Preparing for Business Ownership Transfer

Ideally, the best time to sell a business is when the business is performing well with future projections looking even better. However, there are steps you can take now to increase the "worth" of your business. Not only will these steps ensure a higher sales price, they will also make your business more attractive to a greater number of prospective buyers and increase the likelihood of locating a compatible and capable buyer.

Focus on the income statement and tax returns

All businesses are valued based on the health of their income statements. Specifically, as valuations are normally performed as a multiple of discretionary earnings or EBITDA, you must begin to plan in advance to present the largest Net Operating Income you can for at least three years prior to beginning the sales process. Not only should your internal statements reflect the health of your business, your tax returns need to mirror that profitability. Business owners should be aware that there is an inherent conflict that arises with running a business and preparing it for sale. Many private businesses are run with the objective to minimize taxable income. This accounting practice also minimizes the value of the business. It's now time to change that focus from tax minimization to bottom line maximization.

It is also extremely important that your company's financial records are accurate and verifiable. A potential buyer or lender will eventually need to review them.

Make yourself replaceable and secure key employees

The last thing in the world you want is to have potential buyers think that you and your business are one-and-the-same. Begin in advance to assemble a management team that is capable of running the business after your departure. You need to convince potential buyers that the business will continue its profitable operation with or without your involvement.

In addition, if you have key employees that are critical to the operation of the business, develop employee contracts and incentive plans that will secure their stay after your departure.

Standardize and document all procedures

Do everything possible to ensure a new buyer that the business will transition as seamlessly as possible. Update and document your operating polices and procedures; write a formal business plan; create written job descriptions; develop a systems manual; organize customer and supplier files; consider investing in technology and software tools that will help streamline current procedures.

Review business agreements and contracts

Examine contracts with suppliers and customers. Evaluate them as if you were the new buyer and modify or discontinue those that might be onerous; extend those with favorable terms.

Review your real estate lease. If your location is beneficial to the new owner, renew or modify the term of the lease ensuring that the lease is transferable to a new owner.

Inspect all company equipment to make sure it is in good operating condition and if equipment is leased, make sure that terms and interest rates reflect current market conditions.

Price the business realistically

Many business owners think of the value of their business in relation to their emotions. Therefore, it becomes very important that a credible business valuation be performed that is unbiased and prepared by a certified business valuation specialist. Value is derived from multiples, market comparables, discretionary earnings, capitalization rates, cost of capital, and other mathematical, objective criteria. A realistic price, backed up with an independent valuation, signals potential buyers that the asking price has market justification.

Maintain confidentiality

Once a decision has been made to sell, a business owner should be conscious of the need for confidentiality. Any leaks about the sale of a business can cause panic and fear for the employees, suppliers, landlords and banks. Great care must also be taken to assure that competitors and customers do not learn of the planned sale. Competitors may sabotage a business by leaking information, key employees may start looking for new jobs and customers may be concerned about new management and seek alternative sources for your product or service. If any one of these were to happen, the value of a business could be significantly decreased.

Offer seller financing

Seller financing, in the form of a performance earn-out or note, is a key component in 80% or more of the businesses transferred. The advantages to sellers offering financing are: sellers typically receive a higher purchase price, the probability of selling the business increases, the seller receives additional income from the interest and increased tax benefits. With both the owner and buyer having a vested interest in the future success of the business, the buyer's confidence in the purchase increases and the business is more likely to not only survive, but to thrive.

The time you take now to make your business more marketable will expedite the ownership transfer and increase the purchase price.