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In Search of a Perfect Business

"People wish to be settled; only as far as they are unsettled is there any hope for them."
- Ralph Waldo Emerson

The post-COVID weekly poker game was a gesture in that direction; a cultivated plot of wildness within the garden of each character's life. During these nights, Bill, Bob, Jim, Mike, Tom, and Harry could feel reckless and rebellious.

The friends gathered to discuss what was bothering them at work and let out some steam. Sometimes, they let fantasy take over, imagining themselves as business owners and entrepreneurs, like overgrown boys on a treasure hunt.

The Perfect Problem

Our story begins one Thursday night when Jim started talking about problems at his company. The pizza had arrived and the guys were taking a break during the game. They all went quiet because Jim seldom shared work issues.

He was the maintenance manager at Zebra Print Graphics (ZPG), a large printing company that produced magazines, periodicals, journals, and community newspapers. The printing machines only made money for the company when they were running. Apart from the setup time for each print job, there was no way to predict when the machines would grind to a halt because of paper jams, the ink was not spreading properly, or the bearings overheating till they corroded, bringing the whole operation to a standstill.

ZPG had spent millions fixing the first two issues. Now most stoppages were caused by problems with the bearings. The machines had so many moving parts including thousands of bearings in many different locations.

Jim was tasked with finding ways to save costs and boost machine speeds. He explained that one of the biggest costs was the 24/7 standby crew for when the machines stopped. Jim figured these unexpected stoppages were caused by dirt in the bearings and overheating. However, he reckoned that if they could fix these two issues, the company could then run the presses at higher speeds — like the newer machines in the market — and avoid equipment replacement for another three to five years.

Moreover, the company would save on crew costs.

At that point, Tom joined in the discussion because he was working on fixing a similar problem using predictive software for an oil pipeline business. The customer kept ignoring the problem because it involved battles between different department heads, who always ended up blaming each other. The situation had become toxic, so the company had decided to contact Tom's employer, CrossArrow. He explained they had re-framed the problem after a discovery interview.

"What do you mean?" asked Jim. "How do you do that?"

The Perfect Solution

"By shrinking the problem," explained Tom. "When the bearings fail, the oil flow stops, so we decided to figure out all possible reasons for the failures. It could be due to poor quality bearings, the wrong lubrication, or poor assembly, which allows dirt to get into the mix.

"The real problem for the oil pipelines was not finding a cheaper fix for the oil flow problems but to anticipate the issues and fix them before the interruption," he said.

"So how did you fix it?" asked Mike, who worked at Randall Web, a ZPG competitor, twice its size, with a focus on printing magazines. Mike remembered having had similar discussions with Randall Web's operations manager.

Trial and Error

“We did tests to eliminate the quality of bearings as an issue,” Tom explained. “Then we focused on better assembly to stop dirt getting into the mix. Once we had eliminated those issues, we were left with lubrication.”

Then he talked about the software program he had developed to measure the bearing temperature, which affected the flow of oil and ultimately the speed of the machines.

“It became a trade off of how long the bearings would last at different temperatures,” Tom said.

“How did you deal with this trade off?” asked Jim.

We introduced a third variable: various lubricants,” said Tom. “We wanted to see which one kept the bearings from overheating, hence extending their life. Over time, we built a model that predicted bearing failure rate for different types of lubricants at different run speeds and varying resistance levels for the various materials being printed. Then, we could schedule maintenance and save the company the cost of a 24/7 crew.”

“Are you still working with this customer?” asked Harry.

“Yes, we run predictive models for them to schedule maintenance visits,” said Tom. “Hmm… I will look into that. Thanks,” said Jim.

Finding Opportunities in Unexpected Places

Week after week, as they listened to Jim and Tom chat during poker nights, Bill and Bob started exploring the idea of investing in a business that did not need to grow large.

They thought that the projects their friends had discussed could evolve into a combined venture that would fit their quest of finding the perfect business.

Bill and Bob had known each other for a long time. They would often have lunch on Fridays, following the Thursday night poker game.

Bill worked for Family Partners, a group of high net worth families that invested in private companies.

Bob worked as a financial investment advisor helping wealthy customers invest in the stock market. He had been great at sports while at school, playing professional hockey for a while.

Bob had started out playing on the lakes with friends during winter, because his father did not sign him up for hockey lessons until he was seven. Because the rest of the players on his team had been skating since they were four, Bob was only able to catch up when he turned 12. But by then, he was the star player on most teams. He had lasted eight years as a professional hockey player, until a knee injury put him on the sidelines. After that, Bob had joined his father's investment advisory firm and had helped double the size of the business using his hockey contacts to secure clients.

However, he wasn't happy being in the family business because he could not see his father handing over the reigns unless he died. Bob also didn't find investing clients' funds in the stock market very challenging. That's why he had slowly become more interested in investing his own money in small private companies. This transition had brought him closer to Bill, who had been frustrated for years by many of the financial tools he had learned at business school, and during his years in investment banking, because they were of little use in helping private companies expand.

People were not as rational as financial and economic models required them to be. Many of the planning tools were developed for oil companies and other related resource companies. These models had been reliable, until the oil crisis. Most of the competitive analysis tools assumed steady growth for welldefined industry sectors. Bill needed tools that could be updated quickly to handle business growth and cope with companies that operated across several industries and used technology-based platforms.

Bob was a perfect sparring partner for Bill for these discussions because the former had taken many accounting courses after his hockey career had ended.

Bill's mother was a CPA in a small accounting firm, and she had hoped her son would join her practice. He was frustrated because the accounting formats were great for bankers and tax agencies but of little value to business owners. Bill found he learned more by talking to company executives and industry leaders, than by diving deeply into financial statements. He thought he was better at reading people than numbers. Bill saw profit as the blunt instrument that could be distorted by balance sheet items, such as debt levels, taxes, and capital expenses. Two companies with the same operating profit could show different accounting profits because of different balance sheet structures.

Novice vs. Serial Entrepreneurs

In his time working with investment families, Bill had also discovered the differences between novice and serial entrepreneurs and how the two looked at business opportunities. The former would fall in the startup category, and the latter would start a business, build and sell it, and then repeat the process.

Some of Bill's and Bob's early discussions regarding the features of a perfect company were around investing in a startup that would be the next Google or Microsoft.

As they researched tech startups, they realized the risks were too high. During the early years, these companies often went through a phase when the strategy changed after each phone call. The learning curve for these novice entrepreneurs was so steep that most became overwhelmed and ran out of funds before they could get the business to reach a critical mass to ensure survival.

This trend told Bill the merits of becoming a portfolio entrepreneur. This type of investor does not sell a successful business but uses surplus funds to acquire and operate several private companies.

The Perfect Company Size

Bill and Bob loved talking about the idea of finding the perfect business for investment, as they were both disillusioned with the regulations, costs, and short- term focus of many public companies.

While helping his investor clients, Bill had noticed that after some private companies got to a certain size, they did not need to grow more to stay profitable.

“Imagine finding a business with a niche too small to attract competitors but with the ability to sustain a few large customers, who can pay a high price for a premium service that is a lot cheaper than having their own 24/7 standby maintenance crew,” he said to Bob one day.

“I like it!” exclaimed Bob. “It would be a small private company that does not have to grow much and can throw off great cash surpluses for the owners to take out of the business each year and enjoy a great life and maybe only sell the business when they die.”

“What if Tom’s idea of offering a service to a large company, updating the model and scheduling maintenance, develops into an ongoing revenue relationship?” Bill added.

“That’s a good thought,” said Bob. “We need a business that can solve a similar problem in other industries. We could have someone like Tom service the companies so the business does not need to grow very large, maybe up to 35 or 40 employees in all.”

“Maybe we should order another bottle of wine with lunch?” smiled Bill.

Several weeks later at poker night, Tom asked Jim how he was doing with his bearings problem. Jim's face lit up. He put down his cards and started to explain.

"Let's finish the hand first," suggested Harry.

"Right," said Jim, picking his cards back up.

"Remember Tom talked about shrinking the problem?" he began, after the hand had finished. Everybody nodded.

"Right, so we currently use a cheap oil lubricant, " said Jim. "But I have been experimenting with a new smooth-running grease formula, which is more expensive, but it has other benefits."

"Tell me more," said Tom.

"I have only done a few tests, but it seems the formula significantly lowers the bearings' temperature compared to the cheap oil lubricants," said Jim. "The bearings last longer and the company can run the machines at a higher speed. The challenge is that the grease is more expensive per litre. But it's worth it given the results."

"What about the predictive software that Tom was talking about?" asked Bill. "I am already working nights with Jim on a prototype," explained Tom.

"Where is the pizza?" asked Mike, seemingly disinterested in the conversation.

At lunch the next day, Bill remarked to Bob how Jim's project was slowly bonding the poker players together in a new way.

"It is amazing how projects bring people together," responded Bob. "It seems the only man on the outside at the moment is Mike."

"It is also interesting how Jim does not think about asking us or Harry for help to figure out the value of his proposal to advance his case with his boss," said Bill.

"Also, Tom did not ask for help to work out the benefits of his predictive tools versus the costs of repairs," continued Bob.

A few weeks later, Mike was the one to speak up during the poker night, which he usually spent telling jokes and stories about hockey or baseball players. That evening he started sharing challenges at Randall Web, which was going through some layoffs.

