Questions and Answers on Selling Your Business

1. **I’ve always thought of estate planning in terms of my family only. How does my business fit into the plan?**

   It's not uncommon for business owners to think of estate planning in terms of providing for their family. We find in our conversations with most business owners about what they want to accomplish with their estate plan that they will indicate that they would like to accomplish all of the following:

   - Maintain control while they’re alive and well; and
   - Know how their affairs will be managed in the event of their disability and how they're going to be provided for and how; and
   - At their passing leave what they have to whom they want, the way they want and when they want; and
   - Know that there are systems and processes in place to make sure that the plan stays current with the changes in the law, their family members’ personal situation, and the financial situation of their family members; and
   - Accomplish all of these things while paying the lowest possible amount in taxes all for a reasonable overall cost for the family.

   To accomplish these objectives it is necessary to take into account all of your assets. For virtually every business owner that we work with their most significant asset is their business. It is not uncommon in our experience to see the business equal well over 50% of the value of the estate. Sometimes the business will represent as much as 90% of the value of the estate. The business is the source of the income that supports your current lifestyle. The business will probably be the source of the income that will provide for you and your family in the event you become incapacitated. And, perhaps most significantly, the business is generally the most valuable asset in the estate that must provide for your survivors when you’re gone.

   Since the business is essentially the source of the family's lifestyle and probably it’s most valuable asset, it is not possible to do good estate planning for a business owner without taking into account the business and how it affects the family. Failing to adequately plan for the family-owned business and its disposition at the death of the owner has frequently resulted in irreparable damage to the relationship between siblings and even between children and the surviving parent.

2. **How do I determine how much my business is worth? What factors will be included in an appraisal?**

Simple answer is to have the business appraised. However, the appraiser will need to know the purpose of the appraisal. If the appraisal is for the purposes of establishing the value for estate planning or gifting there are very comprehensive guidelines that the IRS requires a qualified appraiser to follow to develop a defensible valuation. In fact, the IRS has developed regulations which clearly specify what constitutes a qualified appraiser.

The most important Revenue Ruling from the IRS dealing with the valuation of a closely held company requires the appraiser to consider all of the following:

1. History and Nature of the Business.
2. Economic Outlook.
3. Book Value.
4. Earning Capacity of the Enterprise.
5. Dividend Paying Capacity of the Enterprise.
6. Goodwill and Intangible Assets.
7. Recent Sales of Stocks.
8. Market Value of Comparable Companies.

If the purpose of the appraisal is to establish the value at which it will most likely sell in the open market there are additional concerns. For instance is it expected that the business will sell to a financial buyer or a strategic buyer? Financial buyers virtually always pay less for a business than a strategic buyer. This is because the strategic buyer expects to create synergies with the existing company. These synergies should produce significantly greater profit to the buyer as a result of the combination of the companies. A strategic buyer is one that, because of the acquisition, will see profit improvement that does not exist in the acquired business by itself.

A financial buyer is only looking at the company being acquired as it stands alone taking into account its current net profitability and the company's earnings history. No knowledgeable financial buyer will pay more for a business than the present value of the net income generated by an operating business taking into account all known risk factors.

Without regard to the reason for the appraisal there are always 4 elements present. They are:

1. Reasonable buyer and seller standard.
2. The business's financial and accounting information and management's explanation of these things.

3. Methods or business systems that are used by the subject company in producing its revenues and controlling its expenses.
4. The time at which the valuation is being made and the market conditions that exist at that time. These conditions include industry wide conditions, local geographic conditions, national economic conditions and in some cases even international economic conditions.

The reasonable buyer and reasonable seller standard is a hypothetical assumption that in the valuation process assumes that neither the buyer or seller are acting under duress and have knowledge of all relevant facts to make an informed decision to buy or sell. Essentially this means that both the buyer and seller are simultaneously deciding to buy or sell while considering other investment alternatives to either selling the business or buying a business. With the assumed result that a deal is made when the economic incentive to sell is equal to the economic incentive to buy.

Ultimately, the appraisal is entirely dependent upon the financial information and accounting information that is provided to the appraiser. This financial information will include multiple years of income and expenses as well as the balance sheets for multiple years. The appraiser may of course question the information if it appears there may be issues with the information furnished or simply to gain a further understanding of the information. For operating business, as opposed to a mere holding company, a knowledgeable business appraiser will consult with management to be sure that they understand the company's accounting and financial information. They will also look to management for an explanation of anything the appraiser sees that appears to be out of the ordinary and to gain an understanding of how this financial information relates to actual operations of the business. Management will also generally be consulted for an overview of the operations of the business both currently and historically as well as what the current business plan provides for prospectively.

