of building value.

I'll give you just a very specific example for that. If you're an owner and you want to build a very profitable company, you, the owner, would probably do the selling, because you know your product the best. You're the one who's got the contacts. You're the industry expert. You're the guru.

Mark S A Smith: That's exactly it. Most owners are the folks that do the rain-making.

John Warrillow: Exactly. While that would make your business larger, because you do more selling, and more profitable, because you wouldn't have to hire sales people, you would be, at the same time, destroying the value of your company.

Mark S A Smith: Yes.

John Warrillow: Value often competes with growth, and that's one of the big lessons I think we have to learn is that, for most of us, we've grown up in business thinking our

report card at the end of the year is our top-line revenue. Or, perhaps, for some people, their bottom-line profit. I'm a believer that you've actually got to overlay the value of your company as the ultimate in report card every year. What's your company worth?

Mark S A Smith: That value is a fantastic way of pulling the levers to create something that you can sell. Let's talk a little bit about this value competes with growth. I think that's a real challenge for a lot of people. They'll say, "Hey, I need to grow. I need to make more money," so they put all of their time and effort into building their company. Of course, it's all them.

John Warrillow: Yeah. Let me give you another example, a woman I just interviewed on my podcast, a woman named Stephanie Breedlove. Stephanie had a payroll company, and it had a unique niche where they were paying nannies. Busy couples don't have the time to do all the paperwork for the government filing, et cetera. They would hire Stephanie Breedlove's company, which happened to be called Breedlove, to pay their nanny. She hit \$300,000 in sales a year, and she reached a fork in the road where she said, "How do I grow?" She had two roads. I think every business owner reaches the same fork in the road, by the way. I could, A, cross-sell, which every pundit says, "You've got to cross sell. You've got to cross sell." She could have cross sold. What do busy parents need? They need snow removal services. They need garden services. Sometimes they need cooking services and so forth.

Mark S A Smith: But that's all a distraction.

John Warrillow: Yeah, exactly. She did the hard thing, which was continue to do the one thing that she knew better than anybody else, which is how to pay nannies, so she found more people with nannies to sell. The faster way to grow her company would have been cross selling. The more valuable way to build her company was to sell her payroll service into other families.

Mark S A Smith: Okay, stop for just a second here.

John Warrillow: Go ahead.

Mark S A Smith: I think it's really important that my listener gets what you just said. It could be faster to grow the company, but way more valuable if you figure out how to create the value so that you could sell it. Let's stop for just a moment, listener, and say do you want to grow your company, or do you want to make your company more valuable for a future sale? With that in mind, John, carry on.

John Warrillow: Before I give you the punchline of the Stephanie Breedlove story, let me just set up for folks, put yourself in the shoes of an acquirer. When an acquirer goes to buy a business, they've got a buy or build decision to make.

Mark S A Smith: Yes.

John Warrillow: On one hand, they could build what you've created. Don't, for a moment, think that Amazon or Nike or Starbucks or Google don't have the money, bandwidth, wherewithal to build what you've built, whatever.

Mark S A Smith: There's never a doubt.

John Warrillow: There's someone out there that put five engineers in a room for a week and they can build what you've built. They can, A, build it or they can buy you. Well, if your company is based on essentially cross selling services for which you are not differentiated, for which you're competing on price, they're going to rightly make the conclusion that all we need to do is go into this market, price ourselves 10% below the market rate for whatever product this is, and eradicate the competition. Everybody's been trained to buy on price.

Mark S A Smith: Not going to happen, and no, they haven't been trained to buy on price. John, what is the only thing you buy solely on price? What is it?

John Warrillow: Virtually nothing.

Mark S A Smith: Virtually nothing. Even if a gas station down the road was selling it for two cents a liter cheaper, since you're up in Canada, you may not make the drive because it's not worth the dollar to take the drive.

John Warrillow: That's right. What you want to make sure is that your company is not essentially selling on price, because if it is, an acquirer's not going to be interested.

Mark S A Smith: That's right.

John Warrillow: What Breedlove did was she said, "No, we're going to do payroll for nannies, and it's going to be harder for us to find clients. It would be easier for us to cross sell, but we know that we have a unique niche. We are differentiated on selling this service to parents with nannies." The punchline of the story is she went on to sell that \$9 million company, meaning \$9 million in revenue, for fully \$54 million.

