

Selling Your Business: More Than a Price Tag*

U.S. Small Business Administration

You've spent years -- maybe a lifetime -- building a business, and now you're ready to move on. With so much time, money and energy invested, you want to ensure that the fruits of your labor are duly rewarded.

Before you take the plunge, take stock of the marketplace. Is the economy too sluggish or credit too tight? Decide if this is the most opportune time to sell and if your company is ready.

Put yourself in the buyer's seat to determine the salability of your business. It is important to realistically assess its value and strategically target prospective buyers who can benefit from the purchase.

Pay close attention to how the sale may affect your financial and personal situation, and what impact it will have on your employees, suppliers and family. The implications may run the gamut from legal to moral to financial. The sale is bound to take an emotional toll on you.

Look very closely at your reasons for selling, the most common of which are health, boredom, work load, business problems and money. Consider alternatives that may be better for you -- franchising; developing a partnership; merging with a similar company; going public; and absentee ownership or partial retirement, two situations which would enable you to devote less time to the business. Perhaps one of these is the solution.

If after careful soul-searching and analysis, the motives for selling your company appear to be genuine, then carefully develop a comprehensive selling plan. It should include the evaluation, preparation, pricing, marketing and actual selling of the business; negotiations; and closing the sale. Following your plan and surrounding yourself with competent advisors can help you avoid common pitfalls and unpleasant surprises, and result in a smooth transition of ownership.

A Little Objectivity Never Hurts

Selling a business is a complex undertaking. As most of your assets may be wrapped up in the venture, you want to ensure you can sell it for what it's worth. Consider using a professional consultant to eliminate some of the worry and provide expertise you do not possess.

"A professional can bring to bear the objectivity often missing in your own analysis," emphasizes Bill Markus of Ellmark Associates, a consulting firm.

Investment bankers, merger and acquisition firms and business brokers can provide the needed services; business brokers generally deal with businesses worth \$1 million or less. It is wise to get references for intermediaries and to select someone who is familiar with small businesses overall, and particularly with firms similar to your own.

Fred Selinger, managing director of corporate finance for Richard C. Blum & Associates Inc., believes that most sellers retain an investment banker to help them find a buyer, but cautions that "identifying a buyer is only 10 to 20 percent of the reason for securing a consultant.

"Sellers need help in identifying and negotiating with a potential buyer and in posturing the business for sale -- cleaning up law suits, updating financials, ensuring that records reflect the true nature of the company, and maintaining key personnel through the negotiation period and longer," Selinger says. "It is far more difficult to sell a business than to buy one."

He also stresses the importance of using attorneys. "They are able to handle issues which, if ignored, can nullify the transaction. Professional legal counsel is critical to completing the deal at a fair price with reasonable conditions and terms and a minimum amount of business risk."

Selinger offers one more salient piece of advice: "If you are going to sell your business and then continue to run it, never negotiate on your own because at the end of the day, the buyer will be your boss."

It is also a good idea to engage the services of an accountant to provide tax advice and address the tax repercussions of the sale.

Consultants not only help identify prospective buyers and orchestrate the transaction, but they can serve as intermediaries protecting your confidentiality, and help arrange financing. These services, however, do not come cheaply. Be prepared to pay a fixed fee, hourly rate, out-of-pocket expenses, a percentage of the sales price, or some combination.

Marketing 101 Stands its Ground

The four P's of marketing -- product, price, promotion and packaging -- make sense even when you are selling a business. But before concentrating on these areas, take into account two other P's: be prepared to invest time in selling your business, and remember that patience will become one of your greatest virtues. Realistically, the process will take anywhere from six months to two-and-a-half years, so don't be lured into thinking that a deal will materialize overnight. The negotiations themselves may take as long as six months.

Also make sure your expectations and objectives are realistic or you are bound to

encounter frustration.

Key Selling Factors

Similar to anything else on the market, the product has to be attractive to potential buyers. And in the case of a business, the less risk attached to it, the more a buyer is apt to be interested. In his book, *How to Sell Your Business for the Best Price*, Vaughn Cox makes a popular suggestion based on the law of supply and demand -- buy when everyone else is selling and sell when everyone else is buying. He also outlines the less strategic times to sell -- when the business is doing poorly; is involved in a lawsuit; is expecting an increase in revenue or profits, making postponement more advantageous; and when the economy is in a recession or the particular industry is experiencing a downturn. He believes it is a sound economic decision to sell if you can net seven or eight times your annual compensation.