The appraiser will considered the business as being an organized method for producing revenues routinely over a period of time. This view results in a business essentially being divided into two value components. Those value components are:

1. The value of the assets which includes machinery, equipment, buildings and land, usable materials, inventory, intellectual property and other legal rights.
2. The goodwill value represents the premium the buyer would pay for the organization based on its historical recorded cash flows to the extent they exceed an acceptable risk adjusted return on the capital invested in the business.

Very importantly, in considering the value of a business, if it is not realistic that the business will produce a net income in excess of the operator's salary and a reasonable return on investment in the business then the business appraiser is likely to find that the business has no value beyond the liquidation value of its assets.

The market conditions in the economy change over time. The nature of the change whether it's increased interest rates, decreased demand for similar products or services or decreased competition generally will have an impact on the success of the company. While the appraiser must consider these economic and market conditions they are only knowable as of the date of the appraisal. The valuation is only a good indication of the business value at one point in time. This is because nearly all of the factors that must be taken into account to arrive at accurate value change with each passing month.

Many business owners really wonder if they need to have a business valuation done. There are at least six reasons why business owner should have a valuation completed. Those reasons are as follows:

1. A major objective of nearly every business owner is to receive the full fair value of their ownership interest. How can you know the true value of your business without an experienced trained business valuation expert having valued it? Think of it this way; would a sophisticated buyer ever consider acquiring your business without first determining what it is worth? Of course not. Therefore you should not sell to any party without first knowing what your business is worth.

2. To be able to sell your business and maintain your desired lifestyle the after tax proceeds of the sale of the business must produce enough income for the rest of your life. This requires that you know what your business is worth and what the after-tax proceeds from the sale would be.

3. Most business owners don't realize business value is relative primarily due to who the buyer may be. Rules of thumb are incapable of taking into account who the buyer is and the specific characteristics of the business that will increase or decrease the business’s value.

4. Wise business owners know that is important to always grow their business. This is true even when you're contemplating a sale. A critical ingredient of the growing the business is having motivated employees. This is frequently done with employee incentives. The most effective incentives for the business are nearly always tied to the growth of business value. Your best employees will be concerned about the accuracy of the business value and whether it is fair to them. The use of an outside business appraiser is the best way to deal with these concerns.

5. If the business sale is to be to key employees or even children, do you believe that they will find a rule of thumb valuation acceptable? Keep in mind that they typically have no real idea what the business is worth. Even if you're seeking a relatively low price, it is likely they may think it is high. Because of

this it is best to anticipate the problem and use an independent valuation professional to set the price.

6. If part of the business sale plan is to transfer a minority interest to key employee or child a rule of some valuation or best guess will not fly with the IRS or the employee, if they are paying for it. The values used will have to meet IRS guidelines and you will have to be able to defend the value you assign to the interest.

If the effort and cost involved with the professional valuation approach seem excessive or unnecessary, compare that to the cost of receiving even 10% less than your company is really worth. And then there's always the potential cost of defending the value you accepted before the IRS without a proper valuation to support you.

3. Should I be planning for all my personal assets at the same time I'm planning for my business, or are those two completely different things?

When you're planning on what to do with your business interest whether it's because of your planned retirement, a sale of the business or at your passing it's important to take into account all of your assets including your business. It is perhaps best to develop an Exit Plan for your business. An Exit Plan will help increase the profitability of your business while you're actively involved in it and also increase the likelihood of your being able to sell the business when you're ready. When properly created and implemented an Exit Plan will also help make sure that you have adequate resources to be able to enjoy the lifestyle you want when you retire.

Your Exit Plan should be in writing and address these six critical issues:

1. Establish when you wish to exit your business, what annual income you or your surviving spouse will need and who would most likely be buyers of the company.
2. Establish what the current value of your business is.
3. Identify and take all reasonable steps to preserve protect and promote the value of the company and of its assets.
4. Determine if the company can be sold to outside parties (vendors, financial buyers, or a strategic acquirer) or is it more likely to be sold to insiders (partners, key employees, or family members).
5. Plan for and address those contingencies which can have negative impacts on the company's profitability or your ability to sell it or your and your family's financial security.

