Business Advisor

a resource for business owners

FROM THE LAW OFFICE OF MARY HANSON

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About the BusinessAdvisor

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WHETHER AND WHEN TO SELL A BUSINESS

by Mary Hanson

There are many issues for business owners to consider in deciding whether to sell and when to sell a business. Each business owner has his or her own objectives. In addition, his or her key issues will differ depending upon the industry, the challenges and demands of the business, the financial circumstances of the business and business owner, business personnel, and many other factors. A business owner needs to consider different objectives – including contradictory objectives – and make a judgment call about selling the business.

One common recommendation from advisors is that business owners should plan the sale of a business at least a year or two in advance of a sale. That is good advice no matter what the business is and what industry it is in, but it can take more than two years to clear up problems that make a business unattractive to potential buyers. Businesses often need to clean up, correct, or address erroneous records, tax problems, financial statement errors, unprofitable contracts, unnecessary expenses, obsolete inventory, high overhead, low profit margins, customer claims, liens, lawsuits, employee problems, unattractive facilities, and other issues.

Whether a business owner plans to sell in the near future or work in the business as long as possible, the business owner should have an idea of how “saleable” the business is and have a good exit strategy. The business owner should know what he or she will do when and if he or she can no longer run the business. Most exit strategies involve the sale of the business, and the elimination of problems (such as those listed above) can serve to make the business more saleable. More “saleable” means more likely to attract good buyers who will pay a meaningful purchase price.

A review of various sale-related issues might help in identifying a business owner’s objectives and circumstances. Below are descriptions of a variety of issues that are relevant to the decision of whether and when to sell a business:

- Business owners need to know whether their children or grandchildren would want to (and be able to) run the business. If family succession is an objective of the business owner (or the children of the business owner) business plans and personal circumstances must be consistent with that objective. If a business owner must sell a business for a good price in order to retire, then the business owner’s situation does not fit the objective of giving the business to the next generation. If family succession is feasible, the family members expected to run the business must be involved in the business and exhibit the interest and the ability needed to eventually run the business. The business needs to be run in a manner consistent with family succession. The hiring of managers and key employees needs to anticipate future ownership by another generation of the family. Businesses operated like hobbies, or businesses dependent upon the owner to handle 2 or 3 jobs are not good candidates for

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family succession. The plan has to fit the facts of the business and the circumstances of the business owner, or else the facts and circumstances of the business and business owner need to be changed to fit the plan.

- If family succession is the plan, the business owners need to have a contingency plan that addresses a sudden change in ownership or management. In the event of the death, disability, or absence of the current managing generation, the business needs to have adequate management, financial strength, and clear plans to survive a sudden transfer of ownership and control. When family succession is not the plan, the business might be sold in the event of the owner's death or disability, and the buyer of the business would deal with the issues of financing and management.
- If a business is in an industry that is likely to become extinct, it is clearly not a good candidate for family succession. A good time to start planning to sell such a business is probably the moment the business owner realizes that the industry does not have a future. Business owners who wait to see what happens will be the ones trying to sell their businesses when there are no interested buyers for such businesses.
- The termination of almost every business involves a sale, even if the sale is of furniture and equipment, or customer lists and a trade name. By planning in advance and recognizing the potential saleability of various business assets a seller can improve the prospects of getting a good price for the assets sold.
- The differences between a highly saleable business and one that is not attractive to buyers are price, terms, and timing. A great business will sell relatively quickly, at a good price, and on terms that are not very disadvantageous to the seller. A great business is typically one with good profit margins, located in a desirable area, and in an industry that is mature and proven, but with good future prospects. An undesirable business is more likely to be liquidated at "fire sale" prices, as inventory, equipment, and fixtures are sold quickly. Good planning can improve the sale price of inventory and even generate income from customer lists, telephone numbers, contracts, work in process, and trade names.
- If the business owner is essential to the business, the business plan needs to consider the challenges that would be involved with the sudden death or disability of the owner. If the business owner performs too many different functions for the business, the business may be unable to survive long enough to be sold as an ongoing business. Preserving value would require a very quick sale to a buyer who could provide management to cover the loss of the owner's services. The family members handling the estate of the business owner would need to be aware and prepared to make a quick sale.
- When a business owner performs two or more key functions of the business, the best time to sell the business to get a good purchase price is when the business owner is able to continue to work and provide the key services to the buyer of the business.
- If a business owner holds his or her business in a trust, a co-trustee

or successor trustee can sell the business in the event of the business owner's death or disability. A trust provides the ability to sell a business quickly without probate court approval, which can take a long time. In order to take advantage of a trustee's ability to move fast, the business owner should prepare written guidance for the successor trustee that identifies potential buyers, helpful friends in the industry, and professional advisors to engage with regard to selling the business.

