Banks For The Memories

When it's time to sell a business, here's a guide for getting maximum value.

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The opportunities for businesses, especially those with sales of between $10 and $100 million, to sell out for a significant profit in today's marketplace have never been greater. If a search for the right purchaser is broad enough, and the planning process is well thought out, the entrepreneur may reap a reward far exceeding expectations.

However, dangers lurk for the seller who is inexperienced in transactions of this magnitude. Selling to obtain maximum value requires extensive preparation. Among the pitfalls of the process is that many think the process might be quick and easy.

On the one hand, it is understandable that many sellers fail to avoid pitfalls, since the sale of a business is a once-in-a-lifetime event for the vast majority, whereas most of the buyers have already been involved in several transactions and along the way have acquired some sense of what a highly profitable negotiation demands. In this setting, the unprepared seller is at a distinct disadvantage.

On the other hand, sellers have the availability of advice on every aspect of the sale and, if they take advantage of it, can walk away with the maximum possible value for their investment. Every transaction contains elements that are unique, and ample opportunity exists for a seller to use them to his or her benefit.

The art and science of selling a business involve three basic kinds of preparation: the preparation of yourself, your business, and the buyer. This article reviews all three.

PREPARE YOURSELF

Owing to the intense emotional environment that surrounds most sellers of businesses, they are often overwhelmingly inclined to lose perspective and objectivity. Time and again, sellers will react to circumstances and fail to act in their own interests.

Before anything else, ponder this: Have you analyzed your motives for selling? For example, are you certain that selling is in your best interest right now? Have you chosen the best alternative for achieving your goals? Given the mix of emotions that may be involved, the need for objective professional advice is perhaps more vital at this point than at any other. Outright sale just may not be the most appropriate solution.

A common fear among sellers is: How would a buyer change my business? Unless you as the seller have candidly faced that anxiety and dismissed it as a factor in the sale, you are not quite ready to sell.

A realistic, honest examination of your motives may yield a surprising conclusion. Even when it doesn't, such an examination of objectives and concerns will shape the terms and the timing of the ultimate transaction. To avoid surprises and disappointment, therefore, "know thyself."

The most common motivations to sell are:

- **Retirement** or succession of the business.
- **Capital requirements.** A seller may be at a point where the business is no longer a "small" business; yet to expand to the next stage that would ensure survival is too expensive.
- **Personal finances.** This encompasses the desire for liquidity and effective estate planning.
- **Timing.** The market for the particular type of business may seem to be at a peak.

Naturally, other motives will sometimes play a dominant or at least a secondary role. These include: being bored with the business, illness, divorce and other family matters, growth beyond the capability of managing the business, and changes in the marketplace.

ALTERNATIVES TO SELLING

The seller's financial-planning objectives for after the transaction must be established. This includes an analysis of the investment alternatives in light of the economic environment. The question every seller should ask is: Do I have a better investment alternative than the one I am selling?

In deciding whether to sell 100 percent of the business to a third party, you should consider the full range of alternatives, evaluating each of them with an eye toward maximizing shareholder wealth. These normally include:

- Leveraged buyout by internal management.
- Employee stock ownership plan.
- Initial public offering.
- Private placement.
- Recapitalization.
- Liquidation.

Recognizing the optimum moment is possible only after long experience in similar transactions. Since negotiations tend to exhibit an ebb and flow, selling at the peaks of market and industry cycles can make all the difference.

Maximizing shareholder value means bracing for what could become a long process. Those unwilling to face an emotional six to eighteen months should avoid the process althogether or risk the possibility of realizing less than maximum value. In choosing an adviser, beware of those who promise you'll have a check in hand within two or three months. This is just talk.

Softening the emotional shock also implies planning for life after the sale. Rare is the entrepreneur who can leave a well-managed business without some sense of letdown. Nevertheless, it's well to think of the sale not as the end of an era but as the beginning of a new one.

PREPARING THE BUSINESS

Despite the long time horizon customarily required for consummation

of a sale, don't make the mistake of allowing your business operating standards to slip. Indeed, your attitude should be like that of the typical homeowner trying to sell a house: in most cases, the house never looks better than when brokers and prospects arrive.

