

SELLING A BUSINESS

BUSINESS COMPLIANCE
SOLUTIONS
WEALTH PROTECTION
ADVICE
BUSINESS LIFESTYLE
OPTIONS

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1. Plan To Sell

From the moment that you acquire or commence a business, you should assume that one day you will want to sell it or merge with another business. To enable you to do this, so as to generate the best possible return to yourself, you should always keep the business in a “saleable state”.

2. Know The Life Cycle

- Every business has a life cycle covering infancy, development and established business.
- You need to be aware where your business is in it's life cycle. The best time to sell is during the maturing and developing stage, because a prospective buyer can see some potential.

3. Two To Three Year Plan

- The best way to sell a business is ideally over a two to three year period.
- This period will allow enough time to fine tune the financial results and ensure that appropriate systems and records have been put in place so as to enhance the value of the key intangible asset in the business, which is normally known as Goodwill.
- If you decide to sell your business today and want to list it for sale in six weeks time, most probably you will not be giving yourself enough time to maximise the potential return from the business.

4. Planning Ahead

- Planning ahead is very important in selling a business.
- Don't leave it until the last moment to start planning for the sale of the business or for putting the business on the market.
- You need to give yourself plenty of time to maximise the business's sale price, otherwise you might find that your sale price is affected by forces over which you have no control - external economic conditions, rising interest rates, unemployment etc.

5. Selling A Business Is Complex

- Just as the operation of a small business is complex and difficult, so is the sale of the business - if you wish to obtain the top price for your business.

- One of the real causes of the complexity is that the identity of a small business inter-relates so much with the person who owns it.
- Whilst the owner's personality, skills and marketing ability may have been very important in the establishment of the business, all of those skills need to be delegated as part of the planning to sell phase, so that the purchaser believes that the business is retaining those skills as they have been successfully delegated to the ongoing staff.
- If the purchaser does not believe that those skills have been effectively delegated, then even though the business might be very profitable, the purchaser will not be prepared to pay a large amount for Goodwill as the purchaser will argue that the Goodwill really belongs to the vendor and the vendor will no longer be part of the business.
- This is one of the key reasons why there needs to be adequate planning for the sale of a business - so as to ensure effective delegation of responsibilities and skills to people who will remain with the business, once the present owner is no longer involved.

6. The Key Asset Is Intangible

- When you sell a business, reasonable people will readily agree on the value of various fixed assets - land, building, stock etc.
- Where there is wide variances, even by experts, is in deciding the value of the intangibles.
- Intangibles are where the real profit for the vendor is.
 - Intangibles include:
 - the right to make money
 - the trade secrets of the business
 - copyrights
 - the business of business system
 - skilled employees
 - strong management team
 - good customer base
 - excellent relationships with suppliers
 - location
- These are all of the intangibles, which are generally grouped together and referred to as Goodwill in a business valuation.

7. Financial Performance Is Very Important

- People buy a business so as to earn profits to fund their lifestyle.
- What is important is what the future financial performance is going to be - not the fixed assets - land, buildings, plant and equipment etc., that is being acquired as part of the business.
- The financial performance will be determined by:

- the customer list
- loyal suppliers
- well trained, motivated and enthusiastic staff

8. Stay In Touch With The Market

- Circumstances change with all people and business operators are no different. You will never know when you may decide to sell your business.
- So that you can be prepared, it is important to stay in touch with the market and the key aspects which affect the valuation of your business throughout the life of the business.
- This includes:
 - making sure proper systems are installed
 - the business is profitable
 - it has a good cashflow
 - the business has developed its resources - customer base, supplier contact and is well known in the market place.

9. Periodic Valuation

As part of keeping in touch with the market place, many successful small businesses have their businesses valued by an experienced Accountant on a periodic basis - once every two or three years, so that they are aware of what their business would be worth when assessed on real market conditions.

10. Management Skills Are Important

- If there is evidence of bad management skills within a business, this can significantly affect the valuation of a business.
- A potential purchaser is very interested to understand the management structure of the business especially if the vendor was no longer available within the business.
- This is because many SME's are dependent on the owner for their success and there are no systems or management structures to allow the business to run without the direct input of the owner.
- Where this occurs, it is very difficult to maximise the Goodwill valuation of the business to an informed and not anxious buyer.

