Selling Your Business - Why Sell?

Author - Industry Canada Publication Date - 1999-10-22

There are many reasons why you as a business owner may want to sell your company. In many cases, selling out may have been your ultimate goal all along, part of a plan to provide for retirement. In other cases, selling is reflection of changed markets, changed personal circumstances, or changing objectives.

Often, once a business has been stabilized, the entrepreneur who founded it will want to move on to new challenges. Indeed it is typical of some entrepreneurs that they prefer the excitement and risks of creating a new business to the relative predictability of managing an established operation.

In some cases, selling a business is a reflection not of success but of acute difficulty. Owners of a failing business may wish to sell it to someone in a position to reorganize it and turn it into a viable operation. The sale may, in fact, be part of formal bankruptcy proceedings managed by trustees appointed to wind down affairs and liquidate assets on behalf of creditors.

The first step in effecting the sale of a business is to decide whether or not you want to sell, and if so, why. Table 1 lists some of the reasons that owners sell their businesses and provides illustrative examples. Each is associated with a different level of urgency or opportunity that will determine just how badly you want to sell, and therefore at what price and on what terms.

Table 1. Reasons for Selling a Business

1. Reason Examples

Personal Considerations

- After operating the business for many years, you believe it is now worth enough to allow you to make a profitable sale.
- You are reaching an age at which you no longer wish to operate a business or wish to retire Ill health is making it impossible to run the business.
- Poor Returns Demand for your products or services has weakened.
- Sales and profits are down.
- Costs are rising faster than sales or profits.

Changing Resources

- You have lost major clients or contracts
- Key employees have left the organization.

- Key leases (e.g. on your premises) are to expire and either will not be renewed, or will be renewed on unfavourable terms.
- Patents on which you relied have expired.
- Key suppliers you depended on in your business are no longer available to you.

Uncertain Future

- New competitors are entering the marketplace.
- New products or services are competing with yours.

Inadequate Financing

- The business requires a major infusion of cash to develop new products, upgrade equipment or refit the premises and you are unable or unwilling to secure this additional financing.

Frustration

- The complexity and demands of operating a business has become too much for you in terms of government regulations, taxes, managing employees, adverse economic conditions, etc.
- You find it increasingly difficult to collect from your clients and customers.
- You are faced with disputes and lawsuits.
- New controls or regulations have been introduced that increase your liabilities or make it impossible to operate the business as you have done in the past.

New Opportunities

- You believe the same business can do much better in another location.
- You see a lucrative opportunity for starting a different type of business
- You have been offered an appealing position with a large organization.

In thinking about your reasons for selling, you should also decide which of these reasons you want to share with a possible purchaser. If you are selling to retire or pursue opportunities elsewhere, buyers may be encouraged since you have obviously done well by the business. But if your reason for wishing to sell is that you no longer believe the business is viable, you may not want to say this to a buyer.

Remember, however, that serious buyers will be doing their own checking and will find out about any serious problems with your business. Withholding vital information may undermine your credibility later on and the deal could fall through. Presenting misinformation might even leave you subject to legal penalties.

Your best course may be reasonable openness with the buyer without necessarily painting too gloomy a prospect. After all, a different management teams with different skills and resources may see a golden opportunity where you see only trouble and frustration. Remember too that like seller's, buyers have many different motivations. They may see in your business a feature that they value far more than you do.

2. What Are You Selling?

Once you decide to sell, define clearly what it is you are selling. A first step is to determine just what assets are contained in the business. This is essential if you want to put a value on the enterprise. Different types of businesses have different combinations of assets and valuation procedures will vary according to the nature of those assets. The point is illustrated in Table 2, which summarize the different assets that might be held in a manufacturing, retail and service business.

Table 2. Assets of Different Business Types

1. Business Type Characteristics Assets to be sold

Manufacturing

A traditional manufacturing business will likely be rich in both tangible assets such as land, buildings and equipment as well as intangibles such as patents and processes. It may also have a Contract with its employees (especially if they are unionized) and an established network of suppliers.

