



# Selling Your Business



NORTH DAKOTA  
**SMALL BUSINESS  
DEVELOPMENT CENTERS**

*Your Ideas - Our Expertise - Your Success*

**NDSBDC.org**

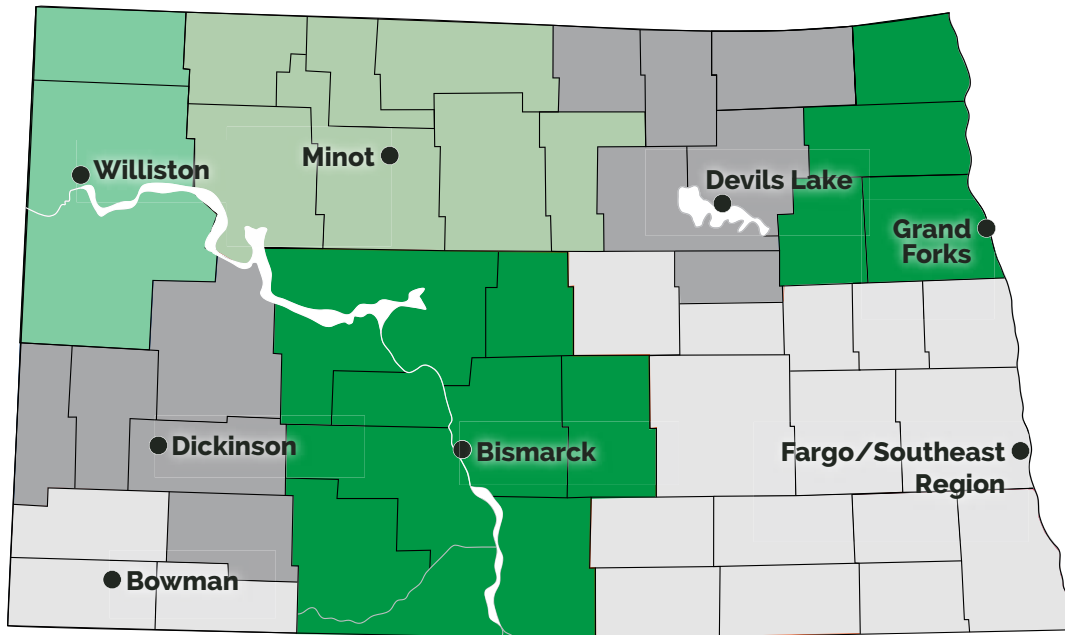


# TABLE OF CONTENTS

|  |    |
|--|----|
| About the Author                                   | 4  |
| Introduction                                       | 4  |
| Chapter 1: Have a Good Reason                      | 5  |
| Chapter 2: Getting Ready                           | 6  |
| Chapter 3: The Question of Price                   | 8  |
| Chapter 4: The Question of Financing               | 10 |
| Chapter 5: Taking Your Business to the Market      | 12 |
| Chapter 6: Meeting with Prospects                  | 14 |
| Chapter 7: The Offer to Purchase & The Negotiation | 15 |
| Chapter 8: Due Diligence                           | 17 |
| Chapter 9: Closing                                 | 19 |

# ABOUT THE ND SBDC

The ND SBDC network of credentialed business advisors empower North Dakota small businesses and entrepreneurs to thrive. We accelerate business growth in communities across North Dakota by providing customized guidance and resources that help owners and entrepreneurs achieve their goals at every stage of their business life cycle. For over 35 years, our network has supported small business owners and entrepreneurs across the state. When small businesses thrive, communities thrive, North Dakota thrives.



[NDSBDC.org](http://NDSBDC.org)



*Funded in part by a cooperative agreement with the U.S. Small Business Administration. All opinions, conclusions, or recommendations expressed are those of the author(s) and do not necessarily reflect the views of the SBA.*

# ABOUT THE AUTHOR



William Bruce is a native of the small Wilcox County community of Catherine in Central Alabama.

He is a graduate of Auburn University with a degree in economics and business administration. He has also done post graduate work at Jones School of Law in

Montgomery, Alabama and the Research Institute of America in New York.

In his business career, William Bruce has owned several businesses with the largest producing sales of several million dollars per year. Additionally, he has served as a bank director, as chairman of his city's airport and industrial development authority and on

several state and national boards of professional and business organizations.

