THE BARCODE PODCAST
Episode 001

Architecting a Successful Exit

Welcome to The Barcode Podcast, where we equip emerging consumer brands. I'm Ben Ponder, and at Barcode, we're here to give our listeners the knowledge and tools you need to thrive in the marketplace.

There are lots of reasons why people go out on a limb and create a startup. Conversely, there are relatively few possible outcomes of a startup. You're either going to fold, hold, or get sold. In most cases that I see, founders imagine eventually selling their company to a strategic acquirer or a private equity firm. A fundamental principle here at Barcode--and one that I think translates well to other areas of our lives--is "begin with the end in mind."

A few months back, we did a live Barcode workshop addressing this important issue: how do you architect a successful exit years before the exit MIGHT happen? We want our founders and listeners to be equipped to think through these kinds of issues like a chess master who sees the board several moves ahead.

BEN Successful exits. Uh, so for most of you, the way that I like to think about this, first of all, it's, it's really important and as was mentioned tonight and probably thought by more of you, the assumption is that you shouldn't think about an exit until like at some arbitrary point in the future. I would contend that you actually should think about it early on, and not like obsess about it, but- but give it the appropriate amount of thought. And so the way that I tend to phrase that is begin with the end in mind.

And why I say it that way is - the choices that you make as a founder, entrepreneur, early team member will certainly foreclose certain options along the way. And let me give you an example of that. If it's an angel investor, which is a high net worth individual, then they may not have the same set of needs or expectations. But a VC, even if it's a huge VC, uh, arguably more so if it's huge VC, they- they actually need to get their money back. That's sort of the business model. And so typically that happens over roughly 10-year fund life cycle.

And so if you take VC money, at some point, they need their money back with a typically substantial return. That's the expectation. That's why they invested in you. So if you think, you know, I love this business, I think I want to run this for 30 years and then pass it on to my children and grandchildren, you're going to be at odds with your investors at that point because their

incentives are not going to be aligned with your incentives, and their expectations are not aligned with your expectations.

So, um, one thing for you to consider, even at an earlier stage is how do I structure my business considering various possible outcome scenarios? Now, the reality is, every one of you ... So I'm gonna talk as if you are a startup founder or co-founder. Every person who starts a business, you will exit that business somehow, right? So let's, let's just like, you know, not to get too existential about it.

AUDIENCE (laughing)

BEN But, um, you- you will not, uh, run this business for infinity years, right? So something is going to happen. Either you keel over at your desk at age 122 or sometime before that you pass it off to your employees, a child, a niece, uh, some- someone else, you sell the business, something's going to happen. Maybe you just decide, I'm not having fun anymore and I have plenty of money and I'm just going to shut it down. You like - everyone exits every business. So that's why I think it's actually useful early on to just take a little bit of time and to contemplate "why did I get into this in the first place?" And you can actually architect aspects of your enterprise around your preferred outcome.

So if you can imagine, think about your business or whatever you're working on right now, and if you can imagine yourself doing this thing, hopefully a little bit bigger, but roughly this thing in 10 years, then okay, that passes one gate. Can you think like in 20 years, so like ... so if you're 30, you're 50, are you running this, are you running this in 20 years? Like, is this still a good time to you? Or when you, when you first started, were you kinda like, it'd be cool for a lot of people - it would be cool to build up a business and sell it to somebody, right? Or back in the 90s, it would've been to get three customers and IPO.

AUDIENCE (laughing)

BEN But that, that's harder to pull off these days, although we're seeing a little bit more of it. But, um, but so now, especially in the CPG space, the most likely exit outcome is likely an acquisition, either by one of two scenarios. It's referred to as- as a- a financial acquirer or a strategic acquirer. Roughly speaking a financial in ... acquirer is a private equity firm. These are, these are firms that have, uh, typically a lot of capital that is deployed often to like buy several businesses, roll them up into, make, take a lot of little pieces, put them into a big piece and then eventually to have their own exit from that.

Another scenario is- is to be acquired by a strategic, and that is typically a larger organization similar to what you do, right? So if you make deodorant, it's that you would be possibly purchased by Proctor and Gamble or some other large strategic CPG company or whatever the thing is. So- so that tends to be the most, that's the most common scenario.