- Land
- Building
- Machinery and equipment
- Existing inventory
- Contractual arrangements with employees
- Client list
- Name, logos, trade marks
- Patents, processes, licenses
- Goodwill

Retail

Many retail establishments rent their place of business so their only physical assets consist of store furnishings and inventory. On the other hand, many retail stores now routinely collect the names and addresses of those who have bought from them. This customer list can be quite valuable in any renewed marketing campaign.

- Store
- Fittings
- Inventory
- Leases on store premises
- Supplier contracts
- Licenses and franchise arrangements
- Contractual arrangements with employees (if any)
- List of regular customers
- Good-will

Service

Service businesses carry few tangible physical assets and little or no inventory. Their chief asset may be a list of clients and the goodwill they have earned. Just as doctors sell their practices, so too consultants and other service providers can sell their client lists, though the valuation of such lists is problematic.

- Name
- Good-will
- Client list
- Introductions and referrals
- Expertise of the previous owner, who may agree to provide training to the buyer

Regardless of the specific nature of your assets, you will have to itemize them and ultimately to assign some kind of value to them. However, it is easier to estimate the value of physical assets such as land or a building than to determine the value of good-will of a client list. Physical assets might be valued according to what it would cost to replace them, or the price that could be received from a sale of the asset. The value of intangible assets such as customer lists or employee contracts might be estimated by comparing valuations used in other similar businesses.

The value of the whole business, however, is more than just the sum of its individual assets. Common methods of assigning a value to an entire business include:

- book value based on the company's balance sheet;
- market value based on valuations for similar businesses,
- the liquidation value based on the sale of assets minus liabilities,
- or the income method based on the revenues the business can generate.

Table 3 is designed to help you prepare an inventory of what is actually being sold. It summarizes what kinds of information that the purchaser will eventually want to see about the asset. You can use column three to estimate the value of these assets.

Work with your accountant to determine which valuation method best achieves your objectives. And remember that whatever the initial value you put on your business, the final sale price will be quite different, since it will reflect negotiations with prospective purchasers who see the business in very different terms.

Table 3. Inventory of Your Business' Assets

1. Asset Information Required Estimated Value*

- Land - Area, location, description of lot, zoning, restrictions.
- Building(s) - Size, type, date of construction, total area, special fittings.
- Machinery and equipment -Type, purpose, when purchased, purchase price, depreciation schedules
- Inventory Amount -, input cost, fair market value, rate of turnover

- Leases, licenses, franchises - Expiry dates, payment details, renewal options, limits and restrictions, other terms
- Patents, trademarks, designs, copyrights - Details of protection, expiry dates
- Suppliers List of regular suppliers -, contractual arrangements, discounts or other preferences, special relationships
- Clients and customers - Contact information, profiles, details of buying patterns
- Accounts receivable - With whom, for what, amount, and age of receivable
- Staffing Arrangements - Number, education, skills, responsibilities in the firm, titles, terms of contractual arrangements

2. Your Financial Records

Once you have listed all of your assets, decide which of them is actually being put up for sale. You may have short-term investments in other companies that have nothing to do with the company you are selling. You may also have a car that you have included in the company's assets for tax purposes but which you would like to keep. This is the time to make those decisions, transfer these assets out of the company, and adjust your balance sheets to remove items that are not part of the offer. Moreover, in doing so, it is a good idea to update all of your financial records, since potential purchasers will want to see them anyway. Make sure that you have solid records of at least the past three years of operation. You may also need audited statements, particularly for larger businesses. Update your corporate minute book to ensure everything of significance is properly documented. And clean up your balance sheets to remove any large receivables from you or payable to you, since this will confuse the purchaser as to the true value of the company.

Remember that your financial records will form the basis of the purchase agreement. If they are in order, they will inspire confidence in purchasers and reduce the possibility of misunderstandings. They will also make your company seem more attractive since buyers want good information about the firm as well as the assurance that an effective reporting system is in place for them to use once they take over.