“Our revenues from some tech customers are now double their normal levels but the food and hospitality industry customers have suffered a lot, so the demand just never recovered to pre-pandemic times,” complained Mike.

He said that had put him under a lot of pressure to grow sales. But it seemed all he got were (1) calls to cancel orders, (2) businesses that could not pay, and (3) requests for discounts. Mike said his gut told him the company should increase prices by 20%. Then, even if they lost about 20% of the customers, the bottom line for the company would be better. But when he had raised the idea with the president, he was ignored.

“What is your current profit as a percentage of revenues?” asked Harry.

“We had revenues of about $100 million and our profit before tax is around $10 million so that means our profits are around 10% of revenues before COVID-19,” replied Mike.

“Ok, now what are your margins after direct costs?” asked Harry.

“That would be 25% — why?” asked Mike.

Harry did not respond. He pulled out his phone and did some calculations. After a few minutes, he put some numbers on a piece of paper and handed it to Mike.

“You’re right, Mike,” Harry said. “With revenues down 30%, you are getting $70 instead of $100 in revenue. If you increase prices by 20%, the revenue goes from $70 to $84. Your profit before tax goes to $16, which is higher than the $10 profit. With the higher price, even if you lose 20% of customers, your profit before tax goes back to $10 — magic.”

	Pre COVID		Now		Plan (20% price increase)		Plan (20% drop in volume)	
	$	%	$	%	$	%	$	%
Revenues	$100		$70		$84		$67	
Direct cost	$75		$53		$53		$42	
Margin	$25		$18		$31		$25	
Margin %		25%		25%		37%		37%
Overheads	$15		$15		$15		$15	
Profit before tax	$10	10%	$3	4%	$16	19%	$10	19%

The profit can be protected!

“Thanks,” said Mike. “Mind if I show this to my boss?”

“No problem,” replied Harry.

“After listening to Mike and Harry last night, I think we need to make sure our perfect company is unique enough so it can raise prices if needed without losing too many customers,” Bob remarked to Bill at lunch the next day.

“Good point,” replied Bill, who was keeping a running list of criteria for their perfect company.

The Treasure Map

A few weeks later, Jim announced he had developed a treasure map.

“What are you talking about?” asked Bill, as the guys started to eat the sandwiches and salad that Harry’s wife had sent along to poker night.

“Hold that reply Jim, I want to hear about the treasure map,” said Mike, as he got up to receive chicken and fries from the delivery guy.

“Thank goodness,” said Bill. “No offence Harry, but my wife has me on a diet during the week, so tonight is my only cheat night.”

“We will probably finish it all,” laughed Jim.

“So where is that treasure map?” asked Harry, bringing everyone back on topic. Jim explained that because he had not had any formal business training, he did not know the right business terminology, but his treasure map was a way he could visualize the solution to his problems.

He took out a piece of paper and put an “X” in the middle of the page. “Here is the treasure,” he said, pointing to the mark on the island.

“We are here in a boat trying to get to the island,” he explained. “What is the treasure?” asked Harry.

“It’s the formula we need to solve our bearings problem,” said Jim. “It’s a combination of the lubrication I am working on and the predictive software model that Tom and I are working on.”

“Why is the treasure on an island?” asked Bill.

“Because right now, it feels like we are on a boat going round and round the island but haven’t landed on it yet,” Jim said. “Even if we did, it would take time to find the treasure. Then we need to keep the treasure safe so others can’t take it. We also need to find a way to sell the treasure bit by bit to have a long and happy life.”

“I get it,” said Mike. “We have so many competitors these days that as soon as you launch something new, they re-engineer what you have done and come out with a cheaper version, undermining all your efforts.”

“Come on guys, Tom has the most treasure on the poker table and we need to clean him out before we go home,” joked Bill.

At lunch the next day, Bill and Bob reflected on Jim’s treasure map.

“Our perfect company needs to offer something that is hard for competitors to duplicate but not so hard to develop that they run of out resources before finding the treasure,” said Bill.

“If the company only sells software, then we need to know the inventors are taking advantage of a window of opportunity to build something with a long shelf life,” replied Bob.

“You think Tom’s predictive software is a solution on its own but it may be short lived once other predictive models are available?” asked Bill.

“Imagine if Jim finds the right formula for the lubrication and can keep that a secret for long enough, then the combination of the lubrication with a software model may be the treasure we need to live a long enough life,” said Bob. “We can live like rich pirates till we die.”

“Maybe we are getting closer to the perfect company?” said Bill, as he took another sip of wine. “I really like this Pinot Grigio. It tastes less sweet than the Chardonnay we had with lunch last week.”

“I am no connoisseur, but I’ve been told Pinot Grigio has a higher acidity level,” said Bob.

A few weeks later, even before the first hand of cards was dealt, Harry asked Jim how his treasure map was coming along.

“I was thinking that we need the treasure to be small enough so it doesn’t attract too many pirates, but be big enough so we can live very comfortably for ever,” said Jim, mirroring Bill and Bob’s conversation.

“Once you have found the treasure, how are you going to dig it up and ship little bits to market every day and find customers willing to pay you a fair price for it?” Bill chimed in.

“You know, that is a good question,” Jim responded. “Tom and I were thinking we should sign multi-year deals with customers so we only need to leave the island a couple of times a year to check on them. If COVID-19 taught us anything, it is that working remotely is the new normal. We need a good broadband system on the island so we don’t have to spend most of our days sailing from port to port. We want to have the luxury to spend most of the time on the island enjoying life.”

“In your dreams,” said Harry. “All of my customers who have built successful businesses work crazy hours and never see their families. That is what you have to do.”

“We want to find a way to have our cake and eat it, too,” said Tom. “We want a business where we make lots of money and have lots of free time to do other things.”

The next day, Bill and Bob invited Charlotte to lunch. She was the owner and manager of a very successful cleaning and restoration company.

Charlotte had started with the company as a summer intern while she was studying for a science degree. She loved chemistry and helped the company transition some of its cleaning products to more environmentally friendly versions. When she graduated, she joined the company full time in the estimating department. Charlotte had taken project management and accounting courses to better understand how to estimate damage claims. She helped the company automate its packages and helped digitize the process.

Over time, she had approached Bill’s family office to help her buy out the owner.

The transaction had worked out well and in 10 years Charlotte had increased the size and profitability of the business to a point where she had been able to position the company for sale. She knew the business landscape was changing and the insurance companies were trying to cut out middlemen like her business. Charlotte was willing to sell the business and take some time off to be with family, but she also wanted to take on a new challenge in due course.

She was one of three female business owners in a portfolio of 30 companies owned by Family Partners, which now had equity positions in 50 private companies, 10 of which were run by women.

Bill spent many hours with Charlotte helping hire her replacement in the cleaning and restoration company and cashing out her remaining interest.

"You know, I spent 20 years working crazy hours to grow a business and barely had time for family and community projects," Charlotte said. "In my next venture, I would like to run a business that is very profitable and only needs my attention a few days a week. I want to run a business that doesn't have an all-consuming need to grow. One that takes a wider perspective than just securing quick profits; a venture that gives me the free time and resources so I can also help my community grow."

As they were walking out of the restaurant after lunch, Bob remarked to Bill, "I think Charlotte would be interested in Jim's treasure map."

"Hmm," said Bill, "but does she play poker?"

"I heard that," laughed Charlotte. "So are you guys going to teach me how to play poker?"

At the next poker night, Bill asked the guys how they would feel if a new person, who had never played the game, joined poker night?

There was a long pause. Eventually, Harry started to ramble, "Look, to master poker — as a social game — you need to learn to sit in both chairs. When we first started, Tom struggled to get this concept and we took him to the cleaners for weeks."

"Once I realized that playing poker is pretending, I started to adopt a series of personas: the guy slow playing a well-hidden full house, or brashly representing a flush when all he had was a pair of sevens," chuckled Tom.

"Yes," Harry continued, "it seems like you become a combination of champ, sucker, and at times a bystander. Sometimes skill is rewarded; sometimes hubris is punished. Sometimes a player, especially Bill, seems to get away with murder!"

"What?!" exclaimed Bill. "I have been wiped out many a night by you bandits!"

"I just know that as the night progresses the games get crazier and the pots get bigger," joked Harry. "Jim's and Bill's cries of excitement and Tom's and Mike's howls of frustration keep my whole neighbourhood awake. If it gets any worse, I may have to insulate my garage from the noise, so you guys don't wake my family."

Bill and Bob took that as a no and didn't push the matter further.

A few weeks later, before the guys had even taken off their jackets, Jim yelled out, "We have given it a name!"

"What are you talking about?" asked Harry.

"We have given the treasure island, I mean our new business, a name!" shouted Jim.

"I don't understand," said Mike. "I thought you were going to get your boss to try your new lubrication and Tom's predictive model and get rid of the maintenance crew."

"Yes, I tried that, but it didn't work," said Jim.

"What do you mean?" asked Mike.

"The boss let me use the new lubrication and agreed to hire Tom's company to provide the predictive model, but they won't get rid of the maintenance crew," said Jim.

"Why not?" asked Mike.

"My boss's pay is partly based on the number of people in his department, so getting rid of the maintenance people means his salary will be impacted," said Jim. "And his nephew is also on the crew."

"Why do you care?" said Mike.