11. Housekeeping Measures

- If you are going to sell your business, it is essential that in the period of time that has been allocated to the business sale phase, that you ensure that all aspects of your business have been reviewed and appropriate systems, management structures etc., implemented so that every aspect of your business functions satisfactorily.
- Key housekeeping measures would require attention to:
 - Debtors
 - Stock
 - Creditors
 - Intellectual Property
 - Leases
 - Business System Manual
 - Premises
 - Staff
 - Signs

12. Debtors

- Review the Debtors' Ledger.
- Chase up outstanding debts.
- Ensure that a Debtors' Aged Analysis is prepared on a monthly basis and that follow up action is taken.
- Compare the average time that Debtors are outstanding to inter-firm benchmarks.
- Confirm with individual customers your business's terms of trade.

13. Stock

- Review your stock recording system. Does it give you accurate information? Are you acting on it?
- Sell off any old or deteriorated stock. If you have a large volume of old or deteriorated stock on hand, a potential buyer may use this as a reason to discredit the other stock on hand that you have.

14. Creditors

- It's a good idea to make sure that Creditors' payments are up to date and within the negotiated payment terms.
- A buyer is going to want to know the names of your suppliers.
- If you are behind in making payments to those suppliers, they may indicate this to the potential purchaser. This could harden the purchaser's attitude towards the valuation of

goodwill in that the purchaser may decide that the suppliers could adopt a hard attitude towards her/him or could insist on a lot tougher payment terms than what are applicable to the current owner.

15. Intellectual Property

- Intellectual Property covers such things as:
 - Business Name
 - Trademarks
 - Patents
 - Copyrights
- If these are part of the assets of the business, which are going to be sold, it is very important that all of the legal procedures necessary to affect proper registration have been undertaken.
- If any of the Intellectual Properties have been developed by staff or sub-contractors, then the appropriate documentation should have been prepared to legally clarify the actual ownership of the Intellectual Property.
- If your business has developed a product or intellectual property, you may need to protect these items legally. If you have not done this, you should consult a Solicitor who specialises in Intellectual Property. The registration of a Trademark can take a long time - up to two years. So the quicker you get started the better.
- If these items are not sorted out, the purchaser will probably wish to severely discount the valuation that has been included for the Intellectual Property assets in the valuation of the business.

16. Lease Of Premises

- The Goodwill value that is applicable in some businesses, particularly retail, depends to a significant extent on the period of the lease still to run.
- If this is the case in your business, then perhaps you should be negotiating for a long term lease (approximately ten years, with options) so as to secure for the purchaser tenure of the lease at the present location.

17. Business Systems Manual

- The existence of a Business Systems Manual which explains, in writing, every function of the business, is vital for the successful operation of a SME.
- It also has an important bearing on the valuation of the business and therefore the goodwill figure that a purchaser will be prepared to pay.

- It is in the vendor's interest to ensure that a Business Systems Manual (that is being used by the employees in the business), is introduced and is seen to be working and contributing to the earning of bottom line profitability.

18. Premises

The premises should be clean. This includes windows, stock room and amenities. Preferably the premises should have been recently painted so as to give a bright prosperous appearance to the business.

19. Staff

- Staff should be well trained, motivated and professional in their dealings with the public at all times.
- Potential purchasers can "check out" a business before making official contact with the vendor.
- The group of people that the potential purchaser is going to be very interested in is the staff.

20. Signs

Inspect the signs of the business. If they are showing wear and tear have them painted and tidied up.

21. Customers List

- You will need to be able to produce a detailed list of your customers, showing name, address, telephone number, fax number, email address and the value of sales made to them in each of the last three (3) years.
- It would also be desirable to be able to advise the gross profit that was earned from each of those customers.

22. Top 20% Of Customers

- Most purchasers will want to understand the volume of business that will be available from the top 20% of customers.
- You will enhance obtaining the maximum goodwill figures if you are able to produce a summary of the sales to the top 20% of your customer base over the last three (3) years,

preferably with an indication of the gross profit contribution from each of those customers.