Finally, while you are sprucing up your financial records, you may also want to dress up the business itself. The purchaser will want to visit the premises. Tidying up offices, organizing storage areas, adding a coat of fresh paint may seem like trivial matters, but they will improve the appearance of the operation and convey a sense of order and efficiency.

3. What Kind of Sale?

At this stage in the process, you should already have a good idea of the form that the sale will take. It may be possible for you to sell all of the assets of your business outright for cash, get on a plane and head for a warm, sunny retirement. However, may business sales are not that simple. You may have to be prepared to accept any one of a host of different alternatives to the outright final sale.

At the most fundamental level, you may find that instead of selling assets, you are selling shares in your business. You may do so because you cannot find a buyer with enough available cash to take your business outright. Or you may adopt this strategy because you are prepared to accept a longer-term transfer of ownership by which purchasers are gradually prepared to take over. This is often done when an owner sells the business to the employees or when the owner wishes to bring in a new partner. This type of arrangement is also common when an owner wants to finance expansion or refitting by bringing in investors with additional capital.

If you sell shares, however, the buyer is actually entering into the existing company and its arrangements. That means the buyer assumes a portion of the responsibility for all contracts, leases, liens, taxes and other liabilities, both known and unknown. And because the buyer bought shares and not assets, he or she cannot get the tax benefits of claiming any depreciation on those assets.

You should also know that buyers are generally advised against these kinds of arrangements unless they can claim previous year's losses against future profits. If you are selling shares, you can sell them to an individual or group of individuals, or you can sell them to the public at large by listing your company on a stock exchange. A public share offering is a lengthy and complex process that is appropriate for businesses once they have reached a certain size or once they can satisfy a series of financial and reporting requirements. The process of going public is described elsewhere in Contact!.

Even if you are selling assets instead of just shares, the sale will involve a period of transition. As part of the sale, you may be asked to remain associated with the business, helping the new management take over the operation. In certain industries, it is relatively common to find the founders of an enterprise selling it to a professional management team while remaining with the operation as a kind of senior adviser or product development specialist. This is often what happens in some high-tech industries founded by engineers who decide they have no aptitude or interest in day-to-day operations and would prefer to focus on the technological development that has always been their first love. You may remain involved in the business because you have actually helped to finance the sale by accepting a promissory note, leasing assets to the buyer, or agreeing to provide the buyer with a mortgage. You involvement can be quite extensive if these financing arrangement contain performance-based clauses in which your payments are tied to the revenues or profits generated by the operation.

For certain types of businesses, it may be that the most valuable part of the venture consists of the company name, trade marks, patents, and processes. Success may have come out of your ability to package a unique product and service combination and it is the packaging that has value. If this is the case, you may wish to sell a franchise in the business, rather than the business itself. By offering the package to potential buyers along with appropriate advice, training, technology transfer and marketing support, you may do a lot better for yourself than if you sold the business outright. Franchising has become an extremely important mechanism for buying and selling businesses. It does, however, require that you remain directly involved after the sale. It is important to be clear in your own mind as to what your objectives are and what arrangements you are willing to accept. Once the business goes up for sale, you may find yourself receiving an unexpectedly wide range of proposals. To deal with them efficiently and appropriately, you should know what your own bottom line is.

4. How to Sell

As an established business owner, you will already have developed relationships with a banker, an accountant and a lawyer. These relationships will be important in helping you sell your business. Your accountant can help you prepare financial statements to present the business in the best possible light and advise you on issues such as the tax implications of different options. Your lawyer can advise you on the terms of the sale and draw up the contract as well as any other documentation. And your banker may be involved if you agree to provide financing to the buyer. All three can also provide you with leads and referrals to people who might be interested in buying the business and the can also use word of mouth to let their own networks know that your business is up for sale.

At this point, you will have to decide if you want to sell the business yourself, using word of mouth, personal contacts, and advertisements or if you want to engage the services of an agent.