"My bonus depends on saving money, and unless they get rid of the maintenance crew, it impacts my bonus," said Jim.

"What are you going to do?" said Harry.

"Tom and I are planning on starting our own business," said Jim.

Mike smiled, "How are you going to land customers?"

"We will hire a sales guy to do that," said Jim. "Want a job, Mike?"

"Maybe," said Mike. "I got my boss to implement the price increase using the paper Harry gave me."

"That's good news, isn't it?" said Harry.

“Great for my ego, but not my bonus,” said Mike.

“What do you mean?” asked Bill.

“My bonus is based on sales, not the bottom line,” Mike said. “As per Harry’s example, our revenues dropped from $100 to $70 and then after the boss implemented the changes, the sales dropped to $67 but because of the price increase the profit was back to $10. Great for the shareholders, but sucks to be a sales guy on commission.”

“By the way, Jim, what is the name of the new company that you and Tom want to form?” asked Harry.

“Fast Lube,” said Jim.

There was a long silence. The guys were not sure whether they should tease Jim about the name or just let it pass.

“Nice name,” Bill said, “I need to get home guys. Can we make this the last round?”

At the next poker night, Jim explained, “We have worked with Harry to figure out that if potential customers spend about $3 million a year on lubricant oils, the standby crew, and replacement of machine parts, we can provide the same service for $1 million with Fast Lube.”

“Wow, that pitch would get the attention of our president and finance people,” said Mike. “Maybe Randall Web can be the first customer for Fast Lube?”

“What about the problem of getting rid of your maintenance crew?” asked Bill.

“We don’t have a maintenance crew on staff,” said Mike. “We outsourced that to Kwik Fix several years ago.”

Know Your Numbers

“How much money do you need to get Fast Lube up and running?” asked Bill.

“Not sure,” said Jim. “I figure we need enough to cover salaries for Tom and myself, and maybe Mike if he joins us, plus office costs until we have our first paying customer.”

"I think you need to spend some more time with Harry running some numbers because I don't think you've given this much thought," said Bob.

"Harry, are you up for the challenge?" asked Jim.

"Sure, now can we get back to the game? I am on a winning streak," said Harry.

At lunch the next day, Bob expressed his concerns to Bill about how unprepared Jim, Tom, and Mike were going into business together. The two financial experts reflected on the various investment options available for the Fast Lube trio.

The Perfect Investment

Family Friends and Fools

Fools are grouped into this category because of the risk associated with lending or investing in a seed venture. Generally, these individuals are not sophisticated investors; rather, they fund foolishly or by following whimsy. Many novice entrepreneurs think the bank will lend them money or angel investors and venture capitalists will be falling over themselves to invest in their idea. For most novice entrepreneurs, finding an appropriate/suitable investor is a journey from hell. It's one that makes or breaks them. They either give up or in most cases find help only in family and friends. Research has indicated that each year between 35% – 40% of startup ventures receive capital from friends and family.

Crowdfunding Investments

The good news is that about half of the crowdfunding efforts by startups are successful; the bad news is that these campaigns are most effective when they are raising small amounts of money — usually less than $10,000.

Angel Investors

This category of financiers typically provides about $25,000 per investment, often through Angel networks, which bring together several investors that contribute about $200,000 to $300,000. Sometimes, they provide additional funding, but it is often 15 years or longer before any of these investments yield a good return. Bob's father belonged to an Angel network that received about 20 applicants a month but invited only two startups to make presentations. Most members of the network invested in only one or two of the 20 they reviewed each year.

Venture Capitalists

Both Bill and Bob had a good understanding of the world of venture capitalists, too. The two friends often attended conferences and chatted to folks in the big money world. These investors were usually looking at thousands of opportunities a year and giving several million dollars in each early stage company they chose as the benefactor. Even then, the venture capital firms seldom had a home run with more than one in 10 investments.

‘Both angels and venture funds will want to know (1) what the company does, (2) where is it going, (3) how are they going to get there, (4) how much money they need, and (5) what do they get in return for their money?’ thought Bob. ‘That may not work for Jim, Tom, and Mike, since they don’t seem to have their numbers in order.’

Loans

‘Loans are bad news for startup companies but great for established businesses,’ thought Bill.

Bankers charge interest rates of 3% to 8% for most loans and venture capitalists and angel investors look for returns that are 10 times the investment. A banker cannot afford to lose too many loans but angels and venture capitalist only need one in 10 investments to work to get the returns they seek. Bankers want guarantees and collateral to protect their loans, unlike angels and venture capitalists, which are focused on protecting their equity investment to participate in the upside. Research shows that about 75% of novice entrepreneurs expect to be successful but only less than 50% of novice business owners will still be running the same company in the few years following the launch.

The Perfect Debt

The two would often have discussions on how much debt should a perfect company have. Some of the business owners in the portfolio companies in Family Partners did not like debt, even if it meant more equity to run the business. It took a lot of persuading on Bill’s part to show them that having some debt would help replace some of the equity they needed in the business and improve their returns on it.

During the COVID-19 pandemic, when interest rates had been very low, Family Partners had helped its portfolio companies take on debt facilities supported by the government, even if they did not need the money, to prepare for possible cashflow issues in the future. This helped because banks do not like to lend when interest rates are low.

Bill showed Bob the one-pager he had used to convince his clients that some debt is good debt.

(millions)	Big Debt Inc.			No Debt Inc.			Explanation
Income Statement (Profit & Loss)	(ROE)			(ROE)			
Revenues	$20			$36			No Debt Inc. has more revenue and is a bigger company
Direct costs	$4			$18			
Gross margin	$16			$18			
Expenses	$12			$12			
Profit before tax	$4			$6			Big Debt Inc. is more profitable
Interest	$2			$0			
Operating Profit	$6	$6		$6	$6		Both have the same operating profit
Balance Sheet							
Assets	$40			$40			
	$20			$20			
Debts	$20		$20	$0		$0	Big Debt Inc. is more risky
Equity	$20	$20		$40	$40		
	$40		$40	$40		$40	
Return on equity (ROE)		30%			15%		Big Debt Inc. provides a better return on equity
Leverage (% debt to equity)			50%			0%	Big Debt Inc. has a higher risk

Bill thought investors would like Big Debt Inc. better than No Debt Inc., because Big Debt Inc. had a higher return on equity (30%), even though (1) they had the same operating profit, (2) Big Debt Inc. had lower revenues than No Debt Inc., (3) both companies had $40 in assets on their balance sheets, even though both funded their assets differently, and (4) Big Debt Inc. has to pay $2 in interest payments, lowering the profit before tax, while No Debt Inc. has no interest payments.

On the other hand, Bob had seen what could happen when companies had too much debt: banks would force them to re-structure. The shareholders would lose control of their company because banks appoint monitors and receivers to retrieve the money. Many of these companies were quickly sold to competitors at big discounts or liquidated because the receivers and monitors didn't know how to run companies. He could understand why many business owners did not want any bank debt.

Bill was also disappointed by the finance courses he had taken, as they focused on the tools that helped public companies invest surplus profits back into the business. These courses did not spend time talking about how to improve profitability by looking at operations. Bill had realized that there were no finance courses teaching how companies could find and weed out unprofitable customers, reposition pricing or assess the advantages of outsourcing some services, rather than hiring more staff.

“Should we keep quiet and let these guys work it out themselves or should we offer to help?” asked Bill.

“Let’s see if they figure out how much runway they need to properly launch this business and how each of them will fit into Fast Lube,” said Bob.

At the next poker game, Jim, Tom, and Mike were very quiet. After the first few rounds, Bill asked, “What’s happening with Fast Lube?”

“When I ran the numbers with the guys, it looked like a nice business, but it is going to take longer and need more cash to get started than they first thought,” said Harry.

“Is money the only issue?” asked Bob.

“No, it is also our spouses,” said Jim, sheepishly. “They don’t want us to quit our jobs.”

“Is Fast Lube dead before being born?” asked Bill.

“We were hoping Mike’s company would be our first customer, because they don’t have to get rid of a maintenance crew as they already outsource this service,” said Jim. “However, we are bogged down because Mike’s IT department wants to deal with Tom, and I have to deal with Randall Web’s operations manager. I still have my day job and I can only meet with the operations manager after hours and on weekends, which makes things more difficult. We really need someone that can reach the president or the chief financial officer to get this idea of the lubrication and predictive maintenance package as a total solution.”

Business Basics

“Even if Jim and Tom get the okay, they don’t have a vehicle to invoice the company,” said Harry.

“You mean they need to form Fast Lube as a company and then invoice Randall Web once they land the service?” asked Bill.

Yes," said Harry, " it does not make sense to form a partnership. A company structure offers legal and some tax protection for both."

Tom jumped in, "I have to be careful because my company offers a diagnostic and predictive maintenance service to oil companies and they don't know I am talking to Randall Web. Also, the outsource company, Kwik Fix, is getting suspicious because of the questions Randall Web's operations manager is asking to help Jim fully scope out their lubrication issues."

"You guys can be fired if your employers find out you are doing this behind their backs," said Bob.

"What do you suggest?" asked Harry.

"Well, first thing's first: why don't you set aside a day when Jim, Tom, Mike, and their spouses can get together and work this thing through?" suggested Bill.

"Do you and Bill want to join us?" asked Jim.

