The future of your business

Everything you always wanted to know about selling for cash

By Frank M. Butrick

Any business owner 50 years of age or older should have a plan for his personal and business future. He faces four basic choices:

• Develop a son or other relative to become the next president and continue the business of the firm.
• Develop another employee as a family surrogate for the same objective.
• Do nothing: run the business as long as health permits, then let it go “smash” or sell it for whatever he can.
• Sell under circumstances which provide a long term career and personal and financial satisfaction.

This article, presented in two parts, will focus on the latter option, which is one many have sought and few have found.

There are many relatively easy steps involved in the sale of a business. Among them are setting a price, finding a buyer, closing the deal and arranging a future employment contract. Yet, almost invariably, these few steps lead to a bitter, frustrated and disillusioned seller.

If a man sells his business because of financial troubles or failing health, the disappointment is usually built in. But when a man works with his accountant, attorney, banker, broker and buyer and still ends in embitterment, then something is wrong. Yet, if you talk to five men who sold their businesses, four will be unhappy. Fortunately, you need not join them if you decide to sell. Too, you needn’t fear selling.

Your comfort with the decision to sell begins with deciding what you want from the sale. The price is only a small part of what you should be seeking.

An early decision will be whether you wish to remain with the company after you sell it. Invitations to remain are common. In assessing your decision, consider that your position will be unlike what it has been. You will find your authority sharply limited. You will also find that you will gradually be required to change your mode of operation to conform with the policies and operations of the new owner.

Early Adjustments

Another thing to consider is the changes you face personally. To date, you have owned your own company. If you had directors, they were virtually powerless to change your decisions. You answered to no individual. Now, suddenly, you will be made to account for your every decision and indecision, your profits or lack of them, for studies, reports, forecasts and progress statements. You’ll be expected to make plans and projections and explain if they are not fulfilled. Up to a third of your time may be spent with the new owners, and you may find yourself sparring on their profits-at-any-cost objectives.

The employment contract that started as your guarantee may then wind up as a sword over your head. So initially, you really have only two choices once you decide to sell: to adjust and join the new owners as an executive member of their system or to simply get out. You cannot stand pat, because it will not work. It never does.

Recognizing your changing role if you remain with the company will help you, before accepting an offer to sell and stay, to take a long look forward and backward. You can assess what aspects of business management you enjoy most. When you reach the decision to sell, you can propose to the new owner that you retain your title for the sake of appearance, but
that you spend six months training a new general manager, so you can move over and concentrate on the things you enjoy doing; things you know and like the best.

With an employment contract like that, you are out of the hot seat. The advantages are built in. At the country club among old friends, you are still the company president, but at the office, you have minimum problems, maximum satisfaction and your best chance for continued years of accomplishment and pleasure.

**Taking Stock**

Once you’ve resolved personal questions, you’ll turn to the price you expect to get for your business. Lay the question of money aside, and first, decide what you will do with your purchase assets. This decision is of prime importance in determining what consideration you will accept, whether you take stock or money, cash or terms, or short or extended payoff terms. All of these options affect what you should ask and what you’re likely to get for the business.

If you take buyer’s stock, you accept limitations. You’ll probably hold it. Most purchases of stock include tight restraint on how much of it can be sold each year. Thus, stock could be a liability for you; there’s no point in accepting stock you can’t sell and which yields dividends too small for you to live on.

All you may wind up doing is increasing your estate and your heir’s taxes. Too, there is no possible way to predict accurately the future of any stock, the economic climate, inflation rates, or even your own future needs. Too, the stock of a privately-owned business has virtually no value, because it offers you no real leverage, rarely gives you the real opportunity to vote on dividends, and is difficult to sell. It is also difficult to borrow against.

So, the best advice is to decline an offer of stock in a privately-held company.

**Cashing In**

Cash is usually very attractive to buyers and sellers, because it has ego gratification and it appears to be advantageous. In fact, in most cases, accepting cash is a mistake which hurts both buyer and seller.

Cash sales almost always yield less return than transactions for terms. Unless the seller is an expert in investments, he has difficulty in putting the money to work for him effectively enough to offset the impact of double-digit inflation and guarantee him a reasonable margin of safety.

Nevertheless, some sellers are going to demand cash, and if that’s your decision, there are proper ways of going about it. Start by deciding what you have to sell and how to make it more valuable. In most cases, you’ll be selling both the assets and liabilities of the business.

(Note: There are a number of factors that can lead to a sale in which liabilities are settled by the seller, such as delinquent taxes, large payables, legal problems or accounting failures. However, it is impossible to determine what course your buyer will take in this regard when you are planning the sale, so we’ll assume you’re selling the total business.)
When you’re selling for cash, you can expect the buyer to be more wary than in a terms sale. Because of the up-front capital involved, he’s going to be more demanding, and he’s going to dig deeper into your business affairs. He has to assume that if problems develop, your lack of financial interest in the future of the business will lead to your abandoning him. That reality makes cash harder than terms, suitable buyers more difficult to find and your time of sale longer.

If at all possible, plan your sale a full three years in advance. You’ll need that much time to do a good cosmetic job on your company. You’ll need to play up its value, convincingly demonstrate its ability to generate profits, show its future potential and make it attractive. (Five years would be even better; there’s that much to do.)

The purpose of the cosmetic job is to make the immediate past and future for your business as attractive as is possible. It’s an incentive to do things you should have done years ago—simple market research, profit analysis and a written growth plan.

In turn, you’ll find an upgrading of the entire operation, which will not only improve your profits, but will also please prospective buyers. The three-year touch-up gives you the chance to convert your firm into a real winner you’ll get top dollar for.

If you don’t have three years, then do as much as you can to demonstrate your planning and progress.

Salesmanship

We’ll tell you how to locate a buyer in our next segment, but once he’s on site, prepare to pull out your financials for the past three years. Sit down with your accountant in advance to make certain you understand your books well enough to answer the buyer’s questions. When you’ve satisfied your prospect, get out your research reports, forecasts, master plan and profit projections. Cover them carefully, step-by-step.

Once you and your buyer are satisfied with the potential of your business to make money, your price tag will be some multiple of these figures, plus any unusual assets and adjustments for unusually high liabilities. A good rule of thumb for setting the price is to start at eight times the earnings capacity for the next five years. Any real estate, by the way, is treated as a separate transaction.

On a cash sale, you’ll probably be offered a figure 4.5-5 times the projected five-year earnings. Starting at eight, you can expect to negotiate a selling price between five and six times the earnings. If you receive a “take it or leave it” offer below five times the average earnings, hold for another prospect. If the offer is for more than eight times the earnings average, grab it!

The value of a company is a nebulous thing, and you should try to negotiate simultaneously with several prospects, which will give you a cross section of opinions and reactions.

The main thing to remember in salesmanship is that even companies with no profit history still have value and some profitable companies have been sold at up to ten times the earnings potential. You should feel five to six times earnings is a good price if you’ve done the right things in the cosmetic period.

Wrapping Up

Your accountant and attorney will wrap up the details of your sale for you, but remember this takes time. Therefore, when you have a deal with a buyer, insist on a short-form written agreement and a partial payment of at least 5% to bind the sale until the final papers are drawn and signed.

Remember that cash means cash . . . right on the barrel head. If the deal is part cash and part stock, say “no”. If it turns out to be part cash and part notes, you’ve got a term sale, and you can get far more money and a better deal by treating it that way.

We’ll look at selling for terms in our next installment.