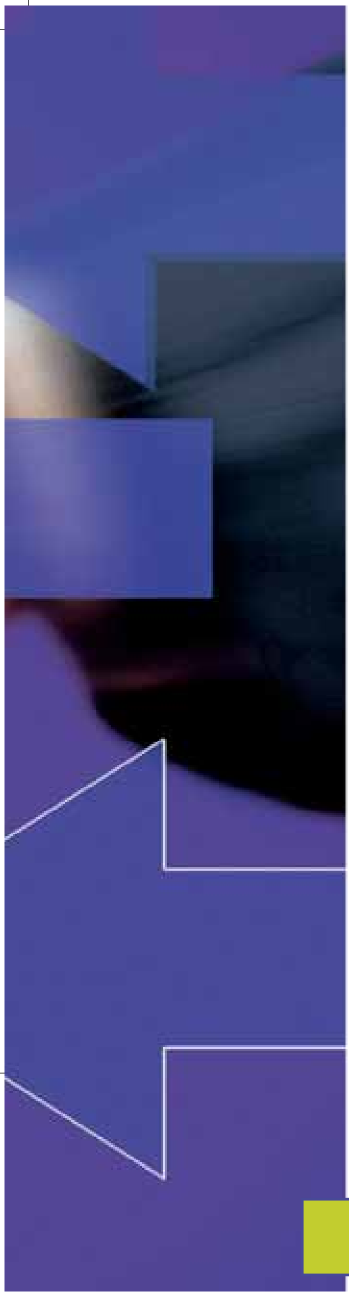
The Art of the Deal

This guide to negotiating and maintaining business deals and relationships in the fitness industry outlines six important steps to produce a win/win relationship.

By Stephen Tharrett, M.S., and James Peterson, Ph.D., F.A.C.S.M.

"THE ONLY GOOD deal is a win/win deal," says Robert Dedman Sr., founder of ClubCorp, Dallas, Texas, in the book *King of Clubs*. In his mind, deal-making is both an art and a science, a process of bringing multiple parties together in a business relationship that produces success for everyone involved. This may seem counter to what is often seen in the news today, or what many people may have experienced in their professional careers. In recent years, far too many business leaders and politicians measure the value of a deal solely in terms of what they receive from the arrangement, no matter what the results end up being for the other parties involved.

This modern-day approach to deal-making is counter to the philosophy and business practices of insightful organizational leaders who understand and accept the value of creating business relationships that result in positive outcomes for everyone involved. A win/win approach to deal-making drives long-term business partnerships and helps foster continual growth and profitability in an organization. The relevance of such a precept could appropriately be summed up in another quote from Dedman: "In the deal-making business, we are also in the repeat business."



Deal-Making Tips

Given the aforementioned foundation for what constitutes appropriate deal-making and the steps involved in its success, several general suggestions can be applied to the process of buying, leasing and selling a fitness center.

Leasing space for a facility

• Apply the 15-percent rule, which refers to the fact that a fitness center should never spend more than 15 percent of revenue on rent.

• Be clear about the cost of the rent. Is it a triple net rent that also requires the lessee to pay taxes, utilities, etc.?

• Understand the common area maintenance costs (CAM charges).

• Set 20 as the upper limit for space (e.g., the rent should never exceed $20 per square foot for the base rent).

• Know what is allotted for tenant allowance (TI). In most markets, clubs should be able to get $15 to $20 per square foot for their facility's TI.

• Determine if the deal provides anything else (e.g., signage, good visibility, partnering in promoting the business).

Buying a fitness center

• Determine the base value of the business by using a fair multiple of EBITDA. In the health/fitness industry, a multiple of between three-times and six-times earnings is relatively fair for a leasehold space and a freehold (e.g., land and building). It should also be noted that, in some instances, the multiple can jump as high as eight-times earnings.

• Make sure to do due diligence on the proposed deal, and get a succinct EBITDA number for the trailing 12-month period, as well as for the past three years.

• Establish a strategic return on assets or return on equity that needs to exist to make the deal work. Establish the price based on what it will take to achieve this return.

• Determine realistic five-year projections. Don't rely on the calculations of others.

• Be careful on leaseholds about buying the business and then having to lease the land and building from the current owner. Such a situation is seldom, if ever, a great deal.

• When someone buys the business, the purchaser is getting the company's assets and liabilities.

Selling a club

• Develop an investment memorandum on the business. This package should tell the story of the fitness center, including its history, marketing data, financial data, information on the people, the competitive market, etc.

• Initially, try to sell the facility to people you know. Work your existing relationships to identify potential buyers.

• Remember that, while brokers can be helpful, they can also be costly. Keep the broker's commission under 6 percent if at all possible.

• Start with the investment memorandum, but get down to personal presentations.

• If the facility for sale has been a successful operation, set a high price-point, but also set a walk-away price. For example, a high asking price for a fitness center could be eight times earnings, while a walk-away price could be five times earnings.

• Determine what financial return the selling price should provide. Sellers need to know what their return on investment is just as much as the buyer does.

What is deal-making?

Deal-making is the process by which multiple businesses or individuals negotiate a business relationship that provides each group with certain desired benefits. A deal can range from the negotiation of a lease to the establishment of working conditions between employers and their employees. While the term "deal" is most often associated with real estate transactions and the purchase and sale of businesses, a deal is really a process involving a situation in which two or more parties come to a mutual understanding regarding a working or personal relationship. In the fitness industry, deal-making can include such business transactions as purchasing a fitness center, selling a facility, negotiating a lease, negotiating out of a lease, negotiating an independent contractor agreement, settling a member dispute or negotiating purchasing agreements with vendors.

