CPA Advisor

Five Steps: The selling price of your business can go from traumatic to dramatic

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The owner of a small business generally has three options when disposing of his or her business. First, cease operations and liquidate. Assets are sold off piece meal and liabilities are paid; what's left goes to the owner. Second, pass on ownership by gift or through an estate. This can be to family members or others such as a charity. Lastly, the business can be sold as a going concern to a third party.

Selling a business can be financially and sometimes emotionally traumatic. Here are five strategies which will help the owner in maximizing the selling price.

1. Prepare the business for sale

- Have three to five years of CPA prepared financial statements. Buyers are more confident in the numbers if an independent CPA has been involved.
- Invest in income taxes. Eliminate excessive compensation and perks. The goal is to demonstrate to the buyer the true earning power of the business. Earnings are also the basis for determining intangible goodwill.
- Make sure you have a well trained work force. Buyers like a "turnkey" operation and will discount the price if there are employee problems.
- Clean up the balance sheet. Sell off unproductive assets or identify those non-operating assets that will not to be sold with the business.
- Eliminate involuntary liens against business assets such as tax liens and judgments. Clear up any potential litigation claims. A buyer will likely ask the seller to represent and warrant clear title to purchased assets.
- Check out assignability of leases, franchises, sales contracts and supplier contracts. Buyers may not buy the business unless important "rights" are transferred.
- Keep the business in good operating condition. Equipment should be in working order; accounting and operating systems should be functioning efficiently.

2. Time the sale

The saying goes, "timing is everything when selling a business." The seller must be in the position of a willing seller, not a forced seller. Selling a business because of ill health, excessive competition, insufficient capital or lack of management depth are viewed by buyers as distressed motives, weakening the seller's bargaining position.

The time to sell is when the business can demonstrate optimum earnings potential. Many businesses go through economic cycles; sell during the up cycle. Buyers are motivated by growth, profits and cash flow. If they see an earnings growth trend, buyers are more easily convinced that the trend will continue under their ownership.

3. Target the buyer.

There are generally three types of buyers, depending on their particular motivations for purchasing the business.

- *Strategic Buyer.* Employees, competitors, customers and suppliers all have a particular knowledge either first hand or about the industry in general. They may be interested in buying the business to maintain employee continuity, reach new markets, expand product lines or enter new geographical

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- *Entrepreneurial Buyer*. These buyers are motivated by a desire to both own and operate the business. They may have no prior experience in the seller's industry nor have owned or operated a business of any kind.
- *Investor Buyer*. This buyer is interested in gaining a partial or controlling interest in the business by an infusion of capital. He or she may have some knowledge and contacts in the industry but are not motivated to operate the business.

The seller should recognize the type of buyer he or she is dealing with and find out the buyer's motivations. The type of buyer desired also dictates the marketing strategy. A strategic buyer maybe found by networking within the industry or advertising through trade journals. Marketing to the entrepreneur might be done through newspaper advertising or listing the business with a business broker. A strategic buyer might offer the highest price; however, there may be more potential buyers if marketed to the entrepreneur. The seller may choose multiple marketing techniques to reach more than one type of buyer.

Buyers scrutinize cash flow. An entrepreneurial buyer will verify that existing cashflows can provide a living wage, give a return on a down payment and leave enough cash to pay off seller or third party financing over a reasonable period of time. Knowing this, sellers should consider pricing the business using cash flow valuation methods.

4. Control financial risks.

During the time the business is for sale, sellers are often concerned about maintaining confidentiality. Sellers fear that customers, creditors, suppliers and employees may defect, thus damaging the value of the business. One reason for engaging a business broker is to assist in maintaining confidentiality during the marketing period.

Sellers normally want as much cash down as possible. This, of course, reduces the seller's financial risk should the buyer be unable to pay off the remaining seller financing. Small businesses commonly sell for 20% to 50% cash down. The balance is often financed by the seller because of the buyer's inability to obtain third party debt financing. With seller financing, the buyer must be screened for his or her financial and management acumen. A seller's note can be protected through security agreements, personal guarantees, life insurance on the buyers and negative covenants such as limiting the buyer's salary and perks.

5. Select competent advisors.

- *Business Broker*. The seller may engage a business broker to assist in marketing the business. Business brokers can also assist in maintaining the confidentiality of a proposed sale. Select a broker with a good reputation for marketing businesses in your industry.
- CPA. The accountant should be experienced in business valuation and understand the tax implications when structuring the sale. The CPA can assist in developing a range of asking prices, help negotiate the allocation of purchase price and review the credit worthiness of a potential buyer.
- *Attorney*. Legal counsel should be knowledgeable about a business closing. Normally the buyer's attorney initiates the purchase agreement. The seller's attorney should review the agreement and draft the necessary security agreements to protect seller financing. The attorney should also be prepared to draft bill of sales, assignments, leases, consulting contracts and covenants not to compete.

It is important that all advisors understand the selling process and have the ability to offer creative solutions to buyer-seller impasses. In the end, of course, the decision to sell at a particular price and terms rests with the business owner.

The business owner who sells his or her business usually faces a once-in-a-lifetime event. The financial consequences are far greater than normal everyday business decisions. To maximize the selling price, sellers should prepare the business for sale, time the sale, know the buyer, control financial risks and select competent business advisors.

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