6. Develop an estate plan that is integrated with your exit and business plan so that your spouse and descendents receive the maximum benefits from your life's work.

4. What professional advisors should I include in the business transition planning and how do I choose them?

You may need to include all of the following in your business transition planning:

1. Exit Planning Professional
2. Certified Public Accountant
3. Business Appraiser
4. Business Attorney
5. Financial Planner
6. Estate Planning Attorney
7. Life Insurance Advisor
8. Property-Casualty Insurance Advisor
9. Employee Benefits Specialist
10. Banker
11. Trust Officer
12. Business Consultant

Not every business owner will need all of these advisors for their business transition. However, at a minimum every business owner should use an Exit Planning advisor, CPA, business appraiser, business attorney and an estate planning attorney. Exit Planning is a new field driven by the hundreds of thousands of baby boomer business owners who need to know how to maximize the value of their business when they sell it. The Exit Planning advisor will have experience in working with business owners to develop a written plan on what they need to do in their business to be able to sell it for what they need so that they can retire comfortably.

The Exit Planning advisor will have experience in working collaboratively with all of the advisors mentioned above in helping the business owner do all of the following:

1. Set their objectives as to when they will leave the business, to whom they want to sell it, and the income they need to maintain the desired lifestyle; and
2. Work with the business appraiser to determine the current value of their business, what the business value drivers are, in the business; and

3. Work with the business consultant to identify the best ways to preserve and protect and promote the value of the business, and identifying incentives that will help motivate and retain key employees and those of the following steps need to be addressed for your business:
    a. Management Team Development Plan
    b. Management Responsibilities Transition Plan
    c. Analysis and Review of Employee Compensation
    d. Review of Qualified Retirement Plan for Possible Changes
    e. Key Person Insurance Planning
    f. Development of Key Employee Incentive Plans
    g. Separation of Business Operations from Business Assets
    h. Employment Agreements and Covenants Not to Compete; and
4. If the desired buyer is an outside third-party, collaborate with the business attorney, CPA, business broker or investment banker to provide advice and direction regarding the following steps that are appropriate for your circumstances:
    a. Presale Due Diligence
    b. Debt Reduction Strategies Presale
    c. Presale Tax Planning
    d. Identify Potential Buyers
    e. Sale Bonus for Employees
    f. Presale Planning for Business Real Estate; and
5. If the desired or expected buyer will be a key employee, family members or co-owners, collaborate with business consultant, business and estate planning attorneys, employee benefits specialist, banker and CPA to provide assistance in identifying which of the following steps or tools are appropriate to help you best achieve your objectives:
    a. Plan to Develop Ownership Skills
    b. Transfer of Ownership Interest As a Bonus
    c. Gift of an Ownership Interest
    d. A Nonqualified Deferred Compensation Plan for You
    e. Sale of Ownership Interest Using One or More of the Following Tools:

        i. Installment Note
        ii. Grantor Retained Annuity Trust
        iii. Bank Financing
        iv. Self Canceling Installment Note
        v. Cash
        vi. Irrevocable Grantor Trust
    f. Buyback Agreement for Minority Owner; and

6. Collaborate with the business attorney, CPA and financial planner, life insurance advisor to provide advice and assistance in determining which of the following planning issues need to be addressed for your business circumstances and objectives:
    a. Wage or Salary Continuation Plan
    b. Buy Sell Agreement with Co-Owners
    c. Stay Bonus Plan
    d. Key Employee Retention Plan for after Your Death or Disability
    e. Continuity Planning Insurance; and
7. Cooperate with the estate planning attorney, CPA, financial planner, insurance advisor, trust officer and business attorney to identify which of the following issues or items need to be addressed in your case and provide advice on their design or implementation:
    a. Review of Existing Estate Planning Documents
    b. Recommendations Regarding Needed Changes or New Planning Documents
    c. Asset Protection Planning Personal Assets
    d. Review of Existing Insurance and Possible New Insurance
    e. Strategies for Transfer of Specific Non-business Assets
    f. Wealth Management Plan for Personal Assets
    g. Plan for Business Real Estate Transfers at Death
    h. Uses a Business Cash Flow at Death
    i. Bequest to Key Employees

As you can see from all of the things that need to be considered that it is impossible for any single professional or in fact for anyone firm to provide you with all of the required expertise to successfully transition your business for your desired financial result. In choosing the advisors to work with, ideally you first will find an experienced Exit Planner. You can find experienced Exit Planners listed on http://www.exitplanning.com/. Look for advisors who are members of the Business Enterprise Institute, the Exit Planning Institute or Pinnacle Equity Solutions. The members of these organizations are generally attorneys, CPAs, financial planners, business consultants or related professionals who have spent time and effort learning how to collaborate with other advisors and to understand all of the issues a closely held business owner needs to deal with to most effectively sell their business.

