Ground Rules for Successfully Selling Your Business

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Sooner or later you are going to exit your business. The question ***isn't*** whether or not ***you*** will be ready. The sixty four thousand dollar question is whether or not your ***business*** will be ready.

It is estimated that seven out of ten privately held businesses have no succession plan to transfer the business to the next generation of owners. What does that mean to you? It means that if you do not currently have a plan in place to transfer your business to family members, existing partners, management or employees, someday you **will** think about selling your business. And, that day might come sooner than you anticipate.

Don't make the mistake of thinking that just because you are not currently ready to retire that you have plenty of time to prepare your business for sale. As a business broker, I have been involved in a number of transactions (and potential transactions) where the business owner wanted to sell, or in some instances, was ***forced to exit the business*** earlier than expected. In fact, retirement is NOT the number one reason why businesses sell. Here is a list of the most common reasons why owners sell (or otherwise discontinue) their businesses:

- Burn-out (this is the number one reason for selling)
- Health issues
- Personal diversification
- Retirement/semi-retirement
- Death
- Divorce/partner disputes
- Business growing too fast
- Second generation not up to the task
- Loss of market share

TAKE GOOD CARE

The sad truth is that many business owners do not take good care of their most valuable asset: the business. They don't groom someone to continue the business in their absence, and do not keep the business in salable shape during the time they operate the business. They get too bogged down in the day to day business operations to worry about--or plan for an event that they perceive won't occur until sometime in the distant future; **selling the business.** Unfortunately, fate sometimes dictates circumstances beyond your control, and tough decisions must be made. If your business isn't ready to sell when the time comes, what are your alternatives?

1. **Liquidation of business assets—**may be a solution, but one that usually returns very little money to the business owner. If the business had been an operating business, the underlying assets (except for real estate) may be outdated and of little use to anyone. At auction, the assets will bring only what the attending bidders are willing to pay. In some instances, underlying assets are sold to liquidators (or scrap) for only pennies on the dollar. Liquidation of a going business often occurs where the owners have become ill or disabled, or need to retire and have not planned adequately for their exit from the business.
2. **Closing the business—**is even less attractive than liquidation.That is because many who find themselves in this situation have a tendency to "put off" liquidating the underlying assets in hope that maybe someone will come along to buy this business. This almost never happens.

BUILD WEALTH NOW BY PLANNING FOR THE SALE OF YOUR BUSINESS

Okay, so you think you have enough to do without throwing more onto the pile. Am I right? That is why I have written this article for you. It provides a "down and dirty" overview of things that you ought to begin thinking about and planning for right now. Doing so will provide you with an additional safety net that will help safeguard your valuable business asset. Here are just a few of the benefits of planning now:

- A planned sale allows for your goals and objectives on ***your*** timetable
- You may begin to identify potential buyers
- You may be able to ***create*** an attractive acquisition candidate
- You can begin to understand why a buyer may want to buy
- You might learn why buyers would not want to buy—and be able to fix the problems

- You may begin to realize the worth of your business now, and learn how to increase the value as part of your retirement planning

BUSINESS VALUE HOUSEKEEPING CHECKLIST

Record All Sales

Business owners often invent remarkable ways to beat the tax collector. But the taxman can be a business owner's best friend when it comes to selling one's business. Income taxes are a great investment in the years immediately preceding an anticipated sale of the business. Paying income tax proves to the buyer AND the banker that your business operations have been profitable.

Nobody wants to pay more income tax. But consider this example: Ronald Bunk systematically underreported business income by an average of $20,000 per year. Assuming a combined tax rate of 40%, Mr. Bunk saved $8,000 in taxes per year. But, the underreported income also reduced the company's earnings base by $20,000 per year. If, for example, the business could be sold for a multiple of 5x the company's reported earning base---the company would sell for $100,000 less ($20,000 average earning base not reported times the price multiple of 5) than it is really worth! Without considering the time value of money, it would take in excess of twelve years of (illegal) tax savings to make up for the loss of $100,000 in business value. The lesson: In trying to screw the government, business owners often find themselves on the short end of the stick; often in more ways than one.

Eliminate co-mingling of business and non business assets

A common practice among closely held companies is to co-mingle non business assets and expenses with business assets and expenses. I have seen businesses owning motor coaches, boats and airplanes; all reported as business assets. The costs of maintaining and operating the assets were expensed as regular business operating expenses. It is true that those businesses (not audited by the IRS) are saving a certain amount of income tax, and providing an extra "fringe" benefit for the owners of the company.