5. Do it Yourself

Many owners assume personal responsibility for selling their businesses. If you choose this route, get in touch with your network of business contacts (accountant, lawyer, banker, suppliers, distributors, manufacturers, and customers), informing them that your are interested in selling and asking for any suggestions as to who might want to buy. If you belong to business associations such as a chamber of commerce, a sectoral business council, or a service club, let your fellow members know as well. You may also let current or former employees know of your intentions, in case any of them are interested in taking over the operation. And last, but not least, your competitors may have long been looking for an opportunity to buy you out. In some ways, they may be your best prospects.

Personal contact by telephone is usually the best approach to take with your network. It conveys seriousness while quickly testing levels of interest. Even if your contacts have no personal interest in buying your business, it is useful for them to know that you are looking to sell it. The may pass that on to their own contacts and word will get around.

You can extend the search for buyers by placing advertisements in local newspapers, trade journals, bulletins and other publications. Many business publications have a special opportunities section listing businesses up for sale or announcing that someone is looking for an opportunity. You can check such publications to see if anyone is advertising an interest in buying a business.

If you are using an advertisement, stick to brief general description of your business that highlights the opportunity. Specify the type of business, annual sales, how long it has been in operation, its location and the nature of its customers. You may also want to include specific conditions of the sale, or indicate your flexibility as to terms. You can provide any other details to those who express interest by contacting you.

Remember that once you announce that your business is up for sale, you may elicit a panicky reaction from employees fearful for their jobs or suppliers and creditors worried about being paid. They will want to know just how stable things are and it is in your interest to reassure them. After all, you will need their continued support if you want to sell the business advantageously.

You may also find that once you have announced that you are looking for a buyer, especially if you use ads, you may be swamped with solicitations from people who want to do everything except actually buy your business. Some may offer to turn around your business or manage it for you for a fee. Others will make various kinds of conditional offers such as taking over the operation on a trial basis and then deciding whether or not to buy it later on. And of course there will be those who are not really serious buyers at all, but are just looking around. This is where knowing exactly what you want out of the transaction is important. If you are only interested in an outright sale, state this clearly and firmly so as to avoid wasting time. If you are prepared to entertain alternatives such as conditional sales, make clear on what terms. You can get sucked into a lot of dead-end discussions if you are not clear in your own mind as to what you are prepared to accept. And you can quickly test whether or not someone is a serious buyer by asking them for a resume, a financial statement or a deposit (see below).

It is also possible that the largest single group of respondents to your ad will be agents and intermediaries who will offer to find a buyer for your business in return for a commission or finder's fee.

6. Using Agents

There are several advantages in using an agent or intermediary to sell you business. It can save you valuable time in finding and screening potential purchasers. It can extend the search to reach a lot of people beyond your own personal network. You can benefit from the professional advice and experience of someone whose job it is to sell businesses. That expert can also help you to establish a realistic price for your business by comparing it to other similar ventures with which they are familiar. Using an agent can ensure discretion if you are concerned that a public announcement that the company is for sale will cause panic or demoralization. An agent can also be helpful in finding sources of financing, putting together groups of investors, or securing licenses and permits that may be required in effecting a transfer of ownership.

Of course, nothing is ever free. The services of an agent will cost you money. Generally, the agent will either take a commission (typically 10% of the selling price) or a flat fee for finding a buyer. For larger transactions, this can become far more expensive than the value of the time you would have to spend in doing it yourself. And smaller transactions may be too small to attract as much care and attention from the agent as you would like. What is more, agents may drive to a deal, any deal, just to collect their fees, regardless of whether they got you the best price. There is also a practical limit to how much time agents can save you. Yes, they can screen out nuisance calls and non-serious offers, but you will still have to spend time on the offers that they do bring you. Negotiating the terms of a sale can be quite complex and you may find that you have not really reduced your overall time commitment to the process by very much. Finally, be careful as to how you list your business with an agent. If the listing agreement specifies only that the agent will bring you offers that conform to certain conditions, you may wind up having to pay the agent a fee, regardless of whether those offer result in an actual sale.