A buyer perceives a well-managed business as more valuable, since it is likely to mean an easier transition with fewer surprises in the short run and a foundation for better prospects in the long run.

Attention to the cosmetic aspects of the company—neatness inside and out—will add value well in excess of the additional time and expense this attention might require.

Danger lurks for the seller who is inexperienced in large transactions.

Also, make sure that operational and accounting records are orderly and accessible. It may also be helpful to prepare additional information that may be obvious to those already working at the company but much less so to purchasers.

An owner should take particular care to prepare employees for a smooth and amicable transfer of ownership. Until the transaction is consummated, however, confidentiality will assist in the orderly continuance of operations. Limiting meetings to off-premises locations is the most prudent way of assuring such confidentiality.

Other issues to address include:

Objectivity in the valuation. Entrepreneurs typically have no previous experience in assessing unsolicited offers for their companies, and a valuation can therefore save considerable time and money. It will, moreover, force you to think hard about the positive and negative points of your business, which will help you to maintain or enhance the value as the selling process goes forward.

Pivotal to the selling process is a clear picture of the business to be sold, and yet no part of the process is more subject to self-deception or disappointment. Many sellers suffer from the myopia that supposes that money might be saved by skipping the valuation step altogether. The result is frustration that sterns from operating in the dark and trying to negotiate from an unstable center.

Choosing a firm for the valuation. Above all other criteria, a buyer is seeking to arrive at a realistic return on his

or her investment. In evaluating your business, the most difficult exercise from the intellectural standpoint is to attain the level of objectivity that will result in a realistic valuation.

It is therefore important to choose a firm with a reputation for objectivity. You should also arrive for appraisal of property, plant, equipment, and intangible assets, which is helpful in minimizing goodwill in the allocation of the purchase price.

First steps. As a preliminary step, a seller's adviser should prepare a business profile that provides prospective buyers with sufficient information to judge whether to move forward at all. This is done on a no-name basis, and no information should be released until a letter of confidentiality is executed.

More important than the business profile is the more extensive assemblage of information on which the buyer will base an evaluation-what is known as the "selling memorandum." The necessity of making this vital document as timely and comprehensive as possible underscores how imperative it is to choose an adviser with adequate resources.

The selling memorandum. This document normally contains, among other elements, an overview of operations and the historical financial statements. The overview of business operations should contain sufficient information about the company's history, prospects for the future, marketing, operations, and management.

Financial statements, naturally, lie at the core of any buyer's interest in a company, and the value of having them audited can hardly be overstated. Credibility and reliability regarding the entire transaction can be established immediately by the mere fact that the statements are audited.

Historical financial statements should be restated to reflect operations under independent management. "Normalizing" the statements requires analysis of the income statement, the balance sheet, and the cash flow statement—at least for three years and preferably for five years. Once the financed statements have been adjusted retrospectively, it becomes easier and more credible to extend them toward the future, using assumptions that are realistically achievable.

PREPARE THE BUYER

Achieving the best price for your business is quite often a matter of understanding the probable characteristics of the ultimate buyer so as to create a mutual accommodation of needs.

It is worth reemphasizing the importance of spreading a broad net in the search for buyers. The net should extend overseas, especially if your adviser has a network that can identify overseas buyers, as this will tend to maximize the value.

The sheer multiplicity of suitors will shift the balance of negotiating power away from the buyer—creating, if you will, a seller's market. So, choosing a firm with a solid international network is essential.

The seller, moreover, is able to avoid the tense rigidity that comes from having the whole transaction hinge on a single buyer. Having other potential buyers "waiting in the wings" provides a vital emotional buffer that benefits not only the seller's nerves but the negotiating leverage as well.

In addition to being aware of the possible geographical origins of potential buyers, sellers should be aware of possible *types* of buyers:

- Corporations versus individuals
- Family members in management
- Customers and vendors
- Leveraged-buyout groups
- Foreign buyers
- Competitors

Ideally, the adviser will have a broad-based network of contacts and significant experience in representing buyers as well as sellers. The ability to put oneself into the shoes of the buyer enables a seller's adviser to anticipate

and thus respond effectively to the buyer's probable moves.

Sensitivity of this type can neutralize problems that are potentially lethal to a successful sale. The adviser simply has to have an instinctive feel for what a buyer will be willing or not willing to do.