In 2000, he moved to Fairhope, Alabama and joined Sunbelt Business Brokers. At Sunbelt, he is an Accredited Business Intermediary and a Senior Valuation Analyst in the Gulf Coast Office in Daphne, Alabama.

He currently serves as president of the American Business Brokers Association.

His business brokerage experience ranges from small retail shops to large manufacturing operations. This broad experience is now available to his clients at Sunbelt Business Brokers.

He may be reached at (251) 990-5910.

# INTRODUCTION

The decision to sell your business may not be easy. In fact, it may be agonizingly difficult.

You probably have an emotional attachment to the business. Over the years, you have attracted a lot of customers and developed many friendships among them. You have also hired and trained a talented group of employees who look to you for their very livelihoods.

And in America, people are identified by how they make their living. Your identity is directly tied to your business, so it's no wonder that the decision to part with your business is difficult.

But things change. And at some point in their life, most business owners decide, for good reasons, that the time has come to sell their business.

One of the motivations for writing this booklet is that many business owners have told me the same

thing. They say that once they make the decision to sell, they don't have a very clear idea of how to go about it. They have spent their business lives managing their company – and in most cases doing a very good job of it – but they have never actually sold a business. It's definitely a different “ballgame.”

Selling a business in today's business environment is a major project fraught with many pitfalls. It can be compared to a narrow path winding through a field of landmines. The issues are numerous including pricing, confidentiality, offers, negotiations, financing, due diligence, taxes, and government regulations to name just a few.

Professional advice and assistance to guide you through the minefield is the best “insurance policy” you will ever buy. But then, I'm prejudiced. I have one of the best jobs in the country. In case you haven't yet guessed, I'm a business broker!

# CHAPTER 1: HAVE A GOOD REASON

This may seem obvious. However, it's important to be able to give a good reason for selling your business. The very first question most prospective buyers ask is "Why is the business for sale?"

Buyers are naturally suspicious. For most, buying a business will be the most important financial decision they will make in their lifetime, and because of it, they will have a heightened level of anxiety about the whole situation.

Some of the business buyers with whom I've worked in the past have expressed the thought that if a business is for sale, there must be something wrong with it. This is not always the case, of course, and being able to answer this feeling with a logical response will be of tremendous value in the sales process.

There are valid reasons that some very good privately held businesses are for sale. The first reason most people would think of is retirement. Another is the fact that the owner may be experiencing health problems which prevent him or her from managing the business as usual.

Other reasons may involve estate planning situations in which the owner would rather leave liquid assets that can be split more easily among several heirs than a business entity.

Still other legitimate reasons could involve friction among the owners. This kind of situation can become particularly serious if the friction is among family members who jointly own the business. I recently handled the sale of a business in which the real motivation to sell was to prevent further deterioration of the family relationships. The differences among the partners were serious enough that they would surely have led eventually, if they stayed in business together, to an ugly family split-up. The partners correctly decided that it was better to sell the business and preserve the family. Each partner took their portion of the cash from the sale and went their separate ways. And now they are still congenial when they get together at Thanksgiving and Christmas!



Perhaps the most common reason that a business is for sale is one that might not be readily apparent. But as a business broker, I see it frequently. And I'll simply label it as "burn out." After an owner has operated the same business for a number of years, some just plain get burned out.

Some people are more prone to burn out than others. It's highly subjective but certainly understandable. On a personal note, I experienced it a previous business that I owned. After twelve years, when it got to the point that I hated seeing customers come in the front door because I knew I'd have to spend time with them, I knew it was time to get out! Burn out is real and I see a lot of it.

So in summary, be able to give a good reason for selling your business. It'll get you started off on the right foot.

# CHAPTER 2: GETTING READY

The time, effort and expense that you expend in getting your business ready to market will pay handsome dividends. Don't underestimate the crucial importance of preparation.

## Your Location

In short, spiff up the place! Start first with curb appeal. Stand back and take an objective look at your business location as you approach from the street. Look critically and make a list of the things that need attention. Prune the overgrown shrubs, haul off the trash, clear the sidewalks, paint the building. Do whatever you need to in order to give a good first impression.

