

# How to sell your business

*At some stage, most owners will want to sell up and reap the profits of their hard work. John Hawkey looks at the mechanics of how to go about selling your business.*

**I**n earlier articles I discussed the importance of choosing the exit option that both maximises your sale price and provides you with the optimum personal satisfaction.

I also discussed the need to groom your business for sale: to maximise its value and to ensure that it is 'investor ready'. Having done this, you need to consider how to go about the disposal process itself.

In this article I will assume that you have chosen a trade sale as the best way to dispose of your business, and I will help you to understand the steps that need to be taken when using this method.

This should enable you either to handle the sale yourself, or to work effectively with any intermediary you might engage.

## What is a trade sale?

A trade sale (or a third party sale) is a sale of whole or part of a business to another business, company or a private individual, with the seller usually exiting the business immediately, or after a reasonable hand-over period.

In summary, the steps involved in a trade sale are as follows:

- Step 1: Decide what is being sold;
- Step 2: Set the sale price;
- Step 3: Obtain taxation advice on the implications of your planned disposal;
- Step 4: Try to determine who the potential buyers might be;
- Step 5: Prepare the business for sale;
- Step 6: Arrange the sale itself.

Steps 1 to 5 are preparatory matters, whilst Step 6 involves the sale process itself.

## What is being sold?

When you are selling a business you need to decide what exactly is being sold. There are a number of alternatives, which include the sale of the following:

- Specific and limited assets only, such as the business name, licences, patents, or brands, etc.
- All the assets and liabilities of the business, but not the business operations or staff.
- The whole business as a going concern, including its name, tangible (or fixed) assets (such as plant and equipment), intangible assets and the taking over of staff. Specific liabilities can be excluded from the sale.
- Where the business is a company, all the

company's shares, the purchase of which will result in the buyer acquiring all the company's assets and liabilities and taking over all operations and staff.

## Setting the price

This involves putting a value on your business (a topic I covered in last month's *Better Business*). When setting the price, you should bear in mind that the asking price often determines whether the business will be sold or not.

It is better at the beginning to face up to what your business is really worth, rather than going through the costly and stressful business of trying to sell a business that is over-priced.

Think carefully about a market value that is based on sound valuation principles, and not subjective issues like 'this business has taken me all my life to build'. If necessary, seek professional help from a reputable valuer.

## Taxation advice

Your aim should be to receive the maximum net price for your business when you sell it. To protect your capital you should get taxation advice on both your personal and business situations, particularly if your business sale is to coincide with your retirement.

It is important to get your advice as early as you can, because certain taxation reliefs under Capital Gains and Inheritance Tax legislation are based on the period of ownership of assets, whilst others are based on the time that has elapsed since transfer.

## Who are the potential buyers?

In the grooming stage of your planning it may be useful to identify your potential buyers, as this could affect the way you structure and present your business for sale. Examples of this are as follows:

- Some advisers distinguish between strategic buyers (who are in your industry and looking for a business that 'fits' their operations in some way) and financial buyers (who are interested in the business for its own sake on a stand-alone basis). Where you believe your buyer is likely to be strategic, you could mould your business activities to fit the buyer's operational requirements.
- Where you are aiming to sell less than a 100% stake now and the balance later, your

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potential buyers (or investors) are likely to be venture capitalists and you would need to prepare yourself for this, including having a professionally-prepared three to five year business plan in place (which includes an exit strategy plan) to have any chance of interesting the venture capitalists in your business.

## Grooming the business

I covered this topic in the April issue, where I stressed the importance of taking a long-term view of your exit strategy planning so that your business was ready for sale. Part of this process was the identification and removal of impediments to sale – those issues in the business that make it difficult to sell, or dramatically reduce its price.

## Arranging the sale

The things you need to do to arrange the trade sale itself can be summarised as follows:

- Produce appropriate documentation;
- Market the business;
- Undertake due diligence and negotiations;
- Enter into agreement for sale.

## Appropriate documentation

It is advisable to provide information to potential buyers in two stages. Firstly, you need a preliminary information sheet (with a confidentiality agreement) to show to initial inquirers. Secondly, you will need a full memorandum of offer document to show those with genuine interest, who have signed the confidentiality undertaking.

### Preliminary information:

This should consist of the basic facts about the business, presented simply. You would not disclose the identity of your business at this stage. The information is designed merely to whet the appetite of potential buyers and to sort out the genuinely interested from the tyre kickers.

Those buyers who are interested in taking matters further, and who have signed the confidentiality undertaking, will receive the memorandum of offer document.

### Memorandum of offer document:

The information required for a memorandum of offer document will be different for each business being sold. However, the following information is usually necessary as a minimum:

- Background of the company: ownership and history;
- Management organisation and control;
- Description of products and services;
- Company's markets, customers and competition;

- Administration and personnel;
- Raw materials and suppliers;
- Arrangements with principals and agents;
- Facilities, plant and real property;
- Financial information in summary:
  - Profit and loss: last three years;
  - Profit and loss forecast: next two years;
  - Current asset and liability (balance sheet) information;
  - Interim financial accounts: not more than six months old.
- Asset information/depreciation schedule;
- Analysis of trading operations;
- Future plans and developments;
- Asking price and reason for sale;
- Schedules:
  - Schedule 1: Full financial accounts (last three years);
  - Schedule 2: Profit and loss and cashflow forecasts (next two years);
  - Schedule 3: Principal and agency agreements (if applicable);
  - Schedule 4: Background of key managers and employees;
  - Schedule 5: Asset depreciation schedule;
  - Schedule 6: Up-to-date business plan.