"You guys should use Harry's help to turn your treasure map into a full plan and think through all the pros and cons, and write down what you want to do and what you need," said Bill. "Then you can bring in Bill and I to help you review it."

"Are you willing to help us, Harry?" asked Jim.

"Sure," said Harry. "Now can we order takeout from that new Indian restaurant? I am starving."

The next day, Bill and Bob invited Charlotte to join them for lunch. She had received the payout from the sale of her business, and Family Partners had also sold its interest in the company. Charlotte was already talking to several company owners, who wanted to sell and retire. Most owners wanted too much for the business and most businesses were not in great shape to sell.

Bob was keen for Charlotte to invest some of her payout in the stock market. Bill wanted to see if Charlotte wanted to join his family office as an investor instead of being in a management role with one of the investment companies.

Bill and Bob wanted to get a better understanding of what types of businesses Charlotte was looking for to invest her money. As an icebreaker to get to know Charlotte's business needs better, Bill and Bob decided to share their mutual quest for the perfect company with Charlotte. She was intrigued by the idea and their insights into Fast Lube.

It was almost two months later when Harry got the Fast Lube guys and their spouses together to thrash out the issues. They now had their plan and wanted to test it on Bill and Bob before approaching investors.

So for one poker night, the guys decided to arrive early and not play poker but use the evening to make a Dragon's Den style pitch to the two friends.

Harry talked about the key numbers.

"Fast Lube only needs 20 customers, which would be an easy number to manage," he began. "Each customer pays $1 million a year for hassle-free maintenance, which gives Fast Lube revenues of $20 million a year."

"We have calculated that Fast Lube can operate with $6 million in direct costs, providing a gross margin of 80% compared to other companies like Regeneron Pharma, MarketAxess, Microsoft, and McDonalds that have margins varying between 89% and 32%.

"We also only expect to have overhead expenses of $6 million a year to support the $20 million in revenues, which gives a 50% profit before tax, compared to 3% – 37% for the other companies," Harry concluded, as he handed around a sheet of paper with the financial information to Bill and Bob.

(millions)	Fast Lube		Green Kleen		Market Axess		Microsoft		McDonalds	
		%		%		%		%		%
Revenues	$20	100%	$36	100%	$615	100%	$143,015	100%	$19,118	100%
Direct costs	$4	20%	$18	50%	$149	24%	$46,078	32%	$9,330	49%
Gross margin	$16	80%	$18	50%	$466	76%	$96,937	68%	$9,788	51%
Expenses	$6	30%	$17	47%	$141	23%	$43,901	31%	$3,516	18%
Profit before tax	$10	50%	$1	3%	$325	53%	$53,036	37%	$6,272	33%

Tom then presented the shareholder perspective.

The first company Tom worked for was Wizz, which started on a $500,000 angel investment and within a few months had secured nearly $15 million from a venture capital firm in a second round of financing. The good news was the business was well financed; the challenge was they hired people for the job, not people who could grow with the expansion. He did not want to work for a company with that challenge. The salaries were good but there was no bonus system or upside in terms of shares in the business. He said he left because he had outgrown his boss. They did not want Fast Lube to be like Wizz.

The second company Tom worked for was PuzzleLink. This company was funded using a small inheritance one of the founders received but as the business grew the owners took on debt from family and friends, even when the company was not earning a lot of revenue. As the cashflow issues built up, Tom and the other 10 employees worked without pay for six months but it was not enough to meet customer demands fast enough. A few months after Tom left PuzzleLink, it was sold to a more successful competitor. He did not want a repeat of that.

Tom's current employer CrossArrow, which was founded by a husband and wife team, paid well, but there was no opportunity to earn equity. Nevertheless, Tom liked having a big enough salary so he could pay off personal debts and afford to move his family to a bigger apartment.

Unfortunately, the husband and wife team split up after two years. A bitter divorce ensued, and the owners lost focus and staff suffered. Recognizing the opportunity, Tom approached Harry to find a private investor and a management team to buy out CrossArrow shareholders. It took Harry nearly nine months before he found Larry, who eventually bought the company.

Larry had got the business back on track and Tom now had shares in CrossArrow and a good salary with benefits. However, the company was so focused on the numbers, that Tom spent most of his time in software maintenance mode, rather than developing new systems. Larry had also hired his son, John, to work in the company, signaling to others that only family members were destined for promotion in the future. They did not want Fast Lube to be run by a husband and wife team or an owner so focused on numbers that there was no time to develop new products.

In essence, Tom wanted investors for Fast Lube who were willing to provide both a good salary and benefits, as well as equity and bonus and allow him to spend time developing new software models.

"Tom, this is a great story, but investors are impatient," said Bob. "You need to tell this story more succinctly during investor presentations."

"What do you mean?" asked Tom.

"Investors want to know (1) what your company does, (2) where is it going, (3) how are you going to get there, (4) how much money do you need, (5) how they can exit, and (6) what do investors get in return for giving you their money?" said Bob.

Tom said he didn't have the answers to all the questions, but he wanted Fast Lube to attract investors, who would provide a million dollars for 20% of the company.

He said he wanted 20% for himself as the tech modelling man, 20% for Jim as the idea man, and 20% for Mike as the sales person. They could keep 20% for the president of the company.

Fast Lube Shares	%
Jim	20%
Tom	20%
Mike	20%
Investors	20%
Sales person	20%
	100%

Next up was Jim. He agreed they needed to hire someone else to run the company. He wanted to earn a good living but also play with various plant-based lubrication formulations and teach chemistry part time. He also wanted to spend more time with his three children.

Finally, Mike presented his plans to get to 20 customers. He figured Randall Web would come on board within three months and that it may take six months to land the second customer. He figured they would have 10 customers in a year and reach 20 customers within 3 years.

“Would you take the business abroad?” asked Bob.

Mike said he recognized the business could go global, but he’d seen how businesses had changed during COVID-19 so he was not interested in travelling outside North America.

Bill and Bob spent several hours asking questions and making suggestions to the Fast Lube team to help improve their pitch before they approached investors.

At poker night, six weeks later, Jim, Tom, and Mike came looking glum. Each week, they had pitched to three or four investors and had either received unreasonable offers or been turned down.

Bill and Bob would try to cheer up the trio, while Harry would sit quietly through most of these weeks not sharing many thoughts.

The next day Bill and Bob invited Harry to join them for lunch. After the second sip of wine, Harry started to relax. Bill and Bob gently asked him what was going on. Harry said he had wanted to join Fast Lube but the guys had not asked him. They were happy to take his advice but kept him at a distance when it came to discussions around hiring and splitting the equity. Harry's wife was also not happy that he wanted to leave his accounting firm. He had a great income, but the work hours were gruelling. However, his wife had built a life of other interests with her book club, tennis buddies, curling friends, and their two daughters. She did not want Harry to risk a lower income or spend more time around the house.

"I guess what really bugs me, I think, is that Jim, Tom, and Mike see me as a parasite rather than a key player," said Harry.

"Why do you want to leave your accounting firm?" asked Bill.

Harry explained that his partners spent most of their time preparing financial statements and giving tax advice to small businesses. He was the only one who had branched out to provide financial and consulting advice. Harry felt he did not have a lot in common with his partners. Since COVID-19, the revenues and profits of the firm had taken a hit and he felt he would be better off financially if he became a shareholder in Fast Lube and perhaps the part-time chief financial officer.

For the next few weeks of poker nights, the group reported on pitches to investors but no one seemed interested in Fast Lube.

It came to a head one poker night when Tom broke into a rant, "People produce business ideas. People put together business plans. People come up with a sellable product. People employ other people to work for them. People make a business a success or a failure, yet all these people are tied together by numbers. Numbers in the form of payroll, numbers in the form of loans, numbers in the form of investments and more. Yet the numbers are not lining up with the people who make the difference. We are the people doing the creative work and heavy lifting, but it seems that the people who control the numbers are really just parasites, yet they want all the glory and the gold."

"I guess you see me as a parasite?" said Harry.

"Well, most financial people but not you, Harry,'' said Tom.

"Why are investors not interested in Fast Lube?" asked Bill.

There was a long silence.

"They want more equity for the money," mumbled Jim. "They want us to have a president in place and a numbers guy on the team. They don't believe our margins.They want a fast-growing business that can go public. They want us to work around the clock for the business and for low salaries if we want equity."

"Well, do you want our help?" asked Bob.

"Do you know someone who could be a suitable president?" asked Tom.

"Maybe," said Bob.

"How about the money?" asked Jim.

"Maybe," said Bob.

"How would this work?" asked Harry.

"Bill and I may know a potential president candidate, who also has some money to invest," replied Bob.

"When can we meet this person?" asked Tom.

"What if we brought this person to a poker night and you can see if there is a fit before we talk about Fast Lube?" asked Bob.

"Why not? Let's do it," said Jim.

"Ok," said Tom.

"Fine with me," said Mike.

The next day Bill and Bob had lunch with Charlotte and outlined the poker night offer. Charlotte was delighted.

"A night with the boys, this will be fun!" she said.

• • •

As the guys assembled in Harry's garage the next Thursday night, they were all nervous to meet this potential investor and president for their company. They were imagining what it would be like trusting their baby to a stranger with a cheque book and whether this person would get on with the Fast Lube team.

