Pocket Summary

Maximising Business Value

Plan to Maximise the Value of your Business & Make a Graceful Exit

By Lucio E. Dana & Harry Kras

More attention should be paid to making a strategic and profitable exit from the owner-managed business. Lack of business continuity and succession planning, incorrect management of the selling process, underdeveloped negotiation skills and the lack of a realistic valuation strategy could undermine the selling price of the business and cause avoidable anxiety and heartache to the hard-working owner-manager.

Introduction

Having built a successful business, owner-managers invariably reach a time a when decisions about the long term future of their business must be made. Retirement (and the transfer of the business) is not a question of 'if' but of 'when'.

The value of the business often represents retirement security for the prospective seller and potential wealth (current or deferred) of other family members. It is important to 'do it right' - yet many owners have never sold a business before. As a result, many 'deals' are turned down, buyers are frustrated, and the seller, who may be great at business but a relative novice at negotiating the sale of a business, loses time (and often money) in delays that occur. Selling the process is stressful and can be detrimental to the employees and the company.

Getting the business ready to be sold in order to realise maximum value and reduce personal stress takes time - sometimes several years. Cleaning up the financial statements and having them audited before the company is sold are important factors.

Negotiating the sale of a business can be both exciting and frustrating. It is exciting when a successful deal benefits both the vendor and the business. It is frustrating when a lack of preparation causes a good deal to fall through, to the detriment of the vendor and the business. *(Source: Mike Cohn* Passing the Torch. *McGraw Hill, Inc. 2nd ed. (1992)*

Key issues Facing Owner-Managers:

- To sell or not to sell? Reasons for selling and reasons for not selling.
- Key issues in selling the family business & options available to family members.
- Collecting information required by the purchaser.
- Understanding and acknowledging emotional issues.
- Obtaining appropriate assistance from specialist advisers.
- Arriving at a reasonable & acceptable (fair and appropriate) valuation of the business.
- Deciding on what type of sale and managing the sale process.
- Housekeeping measures to be attended to prior to the sale.
- Being aware of, and guarding against, information leaks.
- Concluding the sale and tackling the challenges of 'life after the sale of the business'.

Valuing the Family Business

Calculating the fair market value of closely held shares/businesses is tough. There are many ways to value a family business. Underlying all valuation methods are the following assumptions:

- Profitable businesses are worth more.
- Profitability is determined after adjusting for owners' salaries, benefits and perks.

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- Earnings power is as important as earnings trends for future projections.
- Future earnings are viewed in terms of present value.
- Industrial standards and ratios change constantly.
- Financial statements do not accurately reflect value.

Over-valuing the Business

When considering a sale of their business, owners often overprice their business. Some of the reasons are:

- They factor into the price all the sacrifices they have made and the guilt they may feel for having sacrificed family life. In their minds the value of the business is often equated with how hard they have worked over the years.
- They need a certain sum to support a comfortable lifestyle in retirement and they start thinking of the value of the business in terms of that certain sum.
- Sometimes, they unconsciously seek to sabotage the sale.

Financial Modelling

Most business owners have only limited knowledge of the tax implications of transferring their business. Doing some financial modelling that examines different scenarios enables owners to explore the various options available.

Obtaining an Independent Valuation

Obtaining an independent valuation provides a benchmark against which to judge offers. Ultimately the value of a business is, as it is perceived by buyers. Filtering out buyers who do not see value, and targeting high probability buyers who are likely to see the highest value in the business are worthwhile approaches. Some research is needed: Who are the high probability buyers? What are their needs? What are their strategic, operational and, most importantly, their personal motivational drivers? Ranking potential buyers on the basis of mutual needs and, therefore, price expectations and then approaching potential purchasers for negotiations are strategies worth considering.

Obtaining Outside Advice

Negotiations need to be conducted professionally and unemotionally. An independent and experienced broker can be of great assistance.

Concluding heads of agreement (written unequivocally) that are signed by both parties and which incorporate the commercial terms that drive the deal helps to clarify and detail the terms of the transaction.

Putting the Business in Order

In approaching the sale, it pays to do a comparison of the vendor's needs and the purchaser's needs and then arrive at a correlation of mutual needs, which provides a win-win solution for both sides.
Another important step is attending to housekeeping measures to reflect commercial bottom line profitability by taking into account items such as non-commercial levels of superannuation investments and personal exertion payments.

- Making simple and inexpensive operational improvements.
- Cleaning up debtors and stock.
- Ensuring creditors are up to date.
- Securing intellectual property such as business names, trademarks and patents.
- Securing long term leases - especially for businesses that rely on location.

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Selling a Business Involves Preparation

A business sold under adverse, or distress conditions, does not command much value. Many are sold for mere liquidation value. Most businesses, like old soldiers, just fade or are given away. Conversely some businesses are sold for very satisfactory prices. Why? The answer appears simple, yet underneath that simplicity is complexity – a combination of dynamic and subtle factors, many of which are so obvious that they are often overlooked. The answer is Preparation. The quality of the preparation in large measure determines the quality of the results.

The Winning Strategy

- Decide that you will sell someday
- Prepare yourself for the sale
- Identify your ideal successor
- Realise buyers primary motivations are not financial
- Avoid the 'I'll do-it-myself' urge and obtain professional assistance
- Understand the unique rules involved in small and mid-size company valuations and sales
- Understand the factors, financial and non-financial, that drive the value of your company
- Position your company properly.

Common Mistakes to Avoid when Selling a Business

- Inadequate Preparation
- Negotiating with the Wrong Buyers
- Failing to Identify Best Buyer
- Inability to Defend Value
- Failing to Understand Buyer's Motivations
- Structuring Deal Incorrectly
- Failing to Obtain Full Value
- Waiting Too Long or Selling too Soon.

If your business represents your identity and, if you 'are the business', you have two problems:

1. **You probably are unprepared to loose your identity.**
2. **Your business will be difficult to sell and, probably, will not command a premium price."**

(Source: Theodore P. Burbank FCBI)

For more information, speak to a professional adviser or visit the Family Business Resource Centre on www.fbrc.com.au.

**This article by Lucio Dana & Harry Kras is for general information only and should not be relied on as, or in substitution for, professional advice.*

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