7. Information Kit

An important selling tool you will need is an information kit about your business. The exact size, scope and contents of this kit will vary according to the size and nature of your business. You may find it useful to prepare three distinct promotional pieces:

- A summary description of the business in a paragraph or two, highlighting the opportunity and specifying any significant terms or conditions. This summary can be used as the basis of advertisements or as a teaser just to get the word out that you are interested in selling.
- A fact sheet on one page, similar to the sheets used by real estate agents in selling houses, providing the key facts about the business, its key assets, customer base, annual revenues, and operating costs. This can be used to provide additional information to those who have expressed some interest in finding out more.
- A detailed information kit containing a complete description of the business. In some cases, this kit can take the form of a brochure, complete with photographs of the premises, endorsements from satisfied customers and sales projections.

In describing your business, use Table 3 as a guide to the kinds of information that potential purchasers will want about your assets. Beyond that, purchasers will also be interested in:

- A history of the business, its location, when it was founded, by whom (if not you), and its annual revenues over time;
- A description of products, services, customers, geographic area served, how sales are made, who makes them, commissions or other fees on sales (if applicable).
- Potential buyers will be impressed by clarity in defining the business you are in and details of all operating costs (utilities, taxes, maintenance and repairs, insurance, salaries rental payments, equipment leases, etc.);
- Current competitors and their strengths or weaknesses in relation to your firm, competing products or services, market trends, projections;
- Any licenses, permits, inspections, certifications, or regulatory compliance's that are involved in your business which the buyer would have to assume or obtain;
- The terms that you are looking for in the sale;
- Any problems in the business that you feel you should disclose;
- A contact name and telephone number that is not your regular business line.

8. Responding to Offers

A real danger in seeking to sell your business is that your time will be wasted by non-serious inquiries. Your first challenge therefore is to weed out the nuisance and crank calls and focus on promising prospects. You also do not want to divulge a lot of information about your business to unknown callers, especially if there is a prospect that the information could find its way to competitors. A relatively easy way of controlling inquiries is to turn the tables and ask callers for information about them. It is perfectly legitimate to ask a caller for a personal resume with references, as a way of determining if they are in a position to make a serious offer.

If you find a potential buyer that looks like the real thing, do not immediately give away information about your business. Instead, checks references, especially with the buyer's bank, and get an statement of the buyer's net worth, if possible. Frankly, you need to know early on whether or not the buyer can afford your business. If not, do not waste any more time on negotiations. If the buyer needs financing to make the purchase, you need to know that early on as well, particularly if he or she is looking to you to help provide some of it. If the deal leaves you with a continuing involvement in the business, you need to find out everything you can about the purchaser's goals, abilities and trustworthiness. And you need to find out everything you can about the buyer's motivations in buying the business (e.g. to reduce competition, fill out a product line, expand into a new territory etc.). Perhaps they see a value in your business that you have overlooked but that will affect the purchase price. Remember too that while you are finding out everything you can about the buyer, the buyer is finding out everything he or she can about you and your motivations in selling the business. If the purchaser is thorough, all your company's titles, deeds, leases, contracts, licenses, mortgages, patents, copyrights, liabilities etc. will be verified as part of this process.

After both parties have exercised some due diligence, you will be ready to get down to negotiations. Discussions can go through several stages, but typically, the buyer making an offer usually follows some preliminary talks. You may wish to specify that to be taken seriously, a non-refundable deposit, as is done in real estate transaction should accompany the offer. At that point, the real haggling can begin.

Typically in a negotiation the parties start at opposite extremes and work toward the middle. If you receive an outrageously low offer for your business, do not get discouraged. Make a counteroffer that reflects your own sense of what the business is worth and see what happens. Above all, resist pressure tactics and be suspicious of any offer that involves unrealistic or unnecessary short deadlines. At the other extreme, dragging out negotiations can also be a tactic to induce you to sell on unfavourable terms so as not to lose the time you have devoted to negotiations or the money you have spent on credit checks or contacting references. Ultimately, your best protection against a deal that doesn't seem right is your willingness to walk away from it at any time, regardless of how much time and effort you have already put into it.