Robert L. Hulett, a St. Louis-based merger and acquisition specialist, reminds sellers to always negotiate from a position of strength, "which is much easier to do if your company is prosperous. The best time to sell is when you don't have to."

Designing an informal rating scale for key selling factors, as suggested by C. D. Peterson in his book, *How to Sell Your Business*, will give you an idea of how well your business may fare in the marketplace.

Your company's history -- how long you have successfully run the business and how effectively the business has met objectives -- will influence potential buyers. The more solidly you present the firm, the more appealing it will be. Don't forget that the goodwill your company has built up also counts for some points.

People are the core of the business. You need to rate your staff's competence, their morale, and whether or not they will remain once the venture is sold. If the business is overly reliant on you as the owner, it may be necessary to train or hire a successor or offer to stay on, at least temporarily.

Products and services are often the business. Consider quality, price, reputation, delivery, service and competitiveness. Be realistic about this evaluation, basing the rating on how prospective buyers would objectively perceive your products and services.

Undoubtedly, a potential buyer will want to know how well the enterprise has performed financially. Take into consideration the firm's capabilities, history, potential and the objectives achieved. Above all, ensure you can substantiate the performance you claim. (This area will be covered in more depth in the section on "So What's It Really Worth?")

Lee Munson of A.L. Munson & Co., a management consulting firm, stresses the importance of cleaning up debt. "Raise capital in order to get the company out

from under any financial burdens," he urges.

Munson also warns sellers not to sell a business in a distressed state, because "it's difficult to pull off a fast sale at a fair price."

Keeping orderly records and books instills confidence in a prospective buyer. It's not worth trying to hide financial details. Very likely they will come to light and endanger your own credibility and chances of selling.

The condition of facilities and equipment certainly influences the sale of your operation. In rating them, consider their functionality, competitiveness and ability to move the business into the future. Just as if you were selling a house, strive to make the work environment as attractive and comfortable as possible to potential buyers. This may entail repainting; cleaning windows, furniture and equipment; or even making repairs.

Existing long-term agreements with customers and vendors are also a selling point, as they instill confidence in your consistent ability to provide high quality products or services, and pay bills.

Your relationship with lenders is an important criterion in the analysis of your business. Financial strength with lenders is an indication of the security and profitability of the company.

Very similar to the considerations involved in buying a house, location, location, location is important to potential buyers. A prime location -- with available parking, accessibility, well-maintained surroundings and nearby transportation -- can be a strong drawing card, as well as agreeable terms for leasing space, options to buy and opportunities to expand. A prospective buyer wants to feel assured that the business is suitably situated to help ensure its continued efficient operation.

Will your business survive the decade or will its products and services be replaced by tomorrow's Pet Rock and next year's environmentally correct garbage bag? If long-term growth looks more like short-term life, then you may be in trouble. On the other hand, if your industry and specific marketplace are healthy, these growth opportunities can become strong selling points.

It is necessary to rate your competitive advantage in terms of price, products and service. This may well be the time to develop a new competitive strategy.

"If you find a buyer for whom you serve as a critical resource in his growth strategy, then you have found a highly motivated buyer," Munson notes.

Play off the strengths of your venture, take the weaknesses under consideration, and decide if it is worth making changes that may pay off when the business is on the market. Identical to any other commodity, a company has to be attractive to

both a buyer's pocketbook and entrepreneurial spirit.

So What's It Really Worth?

Based on a thorough analysis of your assets, you now need to place a price tag on your enterprise. Make sure you have clarified in your mind precisely what you plan to sell. That can include assets, stock, real estate, franchises, a part of the business, and your time as measured through employment, training or consulting.

Unfortunately, establishing a fair market value for your business is not always an easy task. There is often a discrepancy between what you think the company is worth and the price at which it will actually sell.

The appraisal process can be approached in a variety of ways. Methods of evaluation run the gamut from the following informal guidelines to rigid mathematical calculations made by professional appraisers.

"When selling a business, you have to sell the steak, not the sizzle," advises Don Nolan of Phoenix Consultants, a business broker. "Prospective buyers want the facts -- including balance sheets, and profit and loss statements."

In determining the value of a company, Nolan recommends focusing on four aspects: the condition of the existing lease ("A 10-year lease with an option is ideal; it can help owners make a profit and recoup their investments."); the location of the business; the replacement value of its equipment, fixtures and furniture; and the actual numbers on the books. "Often multiples of income and earnings, about three to five times, can generate a realistic selling price. You have to sell what's really there," he warns.