Wise business owners should endeavor to separate non business assets from the business in the three to five years before a planned sale of the company. Doing so will make it much easier to accurately measure and reflect the true earning power of the business, as it will be unfettered by the capital investment in non business assets and the associated costs.

Buyers of your business are generally purchasing future income and benefit streams that will be produced by your business. The leaner and more productive your business is—the more it is worth. It is never too early to begin segregating non business assets from your business, as it may take some planning and time.

Do your own due diligence

Some executives of both public and private firms get a physical check-up once a year. Many of these same executives think nothing of having their personal investments reviewed at least once a year, if not more often. Yet, these same prudent executives never consider giving their company an annual physical, unless they are required to by company rules, regulations or some other necessary reason.

Anyone interested in purchasing your business will perform "due diligence" procedures on your business before closing on the purchase. All too often, sellers are surprised at the skeletons purchasers can find in the closet. These skeletons can reduce the value of your company, and in some cases, kill any chance at closing a sale. What skeletons are your company's closets?

Why not give your business a periodic physical? In essence, I am suggesting you would do well to treat your business as if someone else owned it—and ***you*** were the potential purchaser. What problems would you discover that could cause you and your advisors to reduce or withdraw your offer? Spending the time and money to discover and fix your company's problems now will pay huge dividends in the form of increased company value—which is exactly what you want when it's time to sell.

Compliance with taxing and regulatory authorities

Mountains of regulation often seem to impede a company's growth and profitability. Some regulations might seem rather easy to "slight" or ignore. Take for example one of my recent sellers who swore to me that the business had no regulatory violations of any type. I reminded the seller that **anything** "hidden in the closet" would most likely be discovered in a buyer's due diligence (investigatory) process. "Nope—no problems of any kind" I was assured.

Well, guess what the buyer's due diligence turned up? Seems the seller had a couple of shipping/storage containers sitting behind the building—which the sellers KNEW were in violation of local zoning ordinances. How did they know? They had received four previous "reminders" from the trustees about the containers, and the need to remove them.

"Why didn't you mention that to me, or disclose that fact on your disclosure statement?" I asked. "Gee, nothing ever happened and the township never did anything—so we just figured it was no big deal." Was the seller's reasoning.

No big deal, except when the purchaser turned up the non compliance issue, it threw a few extra wrinkles into the mix. In that case, the issue was easily resolved (yet, much to the additional cost and chagrin of the sellers). But, sometimes known violations are not so easily remedied. In those instances, a seller runs the risk of blowing a good deal. What's the bottom line? Clean up any tax, industry, OSHA, EPA or zoning issues with which your company does not comply.

Organize and keep records available

One never knows when opportunity might knock. If and when it does knock, will you be ready to strike while the iron is hot?   How many times have you heard someone say something like, "I'd sell anything, including my business for the right price?" Maybe you have even said it yourself. But would you know what paperwork and documents a serious buyer will immediately need in order to pursue the purchase? When a qualified buyer is ready to begin serious due diligence, they will need a variety of company documents. Following is a ***partial*** list of things a buyer will ask for:

- Three to five years income tax returns
- Copies of one to three years quarterly payroll reports
- Three to five years CPA prepared financial statements
- Current year to date financial statements
- Detailed depreciation schedules listing each fixed asset owned by your company
- Corporate Minute Book with updated minutes
- Recent aged accounts receivable trial balance
- Recent aged accounts payable trial balance
- Company organization chart
- Copy of the Summary of Insurance Coverage (provided by your carrier)
- Information about Employee Benefits provided by the company
- Information about Employee Retirement Plans
- Copies of labor contracts
- Copies of other contracts to which the company is a party
- Copies of licenses, registrations for patents, copyrights, trademarks, etc.

The foregoing list is an example of the types of records your company should have up to date and on hand at all times. These records are extremely important to speed the sales process along. Though this advice sounds basic, I often encounter companies whose records are not complete and up to date. This situation can dramatically affect a potential sale.

I suggest using a three ring binder to keep the basic updated records available at all times. This also makes other business needs for the documents much more manageable.

CONCLUSION

You can increase your wealth by knowing a few simple ground rules for successfully selling your business. Just like other owners of closely-held businesses, you know how to operate your business on a day to day, month to month and year to year basis. But your experience in running the business has not prepared you to know how to ***sell*** your business. While the information I provided in this article is not all inclusive, it should help you get started in preparing your business for a successful sale—no mater when the business might be sold.