At the other end of the spectrum, be wary of any offer that seems to good to be true. It is worthless if it is not backed by an ability to pay. And if the high price is part of a conditional offer tied to the performance of the business, consider whether or not the operation can generate the kinds of revenues needed to pay that price.

In some cases, the buyer will ask you for help in financing the transaction by taking a mortgage or in accepting a promissory note for part of the purchase price. You may also be asked to lease rather than sell land or other physical assets, if the buyer doesn't have cash for outright purchase. Such arrangements may, however, involve no security other than the business itself, and you may be subordinated to other creditors. Such a proposal could prove very risky for you and you should consider whether the other terms of the offer are worth taking that risk. Repayment could also be tied to sales or profits, in which case, it depends on the ability of the purchaser to make a success of the business. Occasionally, the purchaser may offer to pay you with shares in another company. This may be acceptable providing that the shares are publicly traded, offer dividends, and are easily liquidated. It also has the advantage of deferring any capital gains taxes you may owe as a result of the sale. Receiving shares in a closely held company, by contrast, is extremely risky and should probably not be considered. Finally, be sure to discuss the tax implications of any conditions with your accountant before you agree to them.

9. The Contract

Ultimately the sale of a business involves a combination of final price, other terms and overall risk. You may be prepared to accept a low price as long as other conditions are met and the risk of non-payment is low. Or you may opt for a high price tied to a higher level of risk. The precise mix will vary in accordance with the nature of the business and the inclinations of the individuals involved.

Whatever the negotiations yield, the details should be spelled out in a contract that itemizes all aspects of the sale. The following is a summary of some standard items that are usually found in such a contract:

- a definition of what is being transferred, from whom to whom, and at what price; this should include an itemized breakdown of costs so that the purchaser will have a record of the value of depreciable and non-depreciable assets;
- details of any leases or liabilities that the purchaser agrees to assume; the method of payment (in cash, by cheque, in shares in another company, in bonds), on what date, by what means; any adjustments to the price to cover financial transactions occurring between the moment the offer is signed and the closing date (this could include sale of inventory, equipment purchases, tax payments, etc.);
- guarantees by the seller of the truthfulness of information supplied and provisions for any penalties in the event that information is not accurate.
- a description of the seller's obligations in operating the business up to closing, implementing the transfer of ownership, and performing any post-sale duties or services;
- how to deal with any losses or damages that might occur to the business between signing the agreement and the closing date
- a clause restricting the ability of the seller to compete with the business once the sale is closed, or limiting the seller's freedom to start up similar ventures;
- any conditions that should be met prior to closing (such as validation of deeds, liabilities, or agreements entered into by the business);
- details of closing including the date, time, place, and individuals effecting the transfer; compensation to be paid by the seller to the buyer for damages
- compensation if information is to be found to be false;
- the amount of the security deposit put up by the purchaser and held in escrow for a period of time as a guarantee that all terms and conditions have been satisfied;
- who would decide the case in the event of a dispute.

12. A Few Final Comments

Selling your business can be a lengthy and difficult process. Before embarking on it, you should be certain that you really want to sell your business but that you are prepared to wait until you receive a reasonable offer. Timing, they say, is everything in business. The timing of your sale may also be important. If your business is seasonal, you may wish to show it off to purchasers (and they may wish to see it) at peak season and not when things are slow. Market trends, competitors' announcements, and changes in the economy may influence the sale (e.g. interest rate fluctuations). You may not have any influence over such factors, but by timing your sale, you may be able to compensate for their impact.

Finally, even though you are in the process of selling the business, you must remain committed to it and active in its daily operations. Many owners lose interest in a business once they have decided to sell it, often with disastrous consequences not only for operations but for the final selling price. In fact, after deciding to sell, you should pay all the more attention to your business to ensure that you can sell it for the highest possible price and the best possible terms.