If you know for sure that, that's what you want to do, you say, all right, I- I like ... I love what I make. Like I love pickles. But I want to build my business up and sell it for whatever the number is. Maybe for a lot of people, like they may think $100 million, right? That's fine. Whatever- whatever you think.

And by the way, this is an important exercise. This is why I encourage people to think through this. If you sell your business for a $100 million, it is, uh, it has happened in- in all of human history, but it's exceedingly rare that you would actually get $100 million. Because typically to get

to that point, you have brought on other people to help you, maybe they're investors, partners, uh, other- other people, and they get a cut of the, of the pie. In some cases, they get a better cut than you do. And that's a, that's an important part for first time founders or people who have never been through this process before to understand is that if you're raising money early on ... So this is why, like sometimes in the media and other things, you get really excited - so and so, they raised a million dollars, they raised $10 million. That sounds really cool, and it might be really cool. Good for them. It doesn't always work out the best for them depending on a lot of the devil in the details kinda legal stuff, right? \

So when you, when you go down this path, and you understand the outcomes, not everyone benefits equally from, uh, from an exit. If you are burning a lot of cash in your business, if you're spending a ton of money on marketing, and you're having to go back to that- that VC, well often, you- you know, so you see, and again, it looks nice. You're like, "Oh, so-and-so raised another round of however many millions of dollars. Wow. They must be doing really well." I see that, and I go, "They're spending a lot of money."

And so ... which is not necessarily a bad thing, some businesses require spending a lot of money. But if you do that every time they go back, and they raise more money the people who are investing in that or taking another piece of the pie. Now that may be a worthwhile trade-off, and a lot of times it is, but you just want to know what you're getting into. Right? So it might be if you do that enough times at the end, um, yeah, you made, you made some money, but you might have your $100 million exit, and you get like a million dollars out of it. Which again, a million dollars is cool. That's great. Um, but it's, it's not a hundred million. And so, uh, it's kind of weird when you bust your tail for five, six, seven years and you get a million dollars in a bunch of people who never showed up at the office, get to split the 99 like that. You're like, "Wow."

There are people in the room who are knowingly shaking their heads 'cause it happens. There's actually scenarios and y'all need to know this. Um, there are scenarios called down rounds or kind fire sale exits as it were, where you as the, because of different preferences written into your funding documents might get nothing, right? So you might work really hard for however many years and if you don't have a smart lawyer working alongside you, who's advocating on your behalf, and- and things don't always go swimmingly perfectly well there could ... and- and- and you raise money at valuation X and then you end up two years later having to sell 'cause the market turned, and you have to sell it valuation Y, which is a little below that, you might be in a scenario where you walk away like with empty pockets. Um, which kind of feels sucky.

I- I get it, but it shouldn't happen that way if you're smart and savvy about it. But think about this, if you're, if you're a venture capitalist, how many deals do you see in a year? Like hundreds? And if you're an entrepreneur, how many deals do you see a year? Some of you are like, "I'd like to see one."

AUDIENCE (laughing)

BEN But like so- so again, if I'm playing a game, and I've played the game hundreds of times, and you've played the game one time, who's gonna win? Right? Like so it's not a fair game. And that's one reason I, I'm pretty passionate about underdogs and one reason that Barcode exists is because I like leveling the playing field a little bit. And so, um, because it's like, it- it- it's not like I- I don't want you guys to be the suckers, uh, like there's going to be plenty of suckers out there, but you don't be the suckers. So, um, so you keep in mind early on, what am I trying to do? I- if your exit, so I think it's actually useful.

And this is an exercise that- that I encourage founders to do themselves and with their loved ones or partners, actually to talk about how much money do we need. 'Cause it's one thing, it's kind of cool. It sounds cool to be like I'm a, you know, a billionaire or something like that. The truth is it's rare in this space that you would have some outcome like that. Right?

So let, let's tamp down the expectations. It's ... I- I think of in the CPG space, a- a business that sells for more than a hundred million dollars is effectively a unicorn in this, in this world.