Bill and Bob kept smiling and winking at each other as the guys set up the poker table and got ready. It was six o'clock and time to start. Where was this mystery person that was going to join them?

Bill explained, “We want this to be a fun night. This person may or may not be a fit for Fast Lube, but it would be great practice for the Fast Lube team to test their skills.”

“What do you mean?” asked Jim.

“I will not tell you anything about this person before they’re here, because that is part of the fun for this evening in addition to playing poker,” said Bill.

“You want us to find out as much as we can about this person during the evening?” asked Tom.

“Yes, but not so it feels like an interview, but a social evening,” said Bill. “Next week, we will compare notes about this person and why they may or may not be a fit?”

“Bring it on,” said Mike. “This is like the training we used to do to get customers comfortable during the sales process.”

“Where is this person?” asked Harry.

“We asked them to come at 6:30 p.m. so we had time to get you guys comfortable with making this a fun evening,” said Bill.

“This is the gang of card sharks you were boasting about Bill?” asked Charlotte as she entered the garage.

“Welcome, Charlotte,” said Bill.

Charlotte was greeted with a stunned silence. Harry was the first to stand up and shake hands with her, while the others recovered and mumbled welcomes. The night started awkwardly, but they all eased up as they played hand after hand.

Charlotte joined Bill and Bob for lunch the next day. The three laughed as they shared stories from poker night.

“What do you think, Charlotte?” asked Bill.

“They are a great group of guys and I loved all the attention,” said Charlotte. “They were all perfect gentlemen.”

“Do you think you want to lead and invest in Fast Lube?” asked Bill.

"Give me a few weeks to think about it?" said Charlotte.

"So let's pencil in lunch, say two weeks from now?" said Bob.

"Done!" Charlotte said.

The next poker night the guys arrived, dressed a little more formally than usual.

"Is Charlotte joining us tonight?" asked Jim.

"No, Jim, we figured one surprise guest a year was enough for you guys," laughed Bill.

"Damn, I was looking forward to her company and winning back some of my money from her," joked Harry.

"Tonight, you guys to give us feedback on Charlotte," said Bob. "Bill's family office is also considering asking her to join their business, and you guys are helping us check her out."

"Well, I liked her," said Tom. "I think she got more out of us than she shared with us."

"Yep", Mike responded. "I figure she had the answers to all sixty questions on each of us by the end of the evening."

"I don't know about that," said Harry, "but she is a mean poker player."

"I think she would be a great asset to your family office, Bill," said Jim. "I think she would be great if she joined Fast Lube," said Tom.

At the next lunch with Bill and Bob, Charlotte did not mention Fast Lube until Bill brought up the subject toward the end of lunch.

"Well, if it was up to me," she said, "I would start out by hiring someone like Harry to help me buy Kwik Fix."

"Why?" asked Bill.

"As Mike explained during poker night, Kwik Fix is the consultant for several of Fast Lube's large customers," said Charlotte. "If Fast Lube got going, it would slash the standby revenues that Kwik Fix gets from its customers and it would only be needed for scheduled maintenance."

“Why not finance the start up of Fast Lube and go head to head with Kwik Fix?” asked Bill.

“Because I know how hard it will be for Fast Lube to land its first few large customers, who need a combination of IT and operations department support,” said Charlotte.

“What do you mean?” asked Bill.

“They will not get far unless they get to the president and give them a ‘return on investment pitch,’ instead of Tom and Jim pitching a ‘cost saving in departmental budgets,’” explained Charlotte.

“Why not?” asked Bob.

“With large companies, unless you are dealing with the president, you end up dealing with several department heads, and they will have others in the background second guessing them,” said Charlotte.

“You think it would be cheaper to buy Kwik Fix to get the customer base and then hire Jim and Tom to cannibalize its 24/7 standby maintenance business with the lubrication formula and predictive software?” asked Bill.

“Maybe,” she mused, “but I would first work with Harry to run the numbers to verify my gut feeling.”

A few weeks later, Charlotte emailed the key numbers from Kwik Fix to Bill and arranged a conference call with him and Harry.

Harry took Bill and Charlotte through the numbers. Kwik Fix had revenues of about $6 million and a margin of 41.7% and an operating profit or earnings before interest, taxes, depreciation and amortization (EBITDA) of $1 million. Harry used three times EBITDA to estimate the value of a small business, so Charlotte could buy this business for about $3 million. The business is paid monthly in advance by customers and so does not need a lot of working capital. It is not very capital intensive so the EBITDA and the ‘free cashflow number’ is about the same for doing a rough estimate of value.

Kwik Fix	
Revenues	$6,000,000
Direct labour	$3,500,000
Margin	$2,500,000
Margin %	41.7%
Overheads	$1,500,000
Operational profit (EBITDA)	$1,000,000
Value multiple	3
Value of the business	$3,000,000

"What would it cost to start Fast Lube and get it to an operating profit of a million dollars?" asked Bill.

"That is half of the big question," said Harry.

"What is the other half?" said Bill.

"The other half is how long would it take Fast Lube to get to that level?" said Charlotte.

"What do you think, Harry?" said Bill.

"I think Jim, Tom, and Mike think they can fund and run Fast Lube on their own and they can reach a positive EBITDA within a year," said Harry. "Charlotte and I think it could take them somewhere between three years and never."

"Have Jim, Mike, and Tom actually said they can launch and run Fast Lube on their own?" asked Bill.

"Not directly, but they have excluded me from a lot of the discussions," said Harry. "They are getting very frustrated can't find investors on their terms. That's why, instead of listening to what the financiers are saying, they are being stubborn and want to go it alone."

"Charlotte, what do you want to do?" asked Bill.

"Maybe we should kick this around with Bob?" said Charlotte.

A week later Bill, Bob, Charlotte, and Harry met for lunch. They took Bob through the dilemma and asked for his advice.

"What do you think, Harry?" asked Bob.

"Well," said Harry, "if it were up to me, I would give Jim, Tom, and Mike enough leeway to realize they are out of touch with reality. But that may not happen until they launch their business and bump their heads because I am concerned they are beyond listening to our advice."

"What do you think, Charlotte?" Bob asked.

"I would like to have Harry dig a little deeper into Kwik Fix, because having met Bruno, the owner, I get a sense he is not doing a good job running the company," she said. "Are you interested Harry?"

"Absolutely," he said.

At their lunch a month later, Bill and Bob took another look at the perfect business list.

"Charlotte is pretty sharp," said Bob. "I like her approach of moving slowly and looking at different options. I must say buying a potential competitor and then bringing on Fast Lube may be the best strategy. However, I feel badly for Jim and Tom, who have these great ideas but don't understand how business works. I worry because Mike is a classic sales guy, over promising and under delivering, which can put Fast Lube, as well as Jim's, Tom's, and his own family in a financial pickle."

During the week, Bill received an email from Charlotte with Harry's latest numbers on Kwik Fix. In a follow-on discussion, Bill pointed out that the margin for large customers was less than that for smaller customers.

Kwik Fix		Large Customers	Small Customers
Revenues	$6,000,000	$5,000,000	$1,000,000
Direct labour	$3,500,000	$3,000,000	$500,000
Margin	$2,500,000	$2,000,000	$500,000
Margin %	41.7%	40.0%	50.0%
Overheads	$1,500,000	$1,000,000	$500,000
Operational profit (EBITDA)	$1,000,000	$1,000,000	$0
Value multiple	3		
Value of business	$3,000,000		

"Harry, would you research the large customer base at Kwik Fix a little more?" said Bill. "I think there are some opportunities there."

"Sure," said Harry, "but Bruno wants to know if we are just kicking the tires or really interested in buying Kwik Fix."

"Tell him we are interested," said Charlotte. "If Bill's hunch is correct, and there is a gap in the large customer mix, it may show some hidden value in Kwik Fix."

At the next poker night, Jim brought a bottle of champagne. He didn't say why he had brought the bottle and none of the guys asked.

Eventually, as they were getting ready to break for something to eat, a car entered Harry's driveway. The car lights shone under the garage door.

"Who ordered food?" asked Bill.

Before anyone answered, Jim's, Tom's, and Mike's spouses walked into the garage bringing food. Jim reached for the champagne. "Today, we launch Fast Lube," he announced.

Bill and Bob were stunned. Harry was also caught off guard. He had warned the other two that this may happen, but he had hoped that Jim, Tom, and Mike would not go through with the idea with a half-baked plan.

The next day at lunch, Bill and Bob dissected what they had learned the previous night. Jim and Tom had resigned from their companies and joined Fast Lube.

Mike had arranged a handshake deal with the president of Randall Web to give Fast Lube their first mandate, which was a pilot project for Jim to try his new lubrication formula and for Tom to develop a model to predict failure for their machines. Once the cashflow improved, Mike would join them to help secure other customers. Jim and Tom each owned 50% of the company and when Mike joined, they would dilute themselves so they were each one-third shareholders.

Jim's aunt had died about a year ago and now that the will was probated, he had found out that she had left him about $100,000. He had decided to invest the money in Fast Lube. Tom had negotiated a six-month buyout from CrossArrow so he could use those funds to cover his living costs for the first few months of working for Fast Lube. The shareholders decided to save money and not have a shareholder agreement.

"They are like prenuptial agreements — who wants them?" Jim had told the group at poker night. He was the only shareholder putting money into Fast

Lube, but it was not structured to be repaid like a bank loan.