- The production of this type of information will emphasise to the potential purchaser that you have installed excellent business systems and that is what they are paying for as part of their goodwill payment.

23. List Of Suppliers

- The Vendor should produce a list of the suppliers to the business under the various business purchase headings, showing:
 - name of the supplier
 - address
 - telephone number
 - fax number
 - email address
 - contact person
 - negotiated payment terms
 - current payments being made
 - details of purchases of that product from that supplier for each of the last three (3) years
- The supply of this information is an important ingredient in the consideration of the valuation of the business through the goodwill value.
- If you want to sell your business, you will ensure that this summary is prepared.

24. Quality Assurance System

- Many businesses have implemented a Quality Assurance System.
- There is an expectation by many potential purchasers that Quality Assurance Systems have been introduced.
- The Vendor should be in a position to explain the status of the business's Quality Assurance System:
 - Is there one?
 - Has it been Accredited?
 - If so, by whom?
 - Which of the business's customers have required that the business has a Quality Assurance System?
 - How do those customers audit the business's Quality Assurance System?

25. Trade Secrets

- If your business has any trade secrets, recipes, formulas, agreements with suppliers etc., all of these should be properly documented and located where they can be found.

- You would not hand over any trade secrets until you were well advanced on negotiations for the sale of your business.
- But as part of your pre-sale planning, it would be desirable to make sure that all of the assets which could be termed “trade secrets” which are going to be part of the sale, have been properly documented and recorded and it is known where the documentation is located.

26. Marketing Strategies

- If your business has developed particular marketing strategies for its customers or some of its customers e.g. “A” Grade customers, “B” Grade customers, “C” Grade customers and a system has been implemented for the ongoing marketing strategies, then a detailed summary of the structure should be prepared so that it is available as part of the negotiations for the sale of the business.
- This information also falls under the “intangible” category. It could have a significant bearing on what a purchaser is prepared to pay for goodwill in the acquisition of the business.

27. Government Accreditations

If the business has been given any Government Accreditations, Approvals or Registrations, these should be appropriately listed with supporting documentation, so that they are available to be tabled in the negotiations.

28. Export Market Negotiations

- If the business has been involved in the development of contacts with overseas customers or potential overseas customers, a summary of the milestones that have been achieved, names of key contact persons, telephone numbers, names of overseas advisers - Solicitors, Accountants, Banks etc., should be prepared.
- This is part of the information which ultimately will be handed over to the purchaser.
- This information is also part of the intangibles of the business.

29. Business Plan

- Your Business Plan should be reviewed.
- Any particular items that are personal to the current owner should be deleted and the Business Plan re-prepared so that it is strictly the Business Plan for the business, so that the Business Plan document can ultimately be handed over as part of the sale process.

- This document is also very important in the consideration of the value of goodwill applicable to the business.
- The Business Plan will set out key information on which the purchaser will require assurances including:
 - Management Structure
 - Organisation Chart
 - Allocation of Corporate Responsibilities
 - Staff Training
 - Staff Appraisals
 - Staff Meetings
 - Management Meetings
- The purchaser wants all of this information, so as to understand how effective delegation has been achieved within the business. In other words - can the business successfully operate without the influence and contribution of the current owner?
- If the potential purchaser believes that the business will have severe handicaps in being able to operate without the present owner, then the amount that the potential purchaser is prepared to pay for goodwill will be significantly reduced.
- If however, the potential purchaser is happy that there has been effective delegation within the business and this is supported by not only the Business Plan but the Staffs' attitude and the decision making process within the business, then the potential purchaser is going to be more likely to agree to a higher goodwill figure.

30. Must Have Proper Records

- The importance of proper records as part of the sale process of a business cannot be over emphasised.
- You cannot expect to get top value for the business, including goodwill, unless the Vendor is able to produce accurate detailed records of the business. These include:
 - Cash Books
 - Bank Statements
 - Deposit Books
 - Cheque Butts
 - Creditors' Invoices
 - Debtors' Invoices
 - Journals
 - Ledgers
 - Monthly Financial Statements
 - Debtors Aged Analysis
 - Creditors Aged Analysis
 - Stock Records
 - Key Performance Indicators
 - Annual Financial Statements
 - Taxation Returns
 - Departmentalised Trading Figures
 - Staff Records
 - Employment Agreements

- If your records are kept in a shoe box then it will be very difficult to achieve a high sales value.