"Buyers don't want to pay so much that they only buy themselves a job," says Bill Haynes, owner of The Business Mart which matches business buyers and sellers, appraises businesses and offers consulting services. "They want to be able to recover their investment."

He suggests that small firms undertake a self-appraisal of assets -- lease, location, physical equipment and inventory (at wholesale prices); consider the amount of receivables and the value of the business based on three to six months of business income; and finally, take a look at comparable companies. Munson concurs on the importance of studying similar businesses, but also recommends a professional appraisal of assets, especially if they are highly marketable. If not, he prefers a discounted cash flow analysis -- based on a realistic projection of sales, expenses, investment needed for growth, and working capital requirements.

"Many sellers have grandiose notions about the selling price," Munson says. "As a small business owner, you must be careful not to have rigid ideas about the company's worth."

Markus of Ellmark Associates has seen some owners assume an inflated view of their enterprises, but has also worked with owners who have erred in the other direction by initially undervaluing them.

Selinger of Richard C. Blum & Associates Inc. emphasizes that "today it's cash flow, cash flow, cash flow because the credit market is tight. Acquisitions are becoming more strategic than financial."

In more of a textbook approach, financial records and a calculation of assets can provide a good foundation for an evaluation. (The guidelines here offer the basics and do not discuss all considerations which may affect the numbers.)

First determine the adjusted tangible net worth of your business by placing a dollar value on tangible assets minus liabilities.

Then calculate your company's net income -- the difference between earnings taken over several years and your expenses, including costs of goods and services, wages and operating costs.

Estimating the value of your business as an investment is the third step in determining value. In short, this number represents the return on your adjusted tangible net worth if it were invested in something else of comparable risk at prevailing interest rates.

The fourth step in this pricing procedure involves calculating your firm's excess earning power. This number is net income minus earning power (which is the investment worth plus your salary as the owner).

All of these calculations -- adjusted tangible net worth, net income and excess earning power -- produce a net base value or the value of all of the business' tangible assets.

The evaluation of intangible assets is a subjective and more difficult task. Intangible factors include location; technological resources and special skills; trademarks, patents and copyrights; new products and services; earnings trends within your industry; growth potential; personnel; competition in the marketplace; and customer goodwill.

Although it is hard to place a monetary value on intangibles, one suggestion is to multiply the excess earning power figure explained above by a factor of three. Add this to your net base value, and you have just placed a price tag on your business.

Now the question is whether or not a prospective buyer can afford your company, and here, effective marketing is crucial to cutting the deal.

Packaging/Promotion Prescribe Perception

As in the case of successfully selling any other product, it is crucial to define your potential market and develop a plan for targeting it. The marketing plan should encompass packaging to make your business look as appealing as possible and promotion so prospective buyers will perceive your business as you desire them to.

First, define your market. There are a variety of potential buyers in the marketplace -- individuals, vendors or suppliers, employees, competitors, companies and investment firms. Qualify these buyers to determine which are most valid, and whose objectives you can best satisfy. Clearly identifying the needs of qualified buyers will enable you to emphasize the appropriate features and benefits of your business that best match these needs.

Hulett recommends focusing on buyers "who already know your business. This could lead to a higher selling price, as well as reduce the time involved in selling it."

Remember that while prospective buyers are analyzing you and your company, it is equally key for you to research their abilities, business and personal qualifications, and financial situations as well.

Once you have preliminarily qualified a buyer, provide a brief description of the business (including general financial highlights, the benefits that would accrue the buyer, and an indication of the financial requirements a buyer should expect to meet). It is important at this point to maintain confidentiality through a formal agreement. News about the impending sale of your business can stir up rumors, fragment your relationships with customers and suppliers, and destroy the morale of employees.

A more comprehensive analysis of the firm should follow if a prospective buyer turns out to be really interested and can afford to buy the business. This is your company's packaging, and as with other packages, needs to distinguish your enterprise from the competition. Preliminary discussions often accompany the business analysis.

The analysis should include an introduction; a description of the proposed transaction; an overview of the business, including its history, products and services, facilities and equipment, operations, markets and competition; a review of the organizational structure, management and staff; a financial analysis; and growth expectations and marketing strategies.

Promotion goes hand in hand with targeting potential buyers, and is the vehicle for gaining their attention.