So I think it's actually useful to think through what's the right amount of money for us because it might not be a hundred million dollars. It might be that you're like, what would I do? I- I would do X, Y, and Z, and I'd paid for my kids' college and whatever the thing is, and it may turn out that that number is significantly lower. That's actually awesome for you if you figure that out. Because when you figure that out, you go, okay, that's my goal. My goal is not that I sell the business for $250 million, my goal is that I exit the business with X. Right? And that's actually likely to be a more achievable outcome for you as a founder than, uh, hitting some kind of arbitrary high number that just kinda makes you feel like psychologically superior.

I think one of the assumptions that people have is I can start a business and in three to five years, I could sell it for $100 million or more. Right?

Does it happen? Yes. But it's really rare. And so I think again from saying ... setting expectations, to pick on a local example, 'cause this is all public knowledge. Um, when was Stubbs founded?

AUDIENCE 1992.

BEN 1992. Stubbs is a great business. Purchased by McCormick for a lot of money. But in 2015, uh, purchased for 100 million-ish. Uh, which again, lots of money, but 1992, 23 years is not an overnight success story. Right? If you had the opportunity to start Stubbs, would you say that's a, that's a good deal? Sure. That, that sounds cool. But just to set your expectations that these are not always like overnight success stories. There's a ton of work, and even like there's a life cycle to a lot of these businesses as well.

So, I'm going to interrupt myself here to let you know two things. First - in the live meeting where this was recorded, I handed out a 7-page document listing CPG acquisitions and investment transactions that occurred over the previous year. Since you're likely listening to this while you're driving or running or doing something else, we thought it would be safer if we edited out some of the audio where I'm talking at length about this 7-page spreadsheet. But as you hear me reference certain companies and investments going forward, they're in reference to that spreadsheet.

Picking back up with the meeting - we're talking about the biggest advantage a startup has compared to a big CPG brand.

BEN So Nestle is the world's biggest food company, right? Uh, just like [Strada 00:22:28], and, uh, so they have plenty of money. Uh, most of the smart big brands realize that they don't do innovation really well in house. They- they can pretend they can make up a fake story about a fake new little sub-line, but it doesn't, it doesn't resonate with consumers in the same way that an authentic story like you guys have, uh, does, which ding, ding, ding ... By the way, side note, important side note. If you're underselling your story, then it, it's kind of like you're Michael Jordan and you don't dunk. Like you're, you're missing something fundamental here. That's why people love your thing.

The unfair advantage that you have is that of a Nestle or a big company has, they have to manufacture a story. They don't have a real story. You often, many of you have an actual story, and the more consumers who are averse to a lot of that other stuff, uh, the kind of corporate hogwash, they love your real story. And so the more you get the real story out to those people, the better. And on that note, certain big companies buy certain things. So what do you see certain companies buying? Like is Coca-Cola, buying corn flour?

Coca-Cola only buys beverages and until they don't, You'll notice like PepsiCo owns a Quaker oats and Gatorade and, um, Frito-Lay and all the trillions of brands they have under that. And they ... So they have Pepsi, yeah, but they have a lot of other things too. Coke says, "Eh, we don't do that stuff so well, we just do beverages." So if you think that your, uh, uh, if your overnight oats company is going to get bought by Coke, it could happen. I don't want to say it can't because Hershey bought KRAVE Jerky because they decided that they were shorting confections, and they were taking the long position on- on high protein snacks and salty snacks.

But, uh, in general you could look at that and say, there's a trend that I might be wasting my time there. That bigger business has their own set of objectives. And if you're taking their market share from them, is it easier for them to compete with you or to just buy you for what is like spare change in the couch in their basement? Really? Um, and- and to throw you on the back of their truck and- and turn you into like household names. What's easier for them? Like people make their jobs easy, right? Th- this is your calling, right? Like you're just, you're teeing this stuff up. Make it like an ... it would ... they'd have to be an idiot to not buy you if that's what you want. Now may not be what you want. And that's why you're going to have a conversation with yourself, and your significant other to determine what you want early on.

Most of the companies are older or are- are more than 10 years old that got bought. And I think that's important to know because some of you are sprinting ... if like ... I like to know this, uh, like, um, if I'm running a race. So if somebody says, "Hey, Ben, you're running a race. Cool. How long is it?"

AUDIENCE (laughing)

BEN If it's like 10 yards, that's a different race than a marathon. Right? Like you just kind of want to know ... You know, don't be the bunny rabbit who goes, "Look at me, I'm beating everybody." And then you're like flat on your face, like, uh, like five minutes in. Right?