- No matter what the plan is, a trust is helpful in the event of the death or disability of a business owner. A co-trustee or successor trustee has the legal power to operate a business and make changes without delays or approvals. The trustee can hire new management, engage consultants, and take other steps needed for the business to replace the services of the business owner. The successor trustee or co-trustee should be briefed on the steps he or she should take to use that power. If a trust is the 100% owner of a corporate business, the trustee would hold a shareholder meeting to name a new board of directors and hold a board of directors meeting to name new officers and approve actions to be taken. The actions needed can be taken without delay.
- When a business faces major changes or challenges it may make sense to sell the business and let a new owner handle the challenges. If the business faces major relocation, major changes in its procedures, changes in product lines or distribution channels, or changes in key employees, there is a risk that the process of change will not go well and that the business will suffer a loss of value. The business owner should calculate the funding and effort required and the consequences of mistakes, delays, and miscalculations, and compare the change scenario to the sale scenario. If the business owner is nearing retirement, a sale of the business may be smarter than taking a risk on major changes.
- If the goal of a business owner is to build a business to maximize value and sell the business for a high price, then the business needs to be operated in a way that maximizes profit and creates a desirable saleable business. The time for such an owner to sell is when the situation reaches its financial peak. The financial peak would be some point when the industry is attractive and the business is profitable, and when taxes on the sale of the business are not too high. Many different factors would go into determining such a point and it would be hard to predict or even recognize. The key for the business owner would be keeping an eye on the value of the business and the economic and financial environment for business sales, and making a judgment call that the business may be near that peak.
- It's true that a good time to sell a business is "when there's an interested buyer." By sheer luck this could be the time when a business owner is ready to sell. But a business owner who wishes to select his or her own timeframe to sell a business faces the problem of not having interested buyers when he or she wants to sell. There is nothing a business owner can do to conjure up interested buyers if the timing is not right for buyers. When a business is financially attractive and there are several interested

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Publisher's Note

The decision to sell a business is often a rather sudden one. In addition to death and disability, which prompt a quick sale of a business, there are many personal circumstances of health, family issues, deaths of friends or family members, and other personal circumstances that cause a business owner to decide to sell rather abruptly.

With or without time to plan, when the decision to sell a business has been made, the seller must have a framework of what the business sale needs to accomplish.

A key piece of information needed for the very first steps in selling a business is a calculation of the tax consequences of selling the business. Because the critical information is the tax basis (of assets held in an entity as well as assets or stock held by individuals or a trust) and estimated tax brackets that might apply, the assistance of the business owner's accountant is needed.

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Attorney/Publisher

qualified buyers is certainly a good time to consider a sale.

- The best situation for a business owner wishing to sell a business at a good price and on good terms is when more than one buyer is interested. Competing buyers will drop demands, make concessions, increase their offering prices, and propose more attractive terms.
- If a business is operated to provide a business owner with a high income lifestyle, the business owner should be conscious of the long term consequences of that choice. Lack of investment in the business may reduce the saleability of the business, and the business owner will need to have other investments and funding for retirement.
- Retirement is expensive and a lot of businesses will never sell at prices adequate to cover the cost of a business owner's retirement.
- Even if a business owner sacrifices everything to invest and build a business, there is no guaranty that the business will be successful, and, even if very successful, that it can be sold for a purchase price that will support the business owner's retirement.
- A business almost always has a higher value as a going concern operating business. It is important to keep the doors open and employees working until the business sells, unless there are good reasons that this can't be accomplished.

Business owners should have an exit strategy and should learn now what they need to know to make good decisions about selling their businesses. BA