31. Staff Details

- The prospective purchaser is going to be very interested in the staff of the business. The information that would need to be made available would include the following:
 - A list of all employees - showing:
 - name
 - position
 - current salary
 - incentive or bonus arrangements
 - annual leave entitlements
 - Calculations for each employee of amounts that the business currently owes for Holiday Pay, Sick Leave and Long Service Leave (if applicable).
 - The position description for each employee.
 - Each employee's Employment Agreement.
 - Details of qualifications, experience, achievements.

32. Portfolio Allocations

If you wish to be able to indicate to a prospective purchaser that there has been effective delegation in the business of the various corporate responsibilities (marketing, sales, administration, staff training, public relations, quality assurance, library, technical facilities, product development, suppliers, bank, legal etc) to members of the Management Team and to employees, the production of a list of the portfolio allocations together with an organisation chart for the business is the easiest way to confirm that effective delegation has been undertaken in the business.

33. Meetings Structure

As part of the effective delegation of responsibility throughout the business, a prospective purchaser would expect to see a formal meeting structure established within the business e.g.

- Weekly Production Meetings by each group
- Weekly Management Review Meetings
- Monthly Formal Management Meetings
- Monthly Board of Directors or Board of Advice Meetings

with appropriate reports being submitted to each meeting and minutes and follow up action lists being produced on every meeting held.

34. Key Employees

- In most small businesses there are usually a number of key employees.
- These people are essential to the effective operation of the business. As their presence will go a long way towards convincing the potential purchaser to purchase the business and to pay the goodwill figure being sought, it is essential that the owner of the business seeks assurances by the prospective purchaser that the key employees are to be retained and then gives those assurances to the key employees.
- If any of the key employees left during the negotiation stage it could have a devastating effect on the sale negotiation and in particular, on the determination of the value of goodwill.
- This highlights the desirability of having all key employees appropriately contracted to the business.

35. Let Staff Know

- One of the quandaries when negotiating to sell the business is whether to tell the staff.
- If you don't tell them you run the risk that they will find out on the rumour mill and then some of them, especially key employees, may decide to leave the business.
- This can be very undesirable from both the Vendor's and the Purchaser's point of view.
- In most cases, it is appropriate that the owner informs the staff that the business is being offered for sale. Tell them that in the negotiations the owner will be highlighting to a potential purchaser, the contribution that the employees make, the fact that there has been effective delegation in the business and that the employees are vital to its successful operations.
- If agreement has been reached with a prospective purchaser that all staff will be retained in the ongoing business venture, then this information should be conveyed to staff at an early opportunity.

36. Financial Information

The financial information which should be made available to a prospective purchaser includes:

- Detailed Departmentalised Statements of Financial Performance for the previous three (3) years.
- Appropriate adjustments, together with full reasons, to the Statement of Financial Performance for any adjustments that are necessary because of:
 - Salaries being paid or not paid to key management employees.
 - Rent adjustment for the utilisation of buildings owned by the business.

- Adjustment to any expenses which are written back for income tax purposes.
- A copy of the firm's income tax returns for the last three (3) years.
- Copies of the firm's Debtors' Aged Analysis at the date of negotiation.
- An indication of the value of stock.
- The various books and records of the business should also be made available. These will include:
 - Cash Books
 - Cheque Butts
 - Creditors' Invoices
 - Debtors' Invoices
 - Debtors' Ledger
 - Journals
 - Ledgers
 - Deposit Books
 - Any other information that the purchaser requires

37. Future Maintainable Earnings

- A prospective purchaser will be wanting to determine what the Future Maintainable Earnings of the business will be.