So it might be a 10 year slog on average for ... and again, there's some selection bias there too. You know, what's not on this chart. Everybody else who didn't get acquired, this is not everybody who started a company in 2000 or 1782, or whatever, the largest transactions or many of the largest transactions were for brand platforms, not for single products. Right? Or for single

categories. Right? So, um, uh, General Mills, uh, bought, uh, Blue Buffalo. Again, that's a, that's kind of a curve ball thing, right? So they're like, General Mills, not a pet food company went all in on pet food. And how- how much did they pay for it? $8 billion that'll spend in Austin. Yeah. I can almost afford a house. So they paid $8 billion for something they weren't in, effectively mortgage the future (laughs) of their company, uh, for that acquisition. That's a big deal. Why?

Well, uh, they're, they're betting on a ... like I think of it as a propulsive macro trend. Uh, one of them. And again, like it's the, like when I was a kid, people didn't give their dogs popsicles.

AUDIENCE (laughing)

BEN You know? Um, but it's the humanization of pets like that. We're, we don't have pet owners, we have pet parents and- and grandparents and godparents and whatever. Like, so, uh, the role of pets and the amount of money that people spend on their pets, much different than it used to be and is trending in a particular direction. So General Mills is, uh, placing a macro bet on that trend with a market leader in that space that had built a very robust platform in- in that world. Right? And so you could look at some of those things. General Mills, one of their bigger acquisitions before then was Annie's, right? Annie's will slap a bunny on everything, uh, in the grocery store if they have to. Like it's a platform. It's not a single thing.

Nestle doesn't own coffee companies. Nestle owns coffee, right? So different game here, like Nestle doesn't own water companies. Nestle owns water, right? Like, so you have to think bigger about what- what their strategic objective is.

Like if you guys ever walk into a s-, a s- a salty snack aisle, we deal with this, uh, you know, at Siete Family Foods. Wa- walk into Walmart and- and start just for fun. Uh, like you'll have do a little bit of homework beforehand, but uh, learn all the Frito- Lay brands and start on one end, and s- and then know ... have your friend go with you and you stand on one end, and they stand on the other end, and see where, how far apart you are when you get to the end of the Frito-Lay brands. You'll barely be able to hear each other. You're that far apart. They have so many ... I think they have like $22 billion brands just in that aisle. Right? So they're not owning chips. They're owning snacking, right? Like it's just a bigger play, right?

So you have to be a meaningful threat to their incumbency in snacking or in yogurt or in what, you know, like the- the- the reason that dairy free yogurt is a big deal is because dairy companies make so much money. Like, do you guys realize how big dairy companies are? They're massive. And so what has happened to dairy companies over the last like few years? They're cratering and- and it's, it's companies like Culina and- and others, uh, like who are taking that market share, and it's scaring dairy companies. And so they have to invest in you or buy you because they have no choice. 'Cause even though they're huge, they're losing.

Another thing to think about when it comes to a successful exit - knowing how to form your company. Should you be an LLC? An S-Corp? A C-Corp? You might be surprised at how some of the biggest CPG companies in the world are structured.

BEN Does it matter how you formed your company early on to, uh, determine like when you think about exiting? And the short answer is yes. Now, if you're in the tech space, the prevailing dogma is that you can be any kind of entity that you want as long as it's a Delaware C Corp. Um, and that is all. Thank you. End of conversation. And there's reasons for that and they're valid reasons.

You'll notice, and you may notice this ... Again, if you're just like a curious person, you just start flipping around packages on the back of things. Like there's a lot of LLCs in this world. And you're like, "Huh?" Even big companies, a lot of them are, it's like General Mills Sales LLC like, "Huh? Why is that?" Well, there's a few reasons for it. Most of which, uh, relate to the fact that our kind of companies ... and don't tell the tech stars folks, make money. It's so cool.

AUDIENCE (laughing)

BEN So- so we, we have a product and we make it for one amount and we sell it for more to the person who's actually going to use it. It's super cool. I'm being facetious. I, I've, uh, I worked in tech, so I can take, uh, some, some shots at that. But I've wondered about this kind of question for a long time. I've asked a lot of industry people, I've only ever gotten one compelling answer, So you- you guys know that RXBar, uh, sold to Kellogg's for $600 million, right? Uh, I talk to investment bankers. I talk to all these people like, "Hey, why should you structure this way or not this way?"

