# 10 Must-Do's

## Before Selling Your Business - *By Dan Wright*

**You've worked hard to build your business and you're thinking, what's next? If selling your business is in your future, know that preparing for a successful sale can be a long-term process. To maximize the value of your business, you'll need to plan and prepare well in advance. As a guide to preparation, carefully consider the following 10 items:**

### 1 Get your house in order.

Your business functions pretty well and is profitable just the way it is. You know there are areas where process or key contracts are not as clear as they could be, but the job gets done without major hitches. Consider, however, how your business would look to a cautious buyer or new key investor. What will they find when they put your balance sheet under a microscope? A careful review of key business processes, assets and contracts can save you major hassles during negotiations and significantly increase the value of your business.

***These areas often need the most attention:***

- Employment contracts: Will your key executives stick around once they find out the business is changing owners? What will keep them from leaving, or competing with the business? Will they be incented to stick around and help the business be successful after the sale? Review key employment contracts to make sure your best employees will work toward a successful sale.
- Financial records and reports: Are your financial statements ready for due diligence? Do they reflect the latest GAAP accounting methods? Have they been reviewed or audited by a respected CPA firm? You may be willing to put great trust in your relationship with your accountants, but how comfortable will the buyer be with their work?
- Intellectual property arrangements: Have you had your business contracts reviewed by an intellectual property attorney? Are all arrangements in writing? Is it clear who owns what in those arrangements? Ownership ambiguity often makes for bumpy negotiations with a buyer or investor. Intellectual assets are often the most important asset category on your balance sheet. When ownership is not clear, the value of the business can be diminished.
- Business legal structure: Is the current legal structure in which the business is owned the most efficient structure for a sale? Will you pay more tax than necessary? Cleaning up the structure before the deal can simplify the transaction and avoid problems when the business is sold.
- Family ownership arrangements: Have you considered transferring some ownership to your heirs in advance of selling the business? This strategy often yields attractive financial and estate planning results.

### 2 Separate different lines of business.

Sometimes trying to evaluate a multi-aspect business as a whole results in distortion in marketability and value. This means the business may not be as attractive as it could be, and potential buyers may find it difficult to value.

While you may think of the business as an integrated whole with different divisions, the buyer may only be interested and may only understand one aspect or division of the overall business enterprise. Sometimes buyers recognize how acquiring key assets of a target business can create a valuable competitive advantage. Yet at the same time they see other assets as more of a liability. When the assets are separated into natural business divisions, buyers can get a clearer picture of the strategic value of acquiring your business (or at least some portion of it). As a result, the buyer may be willing to offer more.

Separating the business can also facilitate retaining a portion of the business. Perhaps you see an undeveloped market opportunity for a portion of the business, or maybe you just want to retain enough to provide you and your heirs with a predictable cash flow. If the buyer isn't interested in the entire business, separating out certain assets prior to the deal could benefit both parties.

### 3 Put together the right team and let them develop a plan.

Business owners sometimes avoid seeking help from outside advisors to avoid the fees. However, experience shows that business owners enjoy much higher net proceeds and far more peace of mind by engaging good advisors. After completing complex negotiations, many business owners recognize that they are at their worst when negotiating on their own account. Recognize that up-front, and take advantage of the benefits of having highly skilled advisors representing your interests.

Before moving forward, carefully evaluate whether your current accountants and legal advisors have the experience to advise you on a transaction of this magnitude. If they have been serving your business for a while, their knowledge into the historical records and activity of the company will play an important role in putting together a deal. If they lack experience with large buy/sell transactions, it's wise to augment the team with specialists.

Make sure the team has a solid plan in place before you engage potential buyers. Getting ahead of yourself can result in negotiation missteps, delays and an overall less favorable outcome.

Once you have your team in place, let them do their job. Some business owners make the mistake of taking over the selling process. They hire good advisors, but then get in the way. Selling a business is a huge deal. It's emotionally challenging to let go. However, maximizing the sale price for your business requires precisely that. The ability to be objective and detached can make all the difference in the outcome. A good team of advisors will listen to you, advise you on your options, help you create a solid strategy, and persuasively advocate for your interests in the negotiation process.

### 4 Understand the value of your business from a buyer's perspective.

It's very common for a business owner to fixate on a sales price from start to finish. While it may seem counter intuitive, such sellers often leave money on the table. It's far more important to ask yourself who the likely buyers are and why do they want your business. Determining how a prospective buyer intends to deploy your business as a strategic asset, before you negotiate, can get you more for your business.

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## 5 Fully understand vulnerabilities.

All businesses face operational vulnerability. However, we all look at our businesses like new parents look at their children. It's easy to be protective and even defensive, and it can be difficult to be appropriately critical. Allowing yourself and your advisors to make realistic assessments will better position the team for a successful sale. Make sure that you embrace the operational weakness. In addition to the ones that are known, find those that are not yet discovered or understood. Similarly, be fully aware of contingent liabilities. If it's not practical to fully eliminate the problem before the transaction, acknowledging and owning the problem before the buyer discovers it allows you to formulate a plan for how best to disclose and control the message to the buyer, and cover your interests when the buy-sell contract is drafted.