Mark S A Smith: Wow.

John Warrillow: Six times the top line. You know, from looking at valuations of companies, it's ridiculous, off the charts. Nowhere on the chart would you sell a small \$9 million business for even one times your top-line revenue is doing pretty well. She got six times her top-line revenue.

Mark S A Smith: What that implies is that she had a valuable system. Not just customers, but something that could scale and create extraordinary value, and it's recurring revenue, the things we all love way more than transactions.

John Warrillow: Yeah, well, you want to be disruptive.

Mark S A Smith: That's why we're here.

John Warrillow: Yes. Here's what she did. She looked at an industry and said, "Okay, I'm going to sell my company. Who can I sell it to?" She looked at the caregiving industry. Remember, she's in the business of paying caregivers, paying nannies. She said, "Who else is in the marketplace that's in the caregiver space?" She came across this company called Care.com. Care.com is the Angie's List of caregivers. You plug in your zip code, and it will give you a list of vetted, peer-rated nannies and elder-care workers in your local market. At the time of the acquisition to Breedlove, Care.com had seven million subscribers. Seven million parents with either kids or parents themselves to basically care for and pay the people that they needed to care for them.

What Breedlove did was she went to Care.com and said, "Look, you've got seven million members. I've got 10,000 customers. If 1% of your seven million members buy my payroll services, that's 70,000 customers, meaning my business would be seven times bigger in your hands. If 10% of Care.com subscribers were to buy Breedlove Payroll Services, it's 70 times bigger." That's how Care.com got their head around spending six times revenue for the business, because they could see how disruptive it would be if they were to buy Breedlove.

Mark S A Smith: Beautiful. What a fantastic disruptive example of bringing two things together to really create something extraordinary. Now, you must get a lot of interesting stories with the Value Builder System podcast.

John Warrillow: Well, we just love talking to entrepreneurs about their exit. Every week, I talk to an entrepreneur, and I say, "Describe what it was like to sell your company. What were the pitfalls? What were the surprises? What were the gotchas that really threw you for a curve?" We try to decode that. We're trying to be the entrepreneur's Robin Hood. We're trying to be out there defending them against that legion of corporate buyers and private equity vultures who really prey on the naivety of business owners. There are people who buy companies for a living, and most of them do it all day long. We, as owners, get to sell usually one business once. We're way outnumbered, way outmatched against these, frankly, corporate mercenaries who come in and try to buy your business. If you look at a private equity company and you look at its mission statement, basically it is to buy low and sell high.

Mark S A Smith: Arbitrage, yeah.

John Warrillow: Right. Guess who they're buying low. You.

Mark S A Smith: Us.

John Warrillow: You don't want to be the Ponzi in that scheme, but most of us, I think, want to get fair value when we sell our company. Our mission in life, as a business, is to fight the good fight, to even up the playing field for business owners and say, "No way. You're not going to take advantage of these people who are the engine of the economy." The people that run the foundation of the economy today are

being completely screwed, in many cases, today, and so we're out to change that.

Mark S A Smith: What do you see as the biggest mistake that business owners make when it's time to sell their business, other than looking at growth versus building value?

John Warrillow: It's probably falling for a prop deal. A prop deal stands for a proprietary deal, which means that a buyer, be it a corporate or private equity company, has identified you as prey. They basically approach you and say, "We want to buy your business." They lull you into a false sense of security, because they wine and dine you, say how wonderful your company is, how wonderful you've done as an entrepreneur, and they get the hook in. They might write you an offer that implies a full value they're willing to buy your business for, but they ask for what's called a no-shop clause when they make you that offer. Which means you sign a letter of intent that says, yes, I'm agreeing to sell my business under these terms for these conditions, and you've got six weeks to do your due diligence.

Well, if they've got a proprietary deal, they know that over that six weeks, they're going to manufacture reasons to lower the price. They are going to manufacture reasons to delay the closing so that six weeks becomes 12 weeks of due diligence. You're worn down, and you agree to a price that's 20, 30, 40% lower than what they'd originally offered you, because they know they've got a proprietary deal. There's no other competition in play. That's probably the biggest mistake I see entrepreneurs make.