And this is the only interesting answer I've ever gotten from anybody in this space. And so this guy says to me, um, that, uh, because ... So- so RXBar never raised money, right? So they weren't diluted. There were four co-founders. Um, and let's assume like they made a lot of money, right? So, uh, again, you raised a lot of ... you raised a lot of capital. Um, you $600 million, you might make a lot of money, you might not, I don't know. Depends on the circumstance. Those- those people made a lot of money. So, it turns out that because of the way that these companies reabsorb an LLC that is either making money, or losing money, and they can kind of determine whether it's going to make money or lose money at that high level of a corporation. Um, there are, there are all kinds of tax advantages to that structure.

So, um, effectively Kellogg's was able to write off the entirety of their RXBar purchase over a 15 year period. Probably most of us in here thing about like riding off maybe a charitable deduction here, they're like, they're going to write off $600 million. Like it's going to, it's going to go away. And so, uh, our, RXBar's as advisors were savvy enough to know that and, uh, because of the original offer I believe was 450. And so they realized that they were going to, um, make another $300 million effectively over that 15-year, uh, time horizon. And so their advisors negotiated for them, "Hey, since you guys are gonna get all this money over the next 15 years, how, how about, how about, so we go halfsies?"

And so because we're an LLC in that case, because they're an LLC, it- it actually made them an extra $150 million. So consult your lawyer and accountant, your situation, your mileage may vary, but it's a consideration. There are all kinds of tax reasons why it ... and again, uh, LLCs are not all created equal. It depends. Just consult your people. You have people. If you don't, you will. Here's my, uh, speculation for what it's worth, which is not much. Um, I think you will see a decent amount of Kombucha acquisitions in the next 18 months. Um, uh, you will see, I think there's a movement toward hard Kombucha, uh, that there's going to be more, uh, more companies out there doing that.

Um, there is talk in the industry that cold brew coffee has jumped the shark. And so therefore, um, 'cause the, again, you have enough options now that ... and I'm not discouraging, people are

doing cold brew coffee. I'm saying this, you better be doing something unique and differentiated or your, your, uh, your swimming, up, like a heavy flowing stream. Um, so if you can do something different that nobody else is doing, go for it. If you're, if you're just making the same cold brew coffee that, uh, Chameleon was making, like in 2009, cut your losses now, it's the hard truth, but I want to encourage you again, like before you throw in the towel, do something different, like find something fresh and that sort of thing. So the only thing that's growing right now in the, in the beverage space, like, and you can see this, uh, in- in different stores like the Kombucha, and there was a fad around drinking vinegars for a while. I think that sort of like didn't last long, but so- so you see some of those things.

I think there's not necessarily all the spoils don't necessarily go to the first. Um, it helps to be early, but not, it's not exclusive, uh, to- to that, but it's, it's easier to get scale if you're early because then you have something, you have a story to tell the retailers.

You have to look for opportunities. My- my hope is for all of you. You're doing things that are authentic to you, that you're solving, uh, ideally personal problems or problems, uh, for those around you. Uh, that I think that's an unfair advantage. And then fundamentally do innovative stuff. The more innovative, differentiated, and maybe at times weird the things you're doing, the less likely that that could be replicated in a lab of a giant CPG company. Right?

So you're zagging while everyone else is zigging and that's your only shot. Because if you play the same game, you know, it's like, I- I think it's like a Moneyball problem a little bit too, right? Like if you're saying, I'm gonna compete with the New York Yankees, but I have the budget of the Round Rock whatever's, um, then, uh, like you're not gonna win. So you gotta play a different game. Like that's your only shot and it turns out it's a great shot because you're gonna actually run circles around them before they even know it. And then at some point they're gonna be like, "Eh, screw it. I'll just buy 'em." And then you all win.

And at the end of the day, what we want here at Barcode is for all of you to win. To create great products that change people's lives. To be wise and take advantage of what the people who have gone before you have learned, and to achieve a successful exit that gives you the freedom to solve new problems and to positively impact even more people's lives.