## 6 Create an exhaustive letter of intent "LOI".

Make sure everything you care about is in the LOI. Sellers sometimes make the mistake of thinking that the LOI only needs to capture the "big picture" view of the deal. When the LOI lacks the appropriate items and details, sellers often face "deal erosion." In contrast, making sure everything you want is in the LOI before you sign gets you much more leverage in post-LOI negotiations. A good strategy for responding to attempts by the buyer's team to erode the deal is to refer them to the signed LOI. This puts the buyer in the position of having to justify why he signed the LOI if he didn't really expect to honor the terms. That's a good place for your team to be negotiating from. It wouldn't work if what you want isn't covered because it didn't seem important enough for inclusion in the LOI.

## 7 Make sure your management team stays focused on the business and not the deal.

We have all heard stories about how buyers came back to the table right before the deal was expected to be signed to ask for a concession because the financial results for the months just prior to closing didn't meet expectations. Often the primary cause of the weaker results is because everyone on the management team was focused on the deal instead of on the business. That can be expensive. Make sure your strategy plan establishes clear assignments on who is managing the business and who is working on the deal. This is another advantage to using outside advisors. Your management team may be aces at growing and operating your business, but may not be skilled at selling the business. It would be rare if they could successfully do both at the same time.

## 8 Consider your tax exposure well in advance of the deal.

While you have filed your federal tax returns on time and paid the tax, you may still have considerable tax exposure. Collection efforts by state, local and international governments, all feeling the pinch of a sour economy, are at an all time high. Many have hired more collection officers and have employed new or expanded collection techniques. At the same time, communication technologies and other developments have allowed small- to medium-size businesses more access to multi-state and foreign markets. Our experience is that many business owners overpay the tax in their home state, while ignoring the exposure in other jurisdictions. Due diligence teams representing the buyers often discover this exposure, which can complicate negotiations. Buyers want money placed in escrow to offset the potential liability exposure (calculated for worst case scenario) and sellers view this stipulation as an attempt to enhance the deal for the buyer.

Perhaps a worse result occurs when the liability is discovered after the deal closes. Deal contracts always contain clauses that require the seller to represent that it is fully compliant with tax law in the jurisdictions it operates in. If the business is audited after the deal closes and the audit results in a material assessment, the liability often becomes the responsibility of the seller. The seller is at a significant disadvantage. Because the seller does not own the business at the time of the audit, it must rely on the new owner for representation in the audit. Because the buyer believes the liability is the responsibility of the seller, it may not take the same level of interest in the audit that it would otherwise. This may not be in the best interest of the seller. This can lead to large assessments, and with the seller paying the liability out of pocket (often after the sale proceeds have been otherwise invested or spent), or it can potentially lead to litigation activity between the buyer and seller.

## 9 Have a solid post-sale personal financial plan.

Your business may be your most valuable asset. Have you given any thought to how you will invest the proceeds to make sure you have adequate assets to reach other long-term financial goals such as individual and family estate planning? You are likely the leading expert at predicting the income your business would yield, the amount of risk in the market, etc. But do you have a post-deal personal financial plan in place? Your plan should consider the following:

- How the proceeds should be invested to replace the income you enjoyed from operating the business, taking into account your personal risk tolerance.
- Whether you should take more cash at closing or consider an earn-out period. If so, how long should the earn-out period be? What is an acceptable trade off ratio (cash now v. more cash later)?
- What type of deal should be acceptable – cash, stock, a note from the buyer, etc.? Would holding buyer stock add too much risk to your investment portfolio? How about a note?
- Should the tax liability associated with the deal be paid now or deferred. Some deal structures can result in tax deferral for the seller who is willing to accept stock in the buyer.
- How will you fund the tax liability associated with the deal? Remember, if you hold options that are exercised on the eve of the deal (or if restrictions are dropped on previously exercised options), the value of the stock minus your exercise price may be treated as compensation (ordinary income rates). This may be in addition to gain on the sale of your ownership interest.

## 10 Consider post-deal participation.

Your plan to sell should anticipate the extent to which you wish to give up control of the company, whether you want to continue as an employee, whether you want to accept options, how much authority you will have as an employee/officer, whether you will hold a board seat and how these items may affect your participation in an earn-out plan. These are just some of the considerations that you need to evaluate before completing the deal. If you wish to continue to lead the company and retain some upside opportunity after a deal, make sure all arrangements are in writing, and that they are reviewed by counsel. In the recent past, it is not uncommon for CEOs to be voted out of their own company once they relinquish sufficient voting power. You've worked hard to create a successful business. Selling your business is a monumental task. The rewards for early and careful planning will be worth the effort.

*Dan Wright, CPA, MST, is with Clark Nuber P.S. in Bellevue. Reach him at 425-709-4800 or **dwright@clarknuber.com.***

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