'They seem to have done everything wrong when it comes to protecting their downside,' thought Bill. 'These guys are so in love with the upside the business offers, they seem to ignore all the things that could go wrong.'

At the next poker night, the Fast Lube team was in high spirits. They now had a signed agreement with Randall Web and had already received their first monthly payment. Bill and Bob looked at each other but said nothing.

The next day, Charlotte and Harry joined Bill and Bob for lunch. Harry shared his latest analysis on Kwik Fix.

"Bruno has some large customers who are very profitable and are getting good margins and some very unprofitable large customers, who not only have lower margins but are sucking up most of the overhead costs because they are needy," said Harry. "If Bruno got rid of his large unprofitable customers and his small customers, who only break even, the revenues would drop in half to $3 million."

"Nice, I see where you're going," said Bob. "In its current state, you can buy Kwik Fix for $3 million. With the under-performing customers out of the way, the EBITDA with large profitable customers will be $1.1 million. And assuming a value multiple of three, you can sell it for $3.3 million."

Kwik Fix		Large Customers	Small Customers	Large Profitable Customers	Large Unprofitable Customers
Revenues	$6,000,000	$5,000,000	$1,000,000	$3,000,000	$2,000,000
Direct labour	$3,500,000	$3,000,000	$500,000	$1,500,000	$1,500,000
Margin	$2,500,000	$2,000,000	$500,000	$1,500,000	$500,000
Margin %	41.7%	40.0%	50.0%	50.0%	33.3%
Overheads	$1,500,000	$1,000,000	$500,000	$400,000	$600,000
Operational profit (EBITDA)	$1,000,000	$1,000,000	$0	$1,100,000	-$100,000
Value multiple	3			3	
Value of business	$3,000,000			$3,300,000	

"Back to Fast Lube," said Charlotte. "Based on the numbers that Jim shared with us, is it possible that Fast Lube may run out of cash in six months?"

"Seems likely," Harry said.

“If that is correct, we need to drag out the negotiations to purchase Kwik Fix until we know that Fast Lube is on the ropes,” said Bob. “Then we can throw Jim and Tom a lifeline.”

“Sounds pretty cutthroat to me,” said Bill.

“Yep, not the kind of stuff you read about in business text books,” said Charlotte.

“If Jim and Tom pull off their plan, then Fast Lube could replace Kwik Fix’s customers,” said Harry, “so Kwik Fix could be out of business in a year. This can cut both ways.”

Three months after the launch of Fast Lube, the pilot project with Randall Web was complete. Jim and Tom had made their presentation to the president and management committee.

For the next few weeks, they sat by the phone and checked emails regularly awaiting the go ahead from Randall Web to implement their proposal.

At the next poker night, Jim and Tom cancelled at the last minute. When Bill and Bob arrived at Harry’s garage they sat around waiting for Mike, who arrived about half an hour late.

What’s up?” said Harry.

“Our president had a heart attack,” said Mike. “He’s in the hospital. It does not look good. Everything is on hold.”

“Why did Jim and Tom cancel?” asked Bill.

“CrossArrow is threatening to sue Tom claiming he’s using intellectual property developed at the company to help Fast Lube,” said Mike.

“What about Jim?” asked Bill.

“Jim’s wife and kids have left him, and he was on his way to ask his uncle for enough money to keep Fast Lube going,” said Mike.

At lunch the next day, Bill and Bob spent most of the time talking about the Fast Lube situation.

Bill had reached out to Jim, who had shared that his uncle was considering lending him some money to hire Mike secure Fast Lube customers.

Jim's uncle had also said he wanted someone other than Jim or Tom to run the company before providing any loans, so Jim was thinking he could hire Mike to run the company and secure customers.

It took nearly a month before Jim's uncle provided the loan. At that time, Mike resigned from Randall Web and joined Fast Lube.

Oscar, Randall Web's chief financial officer, took over as president while his boss recovered from the heart attack, and immediately launched into another round of cost cutting. The insights from the pilot project with Fast Lube enabled him to put the squeeze on Kwik Fix to lower their standby fees with the threat that if they did not, he would go with Fast Lube.

Three months after Mike joined Fast Lube, Randall Web finally gave them the go ahead with their proposal and dropped Kwik Fix.

It was nearly nine months since the launch of Fast Lube when Jim came to a poker night with a big grin on his face. His colleagues were wondering what had happened. Was he back together with his wife and kids, or did he have a girlfriend, or what? Finally, Bill could not stand the suspense and asked Jim why the big smile.

"ZPG," he said.

"Are you going back to work for your old company?" asked Bill.

"No," Jim said. "They called because they are in trouble. The guy who took over from me seems to have made things worse. They have more production problems than ever. They want to hire Fast Lube."

"Great news," said Harry.

"What about the 24/7 crew?" asked Bill.

"We are going to hire the crew as part of the deal," said Mike.

"How does that make sense?" asked Harry.

"It saves ZPG severance for the crew, and we need to have one in place as we add more customers," said Mike.

"How does that impact your cashflow?" asked Harry.

“Not to worry,” said Mike, avoiding answering the question. “We will have new customers signed up in no time and the revenue growth of the company will solve the cashflow gap.”

That afternoon, Bill and Charlotte played a round of golf with two members of Family Partners to see if Charlotte may be a fit to join the family office. She was different from the other partners. They were retired business owners, but Charlotte wanted to get back in the saddle and run another company. She had spent a year looking and had not found a company that was a fit for her to buy and take to the next level. She had the perfect makings of a serial entrepreneur.

At poker night the next week, Tom spent a long time taking the guys through the legal wrangling with CrossArrow. Since Tom had left the company, the rest of the team had revamped the predictive models and they were getting worse. CrossArrow wanted Tom to come back to the company and when he refused, they decided to take legal action to force him to help.

Eventually, they worked out a compromise: CrossArrow would hire Fast Lube as a consultant to oversee their predictive modeling on the condition that Fast Lube would not approach any other companies in the oil industry.

A few weeks later at poker night, Jim announced that his wife was suing for divorce and wanted half of his shares in Fast Lube as part of the settlement. Jim asked Harry to help work through the numbers to find a way to pay out his ex without giving up equity in Fast Lube. The company partners did not have a shareholder agreement to deal with divorce or any other downsides.

A few weeks later, Bob and Bill met with Harry, who wanted advice on how to deal with Fast Lube. While working with Jim, Harry had spent time with Suzie, Fast Lube's bookkeeper, to pull together the numbers. Harry realized that Suzie was now dating Jim, and that made what would be a straightforward business discussion really tricky.

"What is the problem?" asked Bill.

"There is money missing from the company," said Harry.

"And you think Suzie took the money?" Bill asked.

"Not sure," said Harry. "Jim, Tom, Mike, and Suzie all have signing powers and any one can withdraw money from the bank account.

"It seems Mike is putting some of his casino night expenses through the company," he went on. "Jim is paying for Suzie's condo through the company, which is also footing the bill for Tom's fancy car. Plus, Suzie is not a trained bookkeeper so the books are a mess, which makes it difficult to prove all this is going on."

"Who is your customer here?" asked Bill.

"Technically, it is Fast Lube," Harry said. "Although Jim is the one who called me to help deal with his wife's claim on the business."

"Who are Fast Lube's shareholders?" asked Bob.

"They have issued shares to Jim, Tom, and Mike but they still don't have a shareholder agreement," Harry said. "Currently, each owns a third of the company but Jim acts like he is the owner.

"When Jim's uncle loaned them some money," he continued. "He insisted they register the loan. He has the same rights as a bank and has appointed a receiver to take control of Fast Lube, not only to protect his investment but to even bankrupt the company if need be."

"What else? "asked Bill.

"The lawyer acting for Jim's wife is also demanding details on the company and so far, Jim is ignoring him," said Harry.

Two weeks later, Jim called Bill to ask for a meeting. The former shared what Harry had told him about the business, which was now running out of cash, and the promised new customers were still not on board. Jim had asked his uncle for help only to be turned down. His dream company was disappearing before his eyes and he wondered if Charlotte would put money in Fast Lube and deal with Mike, who was now a problem for both Tom and Jim. They no longer wanted their friend as president of Fast Lube. Jim did not mention his relationship with Suzie.

"How much money do you want from Charlotte and what will you give her in return?" asked Bill.

"I was thinking she could pay out my loan and my uncle's loan and take over Mike's one third of the shares and his role of president of the company," said Jim.

"You could ask her, but I doubt she would accept," said Bill.

"Why not?" asked Jim, adding, "Look at these financials Harry prepared. Charlotte could put in $600,000 and her share of the profits in year three would be about one third of the million dollars we project in profit."

"What if you don't reach the revenues in year three?" asked Bill. "What if Mike does not want to give up his shares or his role as president of Fast Lube?"

Fast Lube	Year 1 Actual	Year 2 Forecast	Year 3 Plan
Revenues	$200,000	$1,000,000	$3,000,000
Direct labour	$100,000	$500,000	$1,000,000
Margin	$100,000	$500,000	$2,000,000
Margin %	50.0%	50.0%	66.7%
Overheads	$500,000	$700,000	$1,00,000
Operational profit (EBITDA)	-$400,000	-$200,000	$1,000,000
Jim - loan	$100,000		
Jim's uncle - loan	$500,000		
Total loans	$600,000		

"Tom and I have two thirds of the shares; we can vote Mike out of the company if we want to," said Jim.

