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business sales and acquisitions for entrepreneurs

PREPARING YOUR BUSINESS FOR SALE



Important Steps to Help Ensure A Successful Sale

Following an organized and methodical process to prepare your business for sale can increase the likelihood of finding the right buyer, maximize the selling price, and help ensure a successful closing.

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If you are thinking of selling your business – now or in the future – carefully preparing the business for sale can significantly increase your chances of finding the right buyer and successfully closing the transaction.

You may also be able to identify and fix any challenges or weaknesses that could derail a potential sale, or cause a buyer to offer less than full value. You'll also be better prepared to highlight and discuss the unique strengths of your business to potential buyers.

The time to prepare for a sale is before you put the company on the market! While you may not be able to address every potential issue, the sooner you begin, the more you'll be able to accomplish. It's not uncommon to begin pre-sale planning and evaluation two or three years before a potential sale of the business. Even if you eventually decide not to sell, working to improve the long-term profitability of your business is always a worthwhile exercise.

Preparing the business for sale can help increase the potential selling price of your business, and can identify and resolve any issues that could cause a buyer to walk away.

While every company and situation is unique, the process to prepare a business for sale involves analyzing and resolving any issues involving critical aspects of the company, such as financial performance, accounting methods, sales and marketing, employee performance, facilities, inventory management, and legal issues.

Important issues to consider include:

MARKETING ISSUES

Your ability to articulate and demonstrate future growth potential of the business, your track record of top-line revenue growth, and your competitive position within your industry are vitally important in determining whether your business will be attractive to prospective buyers.

- As a general rule, most buyers want to acquire a business that will continue to grow. You need to be able to clearly articulate how your business can continue to grow over the next three years. Where will new sales come from? Will additional investment be required? You must be able to discuss and substantiate your realistic expectations for future revenue and income growth with a prospective buyer.

- Can you identify any immediate low-hanging fruit to increase revenue? If so, develop and execute a plan to take advantage of the opportunity. Buyers are inherently skeptical – if the growth you anticipate is so easy, why haven't you already done it? This might not be the time to implement an ambitious program to enter a completely new market, but if you believe there are simple opportunities to build revenue, now is the time to do it. For example, can you expand your relationships with existing customers, or increase prices on certain products or services?

- A company with recurring revenues will often sell for a higher price than a company that must constantly seek out new customers. For example, a services firm with clients on monthly retainers will generally receive a higher valuation than a firm that handles clients on a project basis. Can you increase your percentage of recurring revenue? Can you switch some clients to long-term contracts, or are there other ways in which you can encourage repeat business?

- How well do you know your current clients? Do you know how your business is perceived by your clients and distribution partners? It can be helpful to share any feedback with prospective buyers, and it's likely that a buyer may at some point want to speak with some of your clients. It may make sense to conduct surveys or client focus groups to obtain some relevant client feedback, positive or negative. If you sell via retail channels, consider feedback from your end customers, as well as your retail partners.

- If a significant percentage of your business comes from one or a few clients, you may have a customer concentration issue. This can present challenges in selling the business or in obtaining a reasonable price, as a buyer may be concerned about losing revenue if the key customers leave. When trying to address and resolve customer concentration issues, consider developing incentives for your large customers to stay with the business, (for example, will they sign a long-term contract in return for pricing concessions or can you take over services that are hard to replicate in-house), and look for ways to diversify your clientele.

- How well do you know your competitors? Do you know all their products, their pricing and their customers? How does your business differ from the competition? What is the overall size of your market, and how does your market share compare to that of your competitors? Bear in mind a prospective buyer will evaluate your business compared to your competitors, and buyers will ask you about your competitors.

- Also consider that your competitors may in fact be your most attractive buyers. Your business may be attractive to competitors if you can help increase their market share, provide new products, new clients, new technology, better employees, or other strategic benefits. If you're thinking of a future sale, maintaining a positive presence within your industry can help build relationships with prospective buyers. Attending trade shows or industry events can increase your visibility within the industry, help identify prospective acquirers, and provide future opportunities to begin conversations about a potential acquisition of your business.

- Have your sales and marketing programs kept pace with recent changes in technology? Have you fully embraced social media in a way that is appropriate for your business? Are your marketing materials up-to-date? A buyer will look at your website before they visit your business, and if it's out-of-date, you should consider refreshing it. Have you Googled yourself and your business recently? A prospective buyer will, so address any negative comments or reviews.

- Is your sales team using the latest technology to identify, research, contact, and track prospective clients? Is your CRM system up-to-date and appropriate for recent developments in your business?

ACCOUNTING AND FINANCIAL ISSUES

Are your accounting records and financial statements up-to-date and organized? All prospective buyers will want to want to review your financial records, usually sooner rather than later. You can expect to be asked for income statements, balance sheets, cash flow statements, and tax returns, for a minimum of the past three years.