Mark S A Smith: What's the antidote to a prop deal?

John Warrillow: Create tension for your deal. In other words, create a marketplace for your deal. Generally, it means hiring some sort of M&A professional business broker, someone to be your representative. Their job is to create competitive tension, get more than one bidder. Even just the illusion of another bidder in the sidelines helps make ...

Mark S A Smith: Always.

John Warrillow: ... buyers more honest. That's really their role, is to get competitive marketplace, get a number of bidders at the table so that they can look into the eyes of the other side and say, "Yeah, you can play those games, you can delay due diligence, but the moment the no-shop clause is up, we're walking, and we're going across the street to your competitor. If that's the game you want to play, have at it."

Mark S A Smith: It seems to me that a lot of small business owners, or even larger business owners, might resist the idea of using a broker, because they're going to have to pay a commission. What you're suggesting is that commission is going to be a fraction of what's going to be stripped out if it's a prop deal and they wear you out.

John Warrillow: Yeah, absolutely. Let's just take, for example, a typical prop deal, a business worth 10 million bucks. An M&A professional, to sell a business with \$10 million of value, is probably going to charge you 400 grand. \$300,000 to \$400,000, maybe \$500,000 if they walk on water, but generally, it's going to be around 400 grand. So, you're left with \$9,600,000.

Mark S A Smith: Right.

John Warrillow: If you get suckered into a prop deal and you agree to a \$10 million letter of intent, that is going to melt to probably 8.5, 8, 7.5 by the end of the due diligence period on your prop deal.

Mark S A Smith: Wow.

John Warrillow: 15, 20% is very common.

Mark S A Smith: Wow.

John Warrillow: So now you're left with eight. You're being penny... What's the old expression?

Mark S A Smith: Penny wise...

John Warrillow: Penny wise, pound foolish, yeah. M&A professionals cost a lot of money. They wear fancy suits, they drive nice cars, and they make a ton of money. Are they worth it? In my opinion, yes.

Mark S A Smith: That's really extraordinary advice. Now, another issue that I know for a lot of folks who are selling out is the earn-out clause. Let's talk about that for a moment.

John Warrillow: Sure. An earn-out is essentially where you agree to accept some form of payment for your business in the future, contingent on you hitting certain goals, generally, in the future. Let's just take a typical \$10 million deal, where 60% is upfront, 40% is on an earn-out. They'll say to you, "Look, I want to buy your business for 10 million bucks. We're going to give you \$6 million upfront, and the other four million is contingent on you hitting the following goals," and the goals are generally tied to EBITDA, profit essentially, or to top-line revenue growth. Could be customer retention. The entrepreneur hears, in their mind, the 10 million number, but what they've got to remember, the only number that's guaranteed is the downstroke, which is the front payment. The six million, in this case.

An advertising agency, for example, you might have as much as 70% of the sale of your company tied to future performance. You might get a deal that says, "We think your business is worth 10 million bucks. We'll pay three million for it upfront, and the rest of the seven is available to you over a five-, six-, seven-year earn-out.

Mark S A Smith: Which means you're taking all the risk. They're taking no risk.

John Warrillow: Exactly.

Mark S A Smith: You just sold yourself a job.

John Warrillow: Exactly, and one where you're not the boss anymore. You're reporting to a regional manager, who's reporting to a district sales manager, who's reporting to a vice president. You have no control. The CFO and the marketing people and the divisional people don't talk. Try to get things done.

Mark S A Smith: John, that sounds like hell.

John Warrillow: Well, that's what we try to avoid. For folks that go through Value Builder, we try to make them get the highest proportion of their offer upfront. It's not always going to be 100%, but we try to get the majority of the offer upfront with a minority in an earn-out. That way, you could always walk away. If things get untenable and you just can't deal with being an employee seven layers below the CEO, then you can walk, because you got 80, 90% of your cash up front. That's possible if you figure out how to get your business to be not dependent on you. The biggest reason buyers use an earn-out, of course, is because they deem your business to be too dependent on you personally.

Mark S A Smith: Right.

John Warrillow: So that gets back to the beginning of our conversation, where it's about, yeah, you can do all the selling yourself, but if you ever want to sell this company, no one's going to buy it unless you're sticking around for five, seven years.