"Why do you want to get rid of Mike?" asked Bill.

"Mike's job was to run the company and get customers, and he has done neither particularly well," said Jim. "He does not attend our weekly meetings. He is hardly ever in the office. We now have several staff and he is not supervising their activities. Tom and I end up running things by default. He has potential customers he is talking to but can't get them to commit. He is spending money without any accountability. When Suzie wants to go through the numbers, he always has an excuse, except when it is his expenses. He wanted to get rid of Suzie and get Harry to do the work. Harry is too expensive to do the bookkeeping.

"I have had enough," he continued. "Mike is a great guy, but not suited for this job and a small company like Fast Lube. He must go."

"I think you should talk to a lawyer, Jim, you may well find that without a shareholder agreement there is no way you can force Mike to sell his shares," said Bill. "Also, what do your bylaws say about hiring and firing a president or secretary/treasurer of Fast Lube?"

"We don't have bylaws, we do everything on a handshake," said Jim.

"Who controls the money in the company?" said Bill.

"We can all sign cheques and draw money because we trust each other," said Jim. "We have weekly meetings and then I make the key decisions, as this company is my baby."

"I thought Mike was running the company?" said Bill.

"Yes, but it is my company, so I can overrule decisions if they are not suitable," said Jim.

"Jim, you are not the controlling shareholder," said Bill. "For that, you need 51% or more of the shares or you need that authority spelt out in your shareholder agreement.

"When your uncle gave you the loan, did he make you sign any papers?" continued Bill.

"Yes, he said they were similar to what we would sign for a bank loan," said Jim.

"Did you read the agreement clauses on what would happen if you did not pay interest on time or defaulted on the loan?" asked Bill.

"No," said Jim. "He is my uncle, I trust he would be looking out for me."

“What did your uncle actually say when you asked for more money?” asked Bill.

“He told me to send the financial information to his accounting friend, Sam, to have a look,” said Jim. “And when Harry sent over the numbers, my uncle called to say the business was not doing well enough for an additional loan but maybe some of my friends could put in money to keep things going.”

“Did you ask Mike and Tom to put in some money?” asked Bill.

“Yes, but they both said they were tapped out,” said Jim.

“Did you ask if they had friends they could approach?” said Bill.

“Yes, and both suggested we approach Charlotte,” said Jim.

“How are you managing for cashflow at the moment?” asked Bill.

“I have cashed in my savings and sold my house,” said Jim. “I am staying with a friend. Tom is doing the consulting for CrossArrow on the side to cover his bills. Mike and the other staff are still taking salaries, but we can’t do that for much longer.”

“I will sound out Charlotte if you like,” offered Bill. “And if she is interested, you can call her.”

“Great, I owe you one Bill,” said Jim.

Bill invited Charlotte and Harry to his office for a meeting. When they arrived, he was already sipping his coffee. After three hours of going through the numbers, talking about the people at Fast Lube and the potential of the business, Charlotte summed up her thoughts.

“There’s potential here, but I want to talk to Jim’s uncle before I decide if I am interested in doing something,” she said.

A week later, Charlotte called to say she had had a long chat with Jim’s uncle, Pete. They had agreed on a plan going forward. Fast Lube could be saved.

A few days later, Charlotte hosted Bill, Bob, and Harry to lunch at her holiday home on a very nice lake a few hours from the city. When they arrived, she introduced them to Bruno, from Kwik Fix, and Jim's uncle. After a pleasant lunch on the deck overlooking the water, the six went inside and sat at Charlotte's dinning room table that served as the boardroom table for the afternoon's discussions.

Charlotte outlined her plan to acquire Kwik Fix and Fast Lube and combine the operations. Bruno, who had built Kwik Fix, claimed he was a super salesman but struggled to manage the business. Jim had the insight to develop a revolutionary lubrication recipe that could be adapted for many kinds of machines and Tom was the wiz when it came to predictive software. Charlotte wanted Harry as the finance guy and she wanted Bruno, Pete, Bill, and Bob to be the investors in the venture.

"What about Mike?" asked Bill.

"The new president of Randall Web wants to hire him back," said Charlotte.

"What happens to Suzie?" asked Harry.

"She will report to you, Harry, if this deal goes through," said Charlotte. "You will have to decide if you want her to go or stay."

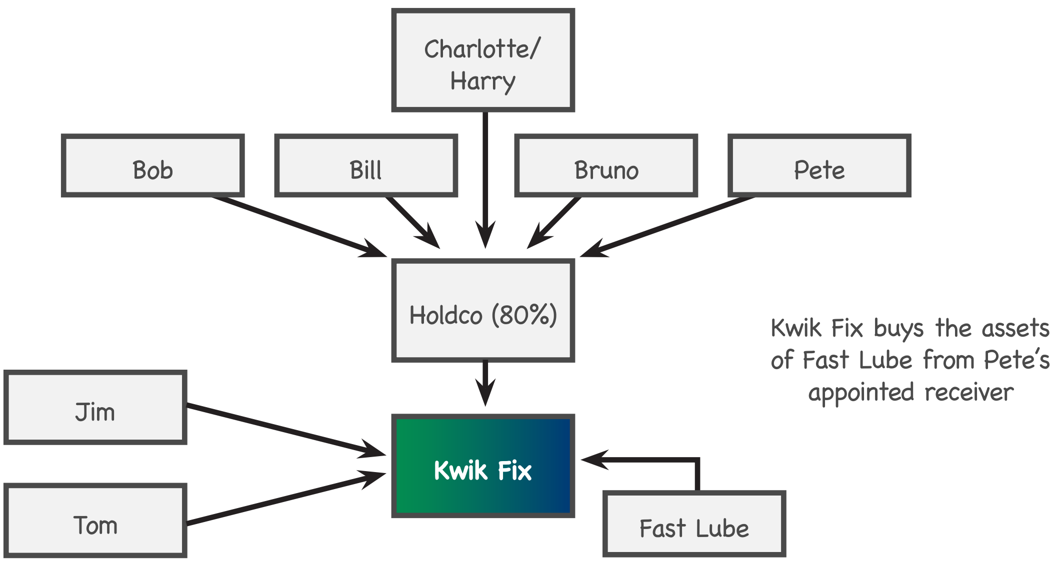
"How will our investment structure work?" asked Bob.

		Source of Funds		Use of Funds
Holdco	%	$		$
Pete	20%	$500,000	Purchase Fast Lube	$500,000
Bruno	20%	$500,000	Purchase Kwik Fix	$1,500,000
Bill	20%	$500,000	Cash Reserve in Holdco	$500,000
Bob	20%	$500,000		
Harry/Charlotte	20%	$500,000		
	100%	$2,500,000		$2,500,000

"I will start by form a holding company, let's call it Holdco," said Charlotte. "It will be owned by Pete, Bruno, Bill, Bob, Harry, and myself. Holdco will buy Kwik Fix and Fast Lube. The holding company will own 80% of Fast Lube and Jim and Tom each will own 10% of Fast Lube."

"How will you sort out the issues in Fast Lube?" asked Bill.

Charlotte explained that with a flow chart of the transaction.



"Pete will exercise his rights as the lender to put in a receiver and sell Fast Lube to Holdco for $500,000, which is equal to his loan," said Charlotte.

"What will Holdco pay to acquire Kwik Fix?" asked Bill.

"Holdco will buy Kwik Fix for $3 million," said Charlotte. "Half of that will come from Holdco and be paid to Bruno, who will receive $1.5 million on closing and the balance paid out over five years as a loan."

		Transaction	Source of Funds		Use of Funds	
Purchase of Kwik Fix	%	$		$		$
Purchase by Holdco	100%	$3,00,000	Cash from Holdco	$1,500,000	Paid to Bruno	$1,500,000
			Bruno loan	$1,500,000		
	100%	$3,00,000		$3,00,000		$1,500,000

"How much money are you looking for Bill and myself to put into the Fast Lube purchase?" asked Bob.

"Pete will put his $500,000 from the payout of Fast Lube into Holdco, and Bruno will put in $500,000 from his $1.5 million payout from Kwik Fix, so that's $1 million," said Charlotte. "I was thinking Bill and Bob could each put in $500,000, bringing the total to $2 million. Harry and I will put in $500,000 between us, so that is a total investment of $2.5 million. Each $500,000 investor will own 20% of Holdco. However, Harry and I will own voting shares, and the other 80% will share in the rewards but not have voting rights. This will be detailed in the shareholder agreement. So, to make the math work $2 million will be paid out on closing to Pete ($500,000) and Bruno ($1.5 million), leaving us $500,000 in cash in Holdco. What do you think?" she asked.

		Transaction	Source of Funds		Use of Funds	
Purchase of Fast Lube	%	$		$		$
Purchase by Holdco	80%	$500,000	Cash from Holdco	$500,000	Paid to Pete	$500,000
Jim	10%	$0				
Tim	10%	$0				
Bill		$500,000		$500,000		$500,000

"I think the shareholder agreement would need some downside protection for the non-voting shareholders," said Bill.

"Agreed," said Charlotte.

"How do we know if Jim and Tom are on side?" asked Bruno.