As you progress through a sales process with a buyer, the buyer's financial questions will become increasingly complex, so it's important that you or a trusted member of your team has the ability to quickly respond to requests for additional financial data.

Assuming your financial statements and tax returns are accessible and organized, other areas to address related to your business financials include:

- Have you been allocating your income and expenses consistently? A buyer will probably compare month-to-month or year-to-year income and expense line items. For example, if you allocated shipping expenses to cost of goods sold one year, and then to fixed expenses the next year, your gross margins will fluctuate, leading a prospective buyer to believe there could be problems that don't actually exist.

- Most business owners already have a tight control of expenses. But if you haven't examined expenses recently, take a look at how costs have crept up over time. Are there areas where you might be able to reduce or eliminate expenses, without sacrificing quality? Could you be saving money by taking advantage of trade discounts? Is it time to shake-up some long-term and possibly complacent vendors or suppliers by obtaining competitive quotes? Remember – the more profitable your business, the higher the likely selling price.

- Do your gross margins vary by client, product, service or location? If so, do you know why? Evaluate any steps you could take to improve the profitability of lower margin products or services. Do you know how your margins and cost structure compare to your competition? Buyers generally love high-margin businesses, and it can be hard to command a premium valuation in a sale if your costs and overhead are higher than industry averages. Your industry trade association may be able to provide information on industry averages for profitability.

- Most small and middle-market businesses are not 100% compliant with GAAP (generally accepted accounting principles.) However, many buyers will want you to represent in the purchase agreement that your financials are compliant with GAAP. Speak with your CPA to understand where your accounting policies differ from GAAP, and be ready to explain any differences to the buyer.

- Take a careful look at your balance sheet. Your assets and liabilities get incorporated into the purchase price via working capital, and the balance sheet is also often a reflection of the health of your business. Is your balance sheet accurate and up-to-date? If you take in deposits before you provide a service, are your unearned revenue liabilities reflected on your balance sheet? Does the inventory on your balance sheet reflect what's actually in your warehouse? Do you need to write off any uncollectable receivables? Are the security deposits for landlords or utilities correctly shown on your balance sheet?

- Can you pay down any high-interest debt – or possibly refinance debt given today's low interest rates? When your business is sold, it's likely a buyer will not assume any debt, in which case you will need to pay off any outstanding debt with the proceeds from a sale. Speaking of debt, when is the last time you met with your banker? Can your bank offer new products or other ways to manage expenses such as bad-check charges, credit card processing fees, or lock-box services?

YOUR FACILITY AND YOUR LEASE

Take a walk around your offices, warehouse or other business facilities. Is your business clean, well lit, organized, and freshly painted? Make a punch-list of every item that needs to be fixed, and invest the time and money to have someone fix, clean and paint. Although it sounds superficial, a neat, clean environment sends a clear message that your business is organized and well run, while a poorly maintained facility suggests that you have not have been investing in the business.

- Ensure your facilities meet and exceed all safety codes and standards, and that all required legal documentation is posted. If employee desks are messy and stacked with files and unfinished work, institute and enforce a clean desk policy. Fix missing or broken signage, clean outdoor areas or parking lots, and landscape if necessary.

- This is also the time to review your lease, and to maintain a positive relationship with your landlord. Check your lease for clauses regarding transfer of business ownership. Most leases state that the landlord will not “unreasonably” withhold approval of a new tenant if you sell your business. However, bear in mind that your landlord’s definition of “reasonable” might be different from yours, especially if you already have a troubled relationship. We’ve seen more than one deal hinge on the mood of a difficult New York City landlord.

- If your lease will soon expire, you may need to make a judgment call as to whether you should renew now. If your business is highly dependent on your location, and losing your current lease would impact your ability to generate revenue, you should ensure you have an attractive, long-term lease in place for a new owner to assume. However, if your business might get acquired by a competitor who wants to combine facilities such as warehouses, flexibility with your lease terms, or a lease that will expire within the next couple of years might be more attractive.

- If you own real estate used to operate your business, determine whether you want to sell the real estate, or keep and lease the real estate to the new owner. A leaseback can provide you with an attractive ongoing revenue stream in addition to the selling price of the business. There are many advantages to holding real estate in a separate business entity, so you may consider working with your lawyer to separate your real estate ownership from your ongoing business. If you own your real estate and have been leasing the property to the business at below- or above-market rent, you'll also need to re-evaluate the profitability of the business based on market rent – and this can impact the selling price of your business.

ISSUES RELATING TO EMPLOYEES

Your employees may play a critical role in your ability to sell your business. A team of well trained, highly motivated, experienced, and appropriately compensated employees sends a positive signal to a buyer.