Mark S A Smith: Yeah, unfortunately, in my business today, that's the way it is. I am the business. I'm in the process of changing all that. A lot of people I know are the business. Without them, the business wouldn't run. That's got to change.

John Warrillow: Yeah, I agree. The biggest secret I found in trying to make the transformation from being an owner-dependent, owner-rainmaker company to being one where you can hire salespeople is doing what Breedlove did, which is a fundamental head shift for a lot of entrepreneurs, which is to sell fewer products to more people.

Mark S A Smith: Yes.

John Warrillow: Most of us, as entrepreneurs, grow up selling lots of things to a few people, and the most valuable companies do exactly the opposite. They find one or two things they can dominate, and they go out and find lots of people who want that product. That's when you can hire salespeople, because salespeople thrive on repetition. If you're doing way too many things, they just don't have enough repetitions to get it right. You're changing it on them. You're customizing it for every second customer, because you're the industry expert, and you can make

the changes on the fly. They're not. They're generally not the industry expert. They rely on systems and repetitive sales scripts, especially for transactional sale. You've got to give that to them, and that means really focusing on fewer products, selling it to more people.

Mark S A Smith: One of the things that really struck me about the book Built to Sell is the concept of widgetizing the product. You have a whole chapter, if not a couple of chapters, talking about how you have to create a system that you can hand off to a salesperson that they can be successful selling. That idea of widgetizing the product was quite an insight, especially for people that are doing intellectual property type of products like I am.

John Warrillow: Well, in particular, I helps in service companies.

Mark S A Smith: Yeah.

John Warrillow: In a service business, if you don't productize that service, name it, make it look and feel and sound like a thing as opposed to a service ... In a service business, you're left as the customer evaluating the service provider. Do I like him? Was his breath bad? Do I think he's going to show up on time? Did he dress well? Does he have the right reputation? Did he go to the right school? How was his diction? All these things, you're left trying to interpret the person, the human being across from you. Whereas, if you say, "Look, here at XYZ Design Firm, we offer the five-step logo design process, and it's worked for companies from Google to Nike to Disney, and it'll work for you. It includes five steps. Step one is this. It takes 12 minutes. Step two is this, and it takes three weeks." You productize the service so that a salesperson can say, "You don't have to believe me, the salesperson, or evaluate my diction. Look at the thing we're selling. Look at the credentials, the testimonials, the proven methodology." That's productizing a service, and if you don't do it, they're left trying to interpret you.

The way you know you haven't productized very well is you find customers asking for references. They'll be like, "Yeah, I like what you have to say here, but do you have any past customers I can talk to?"

Mark S A Smith: That's a really interesting insight.

John Warrillow: They're trying to figure you out. They're trying to analyze you personally. Is he a nice guy? Would I like working with him? As opposed to the thing. The thing's proven. Once you've productized your service and made it the way you describe it, widgetizing your service, then you can make the case of how it helps. The Value Builder System, as an example, we've gone out and quantified that when you start Value Builder, the average score out of 100 is 59, and the average offer those businesses is getting is 3.6 times their pretax profit. For our customers who go on and improve their Value Builder score, get it up to 80 or greater, the average offer they're getting is 6.1 times pretax profit, or 71% higher than the average performing business. That's not do you like me or do you believe in what I have to say or did you read my book. It has nothing to do with any of that

squishy, soft service stuff. It's like here's this system. Do you want a piece of that? Yes or no?

Mark S A Smith: Let's talk a little bit more about the Value Builder System and how our listener can get connected with that and start learning more about how they can do that to disrupt their business so they can make themselves a lot richer when they sell it.

John Warrillow: We start everybody out by completing this 15-minute questionnaire, which gives you a score on these eight drivers of company value that we've, again, validated now through 30,000 different businesses. We look at how they go on to sell, what values they get, what offers they get. We've got framework. Again, there are eight drivers. These would not be a surprise to you, Mark, if I told you what the drivers are. It's things like how dependent is your business on you personally as the owner, ...

Mark S A Smith: There it is.

John Warrillow: ... a topic we talked about already. The growth potential of your business, because buyers are looking, in many cases, to buy your business to grow, so they want to know that you haven't tilled all the soil, you haven't gotten all the market share that's available. Another big one we haven't talked about, but it's a really biggie for a lot of us, is recurring revenue.