"It took a little time to explain to Jim that he was basically broke," said Pete. "And that we were offering him and Tom jobs, and a chance to turn their shares in the company into something with long-term value. Plus, they signed employment agreements and will confirm in-person once we have concluded our deal."
"What about the lawsuit from Jim's wife?" asked Bill.

“I am the trustee for Jim’s aunt’s estate that paid him the $100,000,” said Pete. “There is still money that Jim did not know about until recently. He has signed those funds over to his ex and she has settled.”

“What about Tom’s deal with CrossArrow?” asked Bill.

“They have dropped the lawsuit, provided Tom trains someone to take his place,” said Charlotte. “That is in progress and we can expect that it will be done within the next few months.”

“I would not be surprised if Charlotte ends up buying CrossArrow one day,” Bill muttered to himself.

Then Harry took the group through the business plan and summarized by saying that the key assumptions were (1) form Holdco, (2) use Holdco to buy Kwik Fix, (3) use Holdco to by Fast Lube, (4) combine Kwik Fix and Fast Lube, then (5) get rid of the low-margin customers, and (6) grow the business to revenues of $20 million to increase the value add to customers to generate 80% margins for Holdco. Shareholders can be offered an exit after five years in lieu of their shares.

Based on Harry’s rule of thumb of valuing a business at three times the operating profit, the plan would take the value of $3 million for Kwik Fix and a money-losing Fast Lube and shrink the combined revenues from $7 million to $4 million then boost the operating profits from $800,000 to $1.6 million and grow the value from to $4.8 million to $30 million over the next five years.

Holdco	Kwik Fix	Fast Lube	Combination	Rationalization	Year 5
Revenues	$6,000,000	$1,000,000	$7,000,000	$4,000,000	$20,000,000
Direct labour	$3,500,000	$500,000	$4,000,000	$800,000	$4,000,000
Margin	$2,500,000	$500,000	$3,000,000	$3,200,000	$16,000,000
Margin %	41.7%	50.0%	42.9%	80.0%	80.0%
Overheads	$1,500,000	$700,000	$2,200,000	$1,600,000	$6,000,000
Operational profit (EBITDA)	$1,000,000	-$200,000	$800,000	$1,600,000	$10,000,000
Value multiple	3			3	3
Value of business	$3,000,000			$4,800,000	$30,000,000

“Looking at the plan, Harry, do you think Charlotte can get Holdco to revenues of $20 million a year with 80% margins?” asked Bill.

“Yes, that is why I am putting my own money into this deal,” said Harry.
“What makes you so confident?” asked Bill.

“Charlotte has all the right people doing all the right jobs,” said Harry. “She has a fair deal for all the investors and she has made sure key people are shareholders. She’s also offering a good salary and bonuses to Jim and Tom.”

“I guess Tom and Jim have learned some tough lessons,” said Bruno. “I made similar mistakes when I first started Kwik Fix. Luckily, I had a fellow like Harry to set me straight early on.”

“Jim came to me when he first wanted to set up Fast Lube,” said Pete. “I urged him to listen to the advice he was getting from Harry, Bill, and Bob, but he thought he knew better.”

“What happens when you reach year five of the plan?” asked Bruno.

“We sell out to Bill’s family office,” said Charlotte. “Because if you grow the company larger than that, it will attract competitors and the margins will fall. I think Holdco will be the next chapter in my life, but I don’t want it to last more than five years so I can go on to a new phase.”

“I was hoping to take the company public,” said Bob. “You will get a high value multiple.”

“You can, but Holdco will never be as valuable as it will be when it reaches that \$20- million sweet spot,” said Charlotte. “I reckon that at that size and profit a buyer would pay a multiple of six or seven times the operating profit. Financial people forget the story of Goldilocks — you want a business that is not too small and not too big, just right.”

“I guess poker night will not be the same after this deal is done?” said Bill, laughing.

As they were leaving Charlotte’s beautiful country home, Bill pulled Harry aside and asked, “How did Charlotte get Bruno to agree to sell?”

“She is a great poker player,” said Harry.

“What do you mean?” asked Bill.

“She spent time getting to know Bruno and his family and realized he is like the godfather,” Harry said. “He had several extended family members on the payroll that were not doing much. Bruno knew Fast Lube would hurt his business and Charlotte was willing to be the bad guy and get rid of surplus family members on payroll. She knew everyone’s hand before she even played her cards.”

Bill laughed and went over to Bob who was getting in his car to leave.

“It seems our list for the perfect company is nearly complete,” said Bob.

“I am not so sure,” said Bill. “Just when I think it is, something else pops up. I think the list will get longer when we look at our next deal together.”

When the two dined one evening with Bob’s father, David, they had a great meal sitting on his deck overlooking the lake. The financial veteran asked a lot of questions about the Holdco deal and how it came about.

“Bob and I were on a quest to find the perfect company,” said Bill. “Our venture started when Jim started talking about the problem he was trying to solve at work and the frustrations he was having getting approval for his recommendations.”

“I see,” said David.

“We realized that Jim wanted to start his own business to be able to sell his solution to other companies,” said Bob. “It became even more interesting when Tom realized he was working on a similar issue in a different industry using software to predict the problem, which Jim was trying to solve using various lubricant mixes. Jim was looking for trade offs between high-speed machines with the temperature of the bearings. It was exciting to see that Jim and Tom wanted to work together. However, it was disappointing to see how they were not able to get funding to get their business launched.”

“Why?” asked David.

“We think Tom understood what the potential investors wanted and thought it was probably reasonable, but Jim was stubborn,” said Bob. “He saw this company as his baby and thought he could dictate terms. Tom had worked for several startups and knew the issues of equity and what investors would and would not do in terms of giving money.”

“Jim sounds like a typical novice entrepreneur,” remarked David. “Then what happened?”

“Jim really didn’t understand three important things,” said Bill. “First, he did not understand how hard it was to find customers. Second, how to manage money in a company, and third, how starting a business would impact his family life.”
“He was in a hurry to get a problem solved,” said Bob. “He was also in a hurry

to start a company and was only too eager to put his family money into the business without spending any time considering the downside of it. As a result, he paid a heavy personal and financial price."

"Tom was a little more careful," said Bill. "He had worked for a number of companies and understood the challenges of business that faced financial difficulties. He understood the problems of being a shareholder and taking a lower salary to have more equity. Tom also knew he was not the person to lead the company but was willing to be great technical support for Jim."

"Then what happened?" said David.

"Jim used a small inheritance to start the business," said Bob. "Then he and Tom tried to get customers on their own. When they got in trouble, Jim got some funding from an uncle and hired Mike to help them secure customers."

"How did that turn out?" said David.

"Mike, like a typical sales guy, was overly optimistic and thought they could grow the revenues enough to get the company back on track," said Bill. "When that did not work, Jim and Tom lost confidence in Mike. He also did not realize how tough it was to run a company. And then Jim was really down when his uncle would not loan them any more money. The last straw was probably when Jim sold his house and put that money into the business and it was still not enough. He also seemed surprised when his spouse and kids left him. It was at that point he realized the business was no longer his baby, even though it was his idea."

"Jim only seemed to be willing to take advice when he had lost everything," said Bob.

"Interesting," said David. "Then?"

"Then we introduced Charlotte to the opportunity," said Bill, beaming. "She came up with the idea of buying Fast Lube together with the competitor. That's how we became investors in the operation."

"But the hidden gem was Harry," said Bob.

"What do you mean?" asked David.

"Harry wanted to get out of traditional accounting and do more in finance," said Bill. "But the novice entrepreneur trio did not see a lot of value in his advice. However, Charlotte realized the value Harry's knowledge in numbers could bring to the table, so he became key to getting the deal done. He is now the CFO and investor in the combined business."

"What did YOU guys learn?" asked David.

"Watching Jim go from employee to business owner to almost bankrupt to finally employee and shareholder was scary," said Bill. "However, we were able to put together a list of ideas for a perfect business."

"It is a lot more fun than investing in public companies for clients," said Bob.

"And what did you learn from Charlotte?" asked David.

"She can read people and numbers really well and line them up for a great deal," said Bill.

"I love how she sees a business as a chapter in her life, and not as the whole book," responded Bob.

"Charlotte is a classic serial entrepreneur," said Bill. "At Family Partners, we love to buy businesses from serial entrepreneurs. When we find a serial entrepreneur, we buy out half their business and then spend five years developing the next generation of managers to buy out the remaining shares from the entrepreneur. We often own just over half of these businesses, and if we sell, we often don't sell out our position totally. We like to own a small piece of these companies for generations. That makes us portfolio entrepreneurs. One day, Jim may go from being a novice entrepreneur to a serial entrepreneur. If he takes his business to the level where he wants to exit, we can be there to buy it out."

"Is Family Partners the perfect business for you then, Bill?" asked David.

"Yes," said Bill, "I suppose so. Here, I have been looking for the perfect business and maybe I am already part of one!"

"Well, son," said David, adding with a chuckle, "so have you have outgrown my firm but feel stuck until I retire."

"Well, Dad, that is very insightful," said Bob. "That's why I am thinking of leaving the firm and joining Family Partners."

"Well, son, didn't Ralph Waldo Emerson say something like, 'People wish to be settled; only as far as they are unsettled is there any hope for them?'"

“Yup,” said Bob. “And I hope I will be settled once I join Family Partners.”