You want to choose advisors who have experience in working with closely held business owners over a number of years to develop an Exit Plan. You will want to talk with your existing CPA regarding his experience and willingness to collaborate with other advisors. In fact it is both the experience working with business owners and the willingness to work collaboratively with all of the advisors the business owner may need that are critical in developing a successful Exit Plan. It is ideal if you can find the full set of advisors that you'll need who already know one another and have collaborated successfully to help other business owners. If you can't find this collaborative group ready-made, then you'll need to inquire of each of your chosen advisors about the following:

1. Do they have experience with multiple clients who own businesses that are generally the same size as yours?
2. Is it a routine part of their practice to work on client projects that involve solving difficult problems in doing strategic planning for the future?
3. Is it a routine part of their practice in seeking input from all of the client's advisors prior to making recommendations?
4. What kind of contribution do they typically see from a client's other advisors?

As you interview the professionals that you need you'll be looking to find out if they are knowledgeable in their area of practice, creative in developing strategies for problem-solving. Are they cooperative with clients and other professionals. The following questions will help give you an idea if they have these traits:

1. Do they participate in training other professionals in their field and others?
2. Do they have a system or process to do problem-solving with a client?
3. Can they identify the steps they would take to help identify the best ideas for the client's circumstances?
4. What is their process for resolving differences of opinion between themselves and your other advisors?

5. **Will I need a business broker or investment banker? If so, how do I choose them?**

   If you're selling your business to insiders, that is key employees, family members or co-owners generally neither a business broker or investment banker are needed. In this case the experienced Exit Planning advisor will be your most critical advisor. However, that all changes if you want to sell to an outsider, whether it be a financial buyer or a strategic buyer.

   It's pretty well established that the majority of owners who try to sell their own business fail. When they do succeed they frequently receive substantially less than they might have with a well-thought-out plan. In addition they frequently incur significant income taxes that may have been avoidable. Working with either a business broker or investment banker will not necessarily solve the problem of the income taxes but they will increase the likelihood of selling the business for a better price. It is the author's opinion that with few exceptions all business owners are well advised to use an experienced knowledgeable business broker or investment banker to sell the business.

   A business broker is a person or firm that will represent you in the sale of your business. They frequently will provide you with a preliminary indication of value, advertise the business for sale and not disclose exactly which business it is or who is the owner when they are marketing your company. The business broker will handle initial buyer interviews and discussions and negotiations with prospective buyers. Generally the business broker only gets paid when the business sells. If your business has sales below $5,000,000 will probably work with a business broker because most investment bankers don't deal with businesses this size or smaller. Between about $5,000,000 and $10,000,000 in sales you will find both business brokers and investment bankers providing services. Above $10,000,000 in sales you will generally be best served in working with an investment banker.

   An investment banker is a person or firm that will assist business owners of sufficiently large businesses in finding outside buyers. They will help the business owner determine if the company is a good candidate to be able to find a strategic buyer. (A strategic buyer is one that will pay the greatest possible price for the business because of the synergies created by the combination.) If the company is not a good candidate to be acquired by a strategic buyer then the alternative is a financial buyer. A financial buyer determines the price it will pay predicated upon the expected return on the investment solely from the acquired business.

   In addition to a success fee for selling the business the investment banker will generally charge a fee for the advice and services provided in doing presale due diligence and developing the strategy to market the business. The investment banker will generally manage and assist in all of the pre-closing activities and will work with the attorney in drafting all the appropriate documents. An experienced and motivated investment banker will generally help the business owner receive substantially more for their business than they would be able to achieve on their own.