Unless an adviser has had the experience of analyzing the transaction from the buyer's perspective, that instinctive feel will be lacking. In many instances, an adviser can learn what buyers have offered in previous public transactions as a fairly reliable index of what the seller could expect in the current transaction.

Once you have a fix in your mind on the likely profile of the ultimate potential buyer, it becomes feasible to create ah-native strategies that meet those the buyer might employ. Flexibility is important. Succeeding in a negotiation is not usually a matter of perseverance in a fixed strategy toward a predetermined goal, but rather a level of preparedness that enables one to react appropriately to many possible alternatives.

It is important to bear in mind that the buyer will be evaluating the match between the two businesses, including the seller's management style. A buyer will also assess how much additional capital, if any, will be needed to ensure that your company will provide a return on the investment.

That estimate of additional capital investment will, of course, affect the purchase price. Some buyers are seeking significant growth potential and are less interested in the historical return on investment than in a future that promises synergies with their existing businesses.

SEEKING THE HELP OF OTHERS

The involvement of outside, objective professional advisers at the earliest possible stage, even when merely contemplating the sale, will add objectivity, credibility, and ultimate value.

Often, sellers call in advisers once the deal gets going, but by that time, the wrong signals regarding important issues may have already been transmitted.

Almost no seller has an adequate appreciation of the sheer complexity involved in a change of ownership. Several categories of issues—tax, legal, accounting, financial, and regulatory, each complicated in its own right—can interact to create quite a mosaic. Even if sellers have the expertise to handle all these matters, their time would be better occupied by maintaining the value of the business and running it profitably.

The tax considerations, for example, can range from estate taxes to making a decision between a taxable and a tax-deferred transaction. Is the sale a

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transfer of stock or assets? What are the benefits of a stock or asset sale? Are there important implications in new or pending tax laws?

Always have a tax and an audit partner involved throughout the transaction. This provides a significant advantage during negotiations.

When pondering the accounting issues and forecasts, it is important to ask: What would the balance sheet and income statement look like if the company were a non-owner-managed public company?

Seeking anything less than top quality professional advisers will result in a sacrifice of value that exceeds any savings resulting from lower fees. In choosing an outside firm to represent you as seller in the transaction, several factors should be considered:

- **Independence.** The firm should have no interest in the outcome of the transaction other than your interest as seller.
- **Confidentiality.** Even the awareness among employees that conversations are being held with a firm known to be in the mergers and acquisitions business can trigger off rumors.
- **Expertise.** It should be broad enough to cover the full range of considerations.
- **Reputation.** This includes not just how widely the firm is known but how favorably.
- **Contacts with potential buyers.**

The firm should have an international network of offices.

In evaluating prospective buyers, conduct a "due diligence"—except in reverse. The terms of the transaction may require an ongoing association with the buyer after closing.

This reverse due diligence would document the buyer's: credentials and track record; creditworthiness, especially if a portion of the purchase price is deferred, or is paid in notes or stock; management style; and, integrity.

Among the concerns that may surface during this research is that the timing may be inappropriate for business or personal reasons. Or it may become clearer during the due diligence or the negotiations that the buyer may be the wrong one for another reason.

Discussions with some of the companies the buyer has already acquired might yield further insights. These activities and reflections might clarify genuine reasons to pursue alternatives other than outright sales.

In spite of all the work that has been put into preparing for the sale up to this point, the prudent decision is to walk away from it. In fact, if you have picked the right professional advisers, they will insist you walk away.

Bringing in other professional advisers with experience in your particular industry can be useful at this point in the process and sometimes at other points as well. For this reason, choosing a sizable firm with a one-stop shopping approach is an alternative worth careful scrutiny.

Always explore the possibility of bringing in an industry expert to advise on any transaction. When you're involved in the sale of a construction business, seek the advice of an expert with significant experience in the construction industry.

Reviewing these recommendations, your preparedness as seller of a business implies four policies: (1) maximizing value by effective day-to-day management; (2) maintaining awareness; (3) planning; and (4) executing the plan effectively.

Followed patiently, these steps will enable you to obtain maximum value for your business in a way that leaves you well equipped to move on smoothly to the next stage in your life.

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