- Are your employee records organized, with all appropriate documentation in place? Have your employees signed confidentiality agreements? Are any non-compete agreements legal and enforceable? Do you have all the necessary documentation in place to show that your employees are legally allowed to work in the US? Are any performance issues appropriately documented in the employees' files? Do you have an employee policies and procedures manual in place, and if so, is it distributed to new hires, and is it being followed?

- If you use independent contractors, make sure you're in compliance with applicable employment laws. A potential buyer will not be excited by the prospect of increasing expenses by adding independent contractors who should be properly classified as employees to the payroll.

- You'll also need to determine whether or not to discuss the possibility of a sale with your employees. Most entrepreneurs prefer to keep a potential sale confidential, to avoid causing unnecessary concern or possible departures among employees. However, there are some situations where it may make sense to tell key employees you are considering selling the business. For example, if you are approaching or are already past retirement age, your employees may already be concerned about your next steps. Knowing that you are actively seeking a new owner can provide employees with reassurance that the company will continue to operate, even if you are not involved in a day-to-day role.

- Do you have any key employees whose departure would create significant challenges for the business? A buyer could back out, raise concerns, or reduce their offer if one or several key employees leave before the sale is completed. Some employees may also use their increased leverage as an opportunity to negotiate salary adjustments if they realize their continued employment could impact a potential sale. If you do have an employee whose continued presence enhances your ability to sell the business, it may make sense to encourage the employee to stay with a future bonus or other compensation tied to the sale.

INVENTORY ISSUES

If your company carries inventory, the way in which you handle inventory can make or break a potential sale. Do you know how your inventory levels compare with other companies in your industry? Many business owners carry too much inventory, believing that high levels of inventory allow them to quickly fill orders, and buying in volume can reduce expenses. However, this approach can overlook the high carrying costs of inventory, as well as risks of spoilage or obsolescence.

- Do you have an accurate inventory count and inventory aging report? Does your inventory in your warehouse match the stated inventory on your balance sheet? A buyer will conduct an inventory count before a closing, and any discrepancies between your count and the buyer's count can cause problems.

- Do you have slow moving, old, or potentially unsellable inventory? If so, sell it for a discount, use a liquidator, or take a write-off – get it off the balance sheet and out of the warehouse. A buyer won't pay full price for old or obsolete inventory, so it makes sense to get rid of it before trying to sell the business.

LEGAL ISSUES

It's important that your business is in compliance with all laws and regulations before you start speaking with prospective buyers. Your lawyer will also play a key role in selling your business, reviewing letters of intent, and negotiating a definitive purchase agreement.

- A buyer will eventually want to review all documents related to corporate formation. These documents could include articles of incorporation or organization, shareholder or member agreements, bylaws, minute books, stock certificates, and minutes of board or shareholder meetings. Check to ensure you have these documents available for review, or work with your lawyer to obtain additional copies to avoid last-minute fire drills.

- In addition to issues mentioned previously relating to your employees and lease, it's also a good idea to review all other contracts or legal documents for any issues that could present potential problems during due diligence. For example, check the terms and expiration dates of any documents that are necessary for the continued operation of your business. Look for any clauses that refer to change of ownership or assignment of contracts. Review your contracts with your clients, suppliers, manufacturers and distributors, as well as leases, buy-sell agreements, licensing agreements, advertising agreements, loan documents and insurance policies.

- Consider any issues related to intellectual property related to the operation of your business. Do you have trademarks or trade names that are important to your business? If you use a contract manufacturer to produce product, do you own the formulations, or does the manufacturer? What about patents or copyrights that cover your products or services? It's a good idea to check with your lawyer to ensure that official fees have been paid, and that all your rights are in force.

IN SUMMARY

These are just some issues to consider when planning a sale of your business. You may need to address some of these issues, and there are likely to be others not mentioned here that are specific to your business.

At Hughes Klaiber we offer a customized, free and confidential pre-sale analysis, to help you understand whether your business will sell, and to identify any issues that should be fixed prior to a sale. Contact us today at shughes@hugheskIaiber.com

ABOUT HUGHES KLAIBER LLC

We help entrepreneurs successfully sell their businesses. Our professional approach is tailored to meet the needs of owners of privately held businesses with a minimum of four million dollars in revenues. We have experience serving clients in industries including consumer products, business services, retail, wellness and fitness, manufacturing and distribution.

Contact us to schedule a pre-sale evaluation, and to discuss other issues including:

- *Valuing your business*
- *The most effective strategies to identify and contact prospective buyers, and*
- *Negotiating the transaction, handling due diligence and getting to closing.*

CONTACT US

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