When choosing a business broker you should consider all of the following:

1. You want a broker who has several years of experience. You should look for a business broker who holds the CBI designation from the International Business Broker Association which indicates that not only do they have experience but they also have completed dozens of class hours of training.
2. The experience of your broker should be specific to your type of business and geographic location.
3. Ask the broker for references of satisfied clients and other professionals with whom they worked including CPAs and attorneys.
4. The broker should have experience selling businesses of your size. It's just as bad to work with a broker that generally sells businesses that are substantially larger than yours as it is to work with one whose experience is primarily with much smaller businesses.
5. Make sure that the broker can explain to you the steps in the process they will use or sell your business. What their communication process will be with you and keep you informed of their activities and results and the timeline for their activities in the sales process.
6. Most business brokers do not get paid up front for any of their time or services, so be very clear on why and what you're getting from any broker who wants an upfront fee. Don't be afraid to negotiate the fee the broker asked for. The broker will generally receive no more than 10% of the sales price of the business. As the sale price goes up and depending upon your specific facts you may be able to justify more fees. But keep in mind, a true professional is always worth being well compensated.
7. Try not to commit to too long a contract term with the broker. Expect at least a six-month agreement, but a ninety day agreement may be in your best interest. In ninety days you have an opportunity to evaluate if the broker is really giving you the kind of effort that will be necessary to successfully market and sell your business.
8. As the book *Blink*, by Malcolm Gladwell, points out, go with your initial gut instinct. If this person or firm doesn't feel right to work with then move on.
9. The business broker should have a team that he works with and make sure that the business broker has the appropriate depth in their team to handle all of the presale due diligence and marketing that your business will require.

The above of things you should use to evaluate a business broker also applies to the investment banker with the following exception yes. First expect to pay a retainer either up front or on a monthly basis during the sales cycle. Secondly, the investment banker will typically have a graduated fee schedule such that the percentage goes down as the sale price goes up; an example such a fee schedule is:

-10% of the first million dollars
-8% of the second million
-6% of the third million
-3% of the fourth million
-2% of everything thereafter (above $4 million)

On a $10,000,000 sale the success fee would be $490,000.

6. I'd like to sell my business and retire. Where do I find qualified buyers?

It is often been said that the hardest part of selling a business is finding a buyer. A qualified buyer is one who first has the financial wherewithal to afford the purchase price. The qualified buyer will also have sufficient additional resources to be able to to provide the necessary capital for the ongoing operations either through personal funds or available credit. The qualified buyer will also need to have the necessary management experience and skills to operate this business. These criteria are very important if it's a cash sale. They are absolutely critical if you will be paid in installments over time.

If your experience works out like that of about 95% of business owners you will have great difficulty finding qualified buyers on your own. The place to start is to consider competitors, suppliers, key employees and of course co-owners. You can use classified advertising in print media and possibly listing sites that are available on the Internet. You can tell your professional advisors that you want to sell as well as other friends and relatives. However, before you start such a broad-based public search you need to carefully evaluate how this will affect your business both from a current operations standpoint and the impact on the price you will be able to obtain. Additionally, you need to be concerned about the impact on employee morale, customer and vendor relationships.

Before you begin looking for qualified buyers you should develop a selling memorandum. The selling memorandum will provide current information that prospective buyers will need to know about your business and is essentially a marketing tool. The selling memorandum should provide information about all of the following:

1. History of the Business
2. Management of the Company
3. Marketing Materials or Systems
4. Your Products or Services
5. Employees

6. Your Competition
7. Your Relative Position in the Industry
8. Operational Procedures and Systems
9. Intellectual Property
10. Both Current and Historical Accurate Financial Information, including:
    a. Asset Values; and
    b. Sales Totals Broken down by Product Line or Department; and
    c. Cash Flow and Profit Margin; and
    d. The Trends for All of the Above Over Time.

Essentially you'll have to tell the story of why your business is successful, what will make it more successful in the future and why someone would want to buy it. You'll have to explain any problems that the business may have. It's important that the presentation be professional and that it not make any misleading claims or predictions or guarantees about the future. Do not disclose any confidential information. You need to set the price here as well.

You will want to only share the selling memorandum with serious and qualified buyers. We believe that for most business owners who wish to sell their business that they will be most successful in finding qualified buyers if they work with an experienced and qualified business broker or investment banker. Most of us fare poorly at those things we do for the first time or do very rarely. Most business owners only sell their business once. Real life experiences suggest that they won't be very good at it. They will do much better working with experienced advisors to help them achieve their objectives.

If you are unable to find answers to questions you were looking for, please feel free to view "Leaving Your Business in the Hands of Your Family" or "Taxes, How Do They Affect My Business When I Sell it or Die?"