Mark S A Smith: Yes.

John Warrillow: How confident can the buyer be that the business will continue once the owner hits the golf course or the beach? Recurring revenue is one of those ingredients or, to your point, anecdotes to an owner-dependent business. If you've got recurring revenue, acquirers generally really like that.

Mark S A Smith: Yeah, recurring revenue is definitely one of the magical elements. Since you're going through the list, give me a couple more of the value drivers.

John Warrillow: Yeah, sure. We call one the valuation teeter-totter, which relates to the child's playground set. Essentially, the value of your company goes up as the cash a buyer will need to eject at closing goes down. If you have a positive cash flow cycle and you can demonstrate to a buyer they don't have to write a big check for working capital, that's going to help improve the value of your company. Another one's called the Switzerland structure, named after the country of Switzerland, which, as you know, has this fanatical obsession with independence. The companies that score well on the Switzerland structure are independent of any single customer, employee, or supplier. You want to make sure you're not too dependent on any one of those three stakeholders to maximize the value of your business.

Financial performance is a biggie, obviously, so revenue, EBITDA, profitability. Another one is the customer score, which relates to how satisfied your

customers are with your business. A lot of times, a buyer will actually do a customer satisfaction survey as part of their due diligence. They'll try to figure out how satisfied your customers are, so that's another biggie.

Mark S A Smith: That makes sense.

John Warrillow: The other one is the monopoly control. You've heard Warren Buffett talk about the fact that he buys businesses a deep and wide competitive mode, so they've got that competitive differentiation. It gives them more pricing authority. They're not in a Coke/Pepsi battle where they're just competing on price. With pricing authority, they can actually invest more, because they get better margins. They can invest more in sales and marketing, and that thickens and widens the mote. It creates this sort of domino effect, where if you have the courage and, frankly, discipline to pick one thing and truly differentiate, become the world's best company at paying payroll for nannies, for example, then you become differentiated on that front. People aren't now comparing you to ADP. If you've got a nanny and you want to pay them, you go to the company that that's all they do, and if they charge a little more, well, that's fine. You've got more pricing authority. You've got more to invest in marketing and sales and so forth, and it creates a domino effect.

Mark S A Smith: Very cool. What you just outlined is really the eight elements that generate disruption in a marketplace.

John Warrillow: Interesting.

Mark S A Smith: The more of those you have in play, the more disruptive you can become. Whether you realize it or not, John, you have the disruption formula in play right here, right now, that people can measure themselves against in a very strategic, but very practical, way. It's extraordinary.

John Warrillow: It's getting lots of results for the folks who use it, so we're pretty happy with it, for sure.

Mark S A Smith: And so are they. So, how can our listener get plugged in to the Value Build System?

John Warrillow: Go to valuebuilder.com and get your questionnaire completed. Get your score. It's free. It doesn't cost you anything to get your score. It takes about 15 minutes. Just go to valuebuilder.com.

Mark S A Smith: With that, my friend, you can find out how well you're doing in generating and creating a disruptive business. Now, on the other side, my suggestion is dig into this if you're in a business of building a business so that you can be strategic and intentional about how you go about doing it. I think that John's books are must-have. You've got to read his books if you're going to be doing this. Then, get connected with Value Builder so that you can keep track of how well you're

doing in your path to creating a business that you can sell, retire, and then buy me a beer and buy John a beer and we'll tell stories.

John Warrillow: Sounds like fun.

Mark S A Smith: John, thanks for being a great guest. Any final comments as we head out to the end of the show?

John Warrillow: Great pleasure to be with you. Again, if you want to be disruptive, it's counterintuitive to think about it, but value can often be the enemy of growth, and revenue doesn't necessarily mean you're building the value of your company. That's one of those big head space shifts for a lot of us, but I think it can be fundamental, that if you focus on the value of your company, almost above all else, you will end up with a net result you're pretty happy with.

Mark S A Smith: I love it. John, what a disruptive conversation. What a delight to have a conversation with you in person after reading your books. You are definitely a disruptor in the marketplace, and thank you for sharing your wisdom with my listener.

John Warrillow: Thanks, Mark.