Exit Right: Ways to plan ahead when selling your business

by Heather R. Johnson

Whether a business owner wants to retire to a tropical island or simply move on to the next venture, an exit plan is crucial to ensure a seamless sale. The business owner that plans wisely, in advance, can negotiate a transaction that benefits buyer and seller alike.

Barring unforeseen circumstances (injury, illness, family emergencies), it's wise to plan for a sale at least one to three years in advance. Sellers should have at least three years of unblemished tax returns on hand, which will help an appraiser or broker accurately value the business and give the potential buyer a clear picture of a business's cash flow. No one likes to pay taxes, but if you plan to sell a business, it's best to think conservatively with deductions.

"Normally businesses take very aggressive deductions to minimize their taxable income," says Daniella Simon, a San Jose, California-based attorney and business broker. "When it comes time to sell the business, however, those aggressive deductions can torpedo the valuation." In other words, think twice about writing off that Hawaiian vacation. "A client with really clean books and records has a much better chance of selling their business, because buyers will perceive their financial statement, as well as the valuation from which it's based, as more trustworthy and the acquisition as less risky," says Simon.

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Gene Griffith, former owner and president of All South Supply, a janitorial supply company in Mobile, Alabama, spent about a year and a half preparing his business for sale while the economy recovered from the recession. When his broker, William Bruce, said in 2014 that there were prospective buyers, Griffith was ready. "I cleaned up the balance sheet, and reduced expenses as much as I could," he says. "We also cleaned up the building. We wanted to give buyers a good, clear perspective."

Another way to make a business more attractive is to finance all or part of the sale. "Financing the sale shows that the seller believes in the business," says Bob House, general manager of BizBuySell, an online business-for-sale marketplace. "It tends to align the buyers and sellers and produces a deal that's more likely to result in a successful transition."

Griffith wasn't interested in financing part of his business sale at first. But with some contractual obligations, felt "comfortable enough" to take a note from the buyer. The financing could work to his advantage. "The seller makes interest on the note," says Simon. "Also, financing can reduce a seller's tax exposure because the purchase price is metered out over period of years instead of in one lump sum. If you have a credit-worthy buyer with operational experience, both parties could have a very good outcome."

Assemble the right team

Considering myriad tax issues and contract negotiations, unless a company is very small or has a sales-savvy owner, a broker is worth the expense. "Selling a business is not a straightforward process," says House. "A lot can go sideways. Small business owners are busy running the company. The last thing they want is for the business to suffer because they're trying to sell it themselves."

A broker provides an objective voice at a time when business owners often have an emotional attachment to the company and unrealistic expectations of its value. "Brokers can help bring a dose of reality to that conversation," says House. A broker also knows the methods for valuing a business, which are based on multiples of a business's cash flow.

Tax returns, property value, equipment, and other assets also come into play in a valuation. An appraiser, another valuable team member, knows how to factor these elements into the purchase price. "A machinery appraiser is [helpful] if a lot of equipment comes into play, and it's an asset-based sale," says Simon. "For commercial real estate, it's a good idea to bring in a property appraiser."

An accountant will help keep those books and records in check. A lawyer can assist during contract negotiations as well as consult on real estate, financial, and employment issues.

Exit on a high note

Today's relatively strong economy benefits both buyers and sellers alike. Buyers are more willing to take risks during a time of economic stability and sellers should have at least a three-year record of strong performance. But regardless of economic factors, "the very best time to sell is when you start to see the uptick in gross revenue," says Simon. "On the upside of the bell curve, the buyers are excited, the business is doing well, and that's the green light for business sales."

It's important enough to mention twice that a seller must keep accurate books and records. Not only does this aid the valuation process but also ensures confidence during the due diligence investigation, which both parties conduct to decide whether to move forward with the deal. "The buyer will want to see sales tax returns, accounts payable, equipment purchase receipts, and bank and credit card records," says Simon. "If the buyer sees good, clean books and records, the buyer will have faith that the business is a sound and a worthwhile investment."

Through a broker's network or blind ads, potential buyers will likely want to see the business. Just as in real estate, take time to spruce up the building inside and out. Apply a fresh coat of paint and keep the office or retail space clean and organized.

Do not, however, disclose the sale to friends, neighbors, or employees. "The business can really suffer if vendors, customers, or staff find out that the business is for sale," says Simon. "Employees might look for another job, customers might leave. Not maintaining confidentiality can wreak havoc on a business."

Most importantly, have patience and a positive attitude. The process could take six months to a year. Sellers should consider both sides of the equation. "The deal has to provide a return for the work you've put in to build the business, but it also has to work for the buyer," says House. "The buyer often invests a significant chunk of his assets. It's important to approach the sale with a win-win attitude."

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