This is after adjustments for:

- reasonable management salaries
 - rent being paid for use of buildings owned by the business
 - adjustments for non-business expenditure that may have been incurred by the business
- Unless the business can generate a reasonable Future Maintainable Earnings, after the payment of reasonable management salaries, it is doubtful whether the business will have a sustainable goodwill value.
 - Therefore the owner of a business who is contemplating selling the business, should do everything in her/his power to ensure that, as far as possible, a very clean set of financial statements for the previous three (3) years can be produced. Then an independent Accountant can prepare an estimate of the Future Maintainable Earnings, based on the best available figures that the business can produce.
 - In many cases, for various reasons, unless a business gives itself two (2) to three (3) years to ensure that everything within the business is functioning satisfactorily, it will not be possible to prepare an optimum level of Future Maintainable Earnings. If this is not so, then the overall value of the business will not be as high as what it otherwise could have been.

38. Income Tax Returns

- It is desirable that a reconciliation be prepared between the financial results, as disclosed in the financial accounting information made available to the purchaser and what has been disclosed in the business's income tax returns.
- If, for some reason, there is any money that has been received by the business, that has not been disclosed in the income tax returns, it is very doubtful that a prospective purchaser would accept that amount being included in the sales figure as part of the calculation of the Future Maintainable Earnings.

39. Budgets And Cash Flow Forecasts

The Budgets and Cash Flow Forecasts prepared by the business should, in most cases, be made available to the prospective purchaser, as these will assist the purchaser in analysing the long term profitability of the business and will also be of great assistance to the potential purchaser in negotiating with their bank for finance to assist in purchasing of the business.

40. What Is The Business Worth?

- The availability of many of the matters mentioned in this document will have a direct bearing on the overall valuation of the business.
- A good strategy is to have an Accountant experienced in the valuation of businesses, review all of the material and prepare a valuation of the business, as if he was acting for a purchaser of the business. This would be based on the information that the Vendor is making available to a potential purchaser.
- The benefit of this is that the Vendor will obtain a realistic "arms length" appraisal of the value of the business.
- A report such as this will highlight areas where attention could be given so as to improve the overall performance of the business and therefore, its valuation.
- Most of this attention will be within what is referred to as the "intangibles" of the business, which relates to business systems, customer relations, suppliers relations, staff training and development, delegation within the business. In other words - how the business of the business is functioning.
- Many SME owners spend many years and thousands of man-hours building up their businesses and tend to assume, because of these efforts, that it equates with a certain value in the market place.
- Unfortunately, in many cases, this value is unrealistic.
- The potential purchaser is not going to pay a price merely to recompense the previous owners for the hours of sweat and toil that they have put into the business.

- What a potential purchaser is looking at is what is the Future Maintainable Earnings after the payment of reasonable management salaries.
 - What are the “intangibles” of the business?
 - What is the business’s reputation in the market place?
 - How good are the customers?
 - How enthusiastic and well trained are the staff?
- What rate of return does a reasonable competent interested, but not anxious, purchaser require from an investment in this type of business?
- All of this information is part of the calculation of the overall value of the business, from which is deducted the net tangible assets that are utilised in the business, to determine the value of goodwill.
- The reward for putting in long hours by the owner is how effectively those long hours have been inputted in developing the business of the business i.e. effective delegation of responsibilities and work ethics throughout the business.
- That is what a potential purchaser is negotiating to buy.

41. Asking Price

- The asking price is a combination of:
 - the Future Maintainable Earnings, after reasonable management salaries
 - the value of assets that have been transferred as part of the business sale
 - the goodwill of the business
 - the future potential of the business
 - the required rate of return from the investment
- All of these items contribute to the determination of the overall asking price for the sale of a business.

42. Negotiating Skills

- To be able to sell a business and gain the best price available, a SME operator needs to come to grips with the various matters that have been raised in this booklet/report and to clearly understand what comprises the goodwill of the business and what the other assets are worth, so as to determine a price.
- This requires the SME operator to ensure that they, or their advisers, have adequate negotiating skills to be able to negotiate for the sale of the business.

43. Timing Of The Best Time To Sell

- The best time to sell a business is at the culmination of ensuring that all of the information and systems, as outlined in this booklet/report, have been appropriately

attended to and at a time when the business can present a very sound financial performance for the previous three (3) years and be in a position to enable an optimistic future maintainable profit calculation to be made.

- In most businesses the timing of the best time to sell would be at least two (2) years after making the decision to place the business on the market. In some businesses it could be three (3) to four (4) years later.