*'I don't think this takeover's going to work out'*

## Marketing the business

Once you have prepared your documentation, the time has come to advertise the fact that your business is for sale. Many owners have the problem of wanting to find buyers, whilst keeping as secret the fact that their business is for sale!

The ways of marketing a business for sale include the following:

- Personally contacting potential buyers;
- Using your networking contacts;
- Utilising your local Business Link;
- Advising intermediaries, like accountants, who could have interested clients;
- Mailing to targeted mailing lists;
- Advertising in specialist trade journals;
- Advertising in the general press.

## Due diligence and negotiations

Once you have reached the stage of having one or more serious buyers interested in your business, you need to face the reality of due diligence.

In some cases you will receive an offer for your business 'subject to due diligence', or in others you will be told that there is serious interest subject to due diligence, with the offer price being left open.

Due diligence is the name given to the process of checking the operational, financial, legal and environmental position of a business that is being sold.

The nature and extent of due diligence will

## WEB LINKS

You will find other articles on this topic in the *Better Business Solution Centre* at [www.better-business.co.uk](http://www.better-business.co.uk).

For example, under Selling a business, you will find:

- ➡ *Selling your business – alone or with a broker.*

depend on the size and nature of the business concerned. The purchaser's advisors, who are usually corporate finance specialists, accountants and solicitors, undertake the due diligence work.

Once satisfied that the business is suitable, the buyer will now wish to establish the final price. This usually involves negotiations.

The role of negotiator does not suit all business owners. You might feel more comfortable if someone else handles the face-to-face element of this, whilst you sit in the background and make the final decisions. This could also be a reason why you choose to use an agent or accountant to help you in selling your business.

### Heads of agreement

Once a final price is established, you enter into the formal agreement stage. The drawing up of the sales contract can be in two stages:

- ➡ A 'heads of agreement', which sets out in non-legal terms the commercial understanding of what is being sold and for what price, 'subject to contract', followed by;
- ➡ The final agreement (or contract), usually drawn up by a professional.

The final sale agreement itself can, broadly, be of two kinds, namely:

- ➡ In very small businesses, those drawn up by the owners themselves (or their non-legal advisers);
- ➡ In most other cases, those contracts drawn up by solicitors.

It is always advisable to use a solicitor to draw up your sales contract unless your business is very small.

### Other issues

Besides the cold facts of what is being sold and the sale price, there are some other issues that you should consider before the sales contract is finalised. These include:

- ➡ Vendor finance;
- ➡ Retention of part of the purchase price;
- ➡ Deferred purchase price;
- ➡ Receiving payment in shares;
- ➡ 'Earn-outs';
- ➡ Staying on.

### Vendor finance

In the trade sale of a smaller business in particular, the seller's willingness to lend the purchaser part of the purchase price is an extremely useful tool in ensuring that the seller achieves the price he is looking for. Many owners ignore this option because of the problem of ensuring payment.

### Retention of part of the purchase price

Retention of part of the purchase price usually arises if the price has been based exclusively on future earnings, or is dependent on retention of specific clients. Retained money is usually held

in trust by a solicitor to be released to the seller if sales (or profitability) targets are achieved, or released pro-rata if targets are partly achieved.

### Deferred payment

Deferred payment, or payment on terms, could appeal to the seller for tax reasons, but the potential taxation advantages of being paid over a period of time need to be compared with the risks involved of not being paid. You would need expert advice before you made any firm decisions.

### Receiving shares as consideration

If you are offered shares as part-consideration, the big question is what will the shares be worth when you come to sell them? With a plc you can undertake research to establish the volatility of its share price and the liquidity of its shares. If you are considering accepting private company shares as part-payment, it is more difficult to establish these facts, except that the shares will almost certainly be more difficult to sell.

### 'Earn-outs'

The difference between a retention and an earn-out is that a retention holds back part of an agreed price, whereas an earn-out is a formula for establishing the price based on the future profitability of the business. The weakness of an earn-out from the seller's point of view is that the eventual price is reliant on the ability of the purchaser to stimulate sales and/or profits.

### Staying on

You may consider that a sale of your business coupled with a part-time job with the new owner is a perfect way to ease yourself out of business life. Or, perhaps, you cannot afford to retire yet – or you might be staying on to keep an eye on the business because you have lent money to the new owners.

Whatever the reason for staying on, you should be aware that the relationship between a vendor who stays on and the purchaser is seldom a happy one! Where a hand-over after sale is necessary, keep it as short as possible.

### Common mistakes

Finally, I would like to draw your attention to some of the common mistakes made by owners when trying to sell their businesses:

- ➡ They overprice the business;
- ➡ Their sales documentation is inadequate;
- ➡ They try to sell the past and not the future – they ignore the fact that buyers are more interested in future profits and growth than what the business has done in the past;
- ➡ They have limited vision when it comes to their target market, and usually think that the best buyer will come from their local competitors. In the small business sector most competitors' real desire is not to buy your company, it is to see you go out of business! ❖

## Contact

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