The art of doing a deal is about negotiating a business relationship that produces win/win results for all involved, both from a process perspective and an outcome perspective. While simple in its definition, it is a complex and challenging undertaking few professionals ever have the chance to fully develop.

A framework for deal-making

Deal-making involves six important steps, each of which is critical to helping produce a win/win process and outcome:

1. Establish a relationship. Far too many business deals fail or succeed at this first step. All too often, deal-makers want to discuss the terms and conditions of a deal before actually getting to know with whom they are getting into business. It is absolutely critical that all parties who are considering doing a deal together get to know each other. In some cases, the first several months of talks can revolve around getting to know each other; only after that can discussions proceed to talks about possible terms. The underlying moral is that great deals are often the result of building a trusting relationship with the other party. As Dedman so aptly puts it, "Deal-making needs to be a courtship, not just a transaction."

2. Discuss the deal's social context. Before jumping into a discussion of the business-related terms of the pending arrangement, reach a clear understanding of the underlying social contract of the potential business relationship — and the ongoing social contract. In essence, each party must be able to clearly delineate two key points: what is the real nature of the deal (e.g., what, if any, are the hidden expectations and agendas attendant to the relationship that might not have been put in writing); and what do the parties to the potential business relationship want the ongoing social contract to be (e.g., how will they deal with each other and how will decisions be made, beyond the legal nature of the deal)?

After weak relationships, this factor is probably the second most common reason that most deals fail. Individuals who enter into a business relationship must understand what the other party expects from the relationship and how they want to be dealt with beyond the standard legal verbiage of most deals. Individuals should not allow their perceptions of the social contract to cloud their level of objectivity concerning the deal. An effort should be made to discuss these important issues and arbitrate any areas of potential disagreement or misunderstanding.

3. Do the due diligence on both sides. Fitness professionals should determine what it is they are really negotiating, whether it is a purchase, sale, lease or simple contract. In other words, you should know everything you can about the other business and the people involved with that company. An article that appeared in the *Harvard Business Review* in 2004 noted that "deal-making is glamorous, but due diligence is not." Many deal-makers fail to do their homework, and, as a result, don't have a thorough understanding of the deal. In this regard, a list of the key elements that should be addressed before entering into a business relationship includes the following:

- Know the customers of the business with whom you are considering doing business.
- Know the competition for the business.
- Verify the economics of the business with your own people; don't depend on the data you are given.
- Verify the cost economics of the deal.
- Take stock of the core capabilities of the other party (core competencies).
- Determine the stand-alone value of any deal as if it was not going to be a part of your business.

4. Know the synergies and skeletons of the deal. From the club professional's perspective, this step involves knowing both your business and that of the other party. It requires that an honest S.W.O.T. (strength, weaknesses, opportunities and threats) analysis be performed for both your business and the other business. Once the S.W.O.T. analysis is conducted, a spreadsheet should be compiled that illustrates how the various strengths, weaknesses, opportunities and threats line up. This depiction will help delineate key points. For example, are there synergies between the parties involved? Do your perceived strengths work well together or do they complement each other's perceived weaknesses? Are the business opportunities enhanced by the potential relationship or weakened?

Once a spreadsheet has been developed that clearly shows the potential synergies between the parties involved, a timeline and cost should be assigned to each of them. Then, assess if the timelines and costs make sense, and what effect they might have in influencing the direction of the negotiation. Such a detailed investigation will also help you identify and deal with any potential skeletons (i.e., barriers and hurdles that will have to be overcome if the deal is to be done) that might exist. Sometimes individuals choose to ignore such skeletons because the synergies attendant to the relationship seem to be strong. Other times, skeletons can bring down the entire deal, but usually only after the deal has been made.

5. Determine a walk-away price. For every deal, individuals need to establish a set of clear benchmarks that frame whether they will proceed with a deal. Such a benchmark may be any number of criteria or factors (e.g., a minimal purchase or sale price, a certain lease rate, a particular timeline for closing the deal, the involvement of a certain person). Draw a firm line that you won't step over, no matter how good the rest of the deal looks. Too many people dismiss red flags or warnings concerning a possible business relationship because the perceived immediate outcome looks so good to them. Having a walk-away price or benchmark enables you to create an objective perspective of every deal, and diminishes the emotional capital that often comes along.

6. Employ a team approach. Deal-making is not and should not be a lone shark approach. When only a single individual controls the deal-making process for a business, emotional thinking can interfere with objective decision-making. All factors considered, if a business forms a relationship with another company, it's better to have several people from each business have some sort of relationship with individuals in the other company in the event that an individual integral to the potential business relationship leaves the organization. Too many deals fall apart because an influential person left an organization.

Once a business enters into due diligence, it's critical to have a team of individuals from that organization with contrasting strengths be involved in the process. This step can enable the strengths of an organization to be leveraged to the benefit of everyone. Furthermore, having more than one person from a particular business involved in the negotiating process can help facilitate matters when sticking points are reached. Finally, several minds working together almost always arrive at solutions and decisions that inspire greater ownership than those reached by a single person.

More than a handshake

Sound deal-making involves adhering to certain precepts, concepts and principles. The days are long past when deals are consummated with a heavy dose of trust and a simple handshake. Rather, deal-making should be the systematic process that leads to a fair and appropriate business relationship between the involved parties. Ultimately, the basic foundation of the process will be the underlying elements of the proposed relationship and the people who are part of it. Perhaps no one states this critical connection better than Dedman: "It takes two things to make a great deal — the deal and the people who come with it!" **FM**

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