Advertising in the business opportunity section of a local newspaper or in The Wall

Street Journal, or placing blind ads in the classifieds, will reach the general public. Advertising in specific trade publications can narrow down your audience. Direct mail, telemarketing (especially when an intermediary is used to maintain confidentiality) and networking are other possible channels of promotion.

In addition, an astute consultant should be able to provide names of potential buyers who have previously indicated interest in a business in your specific industry.

Structuring the Deal

Prior to an offer being made, you and the prospective buyer must establish a structure for the deal -- the amount of payments, when they are paid and in what form they are made. As the owner, you can affect affordability, which is a key issue at this point.

Methods of payment may include cash; stock; notes payable, in which the seller agrees to carry back a note for part of the purchase price which is repaid, with interest, by the buyer; an earn-out situation, in which the buyer agrees to pay additional money if the company earns a certain amount of predetermined profit; and consulting and employment contracts. A non-compete clause may also be part of the deal, in which the seller agrees not to compete within some appropriate geographic limits for some reasonable period of time.

"Present a deal that is structured the way you think will make the most sense to a prospective buyer while achieving your own objectives as well," stresses Hulett, the St. Louis merger and acquisition specialist.

When you feel it's time to push for an offer, remember to make it easy for the buyer to transact the deal. An official offer should contain a description of what the buyer intends to purchase; the date, expiration date and closing date of the offer; the price; the terms; the repayment schedule; down payment, if applicable; and any contingencies. A non-refundable deposit usually accompanies the offer.

It's a Matter of Compromise

The negotiation stage can be a tricky one. "When a deal is on the table, an agreement will happen somewhere in the middle but not without a lot of stress and strain," Selinger says. "The more sellers think about their businesses, the higher a value they place on them, which is often unrealistic. Their expectations are too high. Buyers, on the other hand, who are facing a credit crunch, want to make a wise investment without overpaying. So the dilemma becomes how to bridge the gap."

Selinger believes the answer is compromise. "Given the current economic climate, the posture of banks toward financing such transactions is tight, so you need more

creative ways of financing than in the past." He suggests an earn out or a note payable.

As you move into the negotiation process, be prepared to counter any buyer objections such as too high an asking price or an unsuitable location. Based on your previous analysis of your company's strengths and weaknesses, you should be able to anticipate some of these objections, and make reasonable concessions, if necessary, to keep the negotiations moving.

Establish credibility, maintain integrity, persuasively play up the returns of the transaction, and reduce any perceived risk associated with buying your business. Negotiations can be a win-win situation if both parties benefit from the results.

By keeping things in perspective, you are bound to come close to meeting your expectations. At the same time, realize that if the deal doesn't go through, other prospective buyers exist in the marketplace.

Signing on the Dotted Line

Once an acceptable offer has been made, your attorney will begin drawing up the final documents. Additional deposit money may be put up at this time. Under what is termed the "due diligence" process, the buyer now has an opportunity to review all the company's records, books, facilities, contracts and, if the offer contained such contingencies, to talk with employees, customers, suppliers and others. At this point, you must refrain from entertaining any other offers.

Unfortunately, closing the transaction does not always run smoothly. A checklist of what needs to be done -- such as transfer of banking arrangements and utilities, customer lists, a breakdown of funds to be disbursed, and clearance of outstanding liens -- and who is responsible can often mitigate any problems that may arise.

When the final papers are signed, you now have time to pursue other interests or take that long-awaited, three-month vacation in Hawaii. But if you still have the entrepreneurial spirit that initially motivated you to start up a company, you may well find yourself on the other side of the table -- as the prospective buyer of a business.

"Using a broker for the right reasons -- such as sales visibility, thorough canvassing of the market, and scouting for qualified buyers -- makes good sense when selling a business. However, it's important not to abdicate your position as the principal voice during negotiations. No one is better prepared to represent your interests, particularly if you clearly understand your own needs." John Faubion, now managing director for the health care practice of The Zivic Group (a nationally respected executive search firm with offices in San Francisco and Glendale that operates exclusively under retainer), speaks from experience. After buying and managing a small travel agency, while working as a health care administrator at a

large Los Angeles teaching hospital, Faubion decided it was time to sell. "I realized that the agency, which had tripled in size in five years, needed full-time management to continue to thrive." His advice to sellers is to "be realistic in your expectations as to what the business is worth. It's also critical not to sell under pressure. A mutually satisfactory sale requires both time and patience." Faubion, who brought in a broker at the start, feels "the money was well spent."

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