Even in the sale of a business, first impressions really do count. You might think that business buyers would normally concentrate on the profit and loss statement to the exclusion of appearance, but some prospective buyers that I've worked with were just never able to get over a shoddy look when they turned into the parking lot.

On the other hand, I've had some buyers tell me they knew from the moment they saw the business that it was the one they wanted. And this was before they saw any of the financials! The first impression was just that good.

Next, go inside your business with the same critical eye and clean it up. Get all those files off the floor and back into the cabinets. Steam clean the carpets and wax the floors. Paint the dirty walls. Replace the light bulbs. Put inventory on the shelves. In summary, make the place look neat and inviting. After all, the prospective buyer is trying to convince himself that your business is where he ought to spend the next ten to twenty years. Make it easy for him to picture himself enjoying the nice, neat, bright environment of your business.

In summary, there is just no sense in taking the chance of getting off on the wrong foot with an otherwise good prospect because of a poor appearance. This is one phase of the selling process that you can control one hundred percent. Take control, and turn it to your advantage.

## Your Books

Business buyers – and their lenders – will expect, at some point in the process, to see at least three years of your financial statements and tax returns. As we'll discuss later, you should not give these records to just anyone; however, qualified prospects who have signed a confidentiality agreement will expect to be able to review the financial performance of the business. Accordingly, you should make sure that all of your financial statements and tax returns are up to date.

Which brings us to a real problem. Your profit and loss statements and tax returns, if they are like the books of most privately held businesses, don't show much profit. They may even show a loss.

It's because – let's see, how shall I delicately say this – most business owners do not keep books to pay income taxes. In fact, most businesspersons make strenuous efforts to write down any profits. You may be making an excellent living out of your businesses, but you're taking advantage of all available possibilities



to reduce the profit that you show Uncle Sam.

As an example, take the sale of a restaurant that I recently handled. The profit and loss statement from the business was actually showing a small loss. However, the owner's wife drove a Lincoln Navigator which was listed on the books of the business as a company vehicle. The company also paid for all her gas and maintenance on the Navigator although she has no role in the operation of the restaurant. Same for the daughter's Honda which she drove back and forth to college. The daughter was also on the payroll as an employee of the restaurant which furnished her with spending money at college, although she never actually worked at the restaurant. The family ski vacation to Colorado was charged to the business because the owner attended a business meeting for a couple of hours while in Aspen. You see where I'm heading here, don't you? By the time all these items plus any non-cash expenses were accounted for, the restaurant was actually producing a nice yearly cash flow for the family.

But the situation presents a problem for a potential buyer of the business. The owner's bookkeeping practices camouflage the actual cash producing ability of the business. The solution for someone selling his or her business is the cash flow worksheet.

## Computing Cash Flow

### ODCF:

Owner's discretionary cash flow is defined as the amount of cash that the business produces in a year's time that is available (1) to pay back any debt that the owner of the business incurred to buy the business and (2) for the owner's personal living expenses.

So first let's define cash flow. Some business brokers refer to it as owner's discretionary cash flow or owner's discretionary cash flow (ODCF). ODCF is defined as that amount of cash that the business produces in a year's time that is available (1) to pay back any debt that the owner of the business incurred to buy the business, and (2) for the owner's personal living expenses.

Another way to express it is that ODCF is the amount

of cash the business produces after all necessary operating expenses – and only the absolutely necessary operating expenses --have been deducted. This process of computing cash flow is referred as the recasting or normalizing of income. In recasting a profit and loss statement, this is the procedure that is used to compute ODCF:

- Start with the company net profit (or loss) as shown on the profit and loss statement or tax return.
- Add any non-cash deductions that have been taken such as depreciation and amortization. (These are "paper deductions" allowed by the IRS for which no check is written.)
- Add any interest expense (because you will be selling the assets free and clear so the buyer will not incur this expense. It will be available for his debt service.)
- Add the owner's salary and perks (because this amount will be available to the new owner for his own living expenses.
- Add any family perks (cars, vacations, non-working employees, etc) that have been run through the business as a business expense.
- Add any one-time, extraordinary expense items that will not be routinely incurred again (such as a major repair bill).

The total of these items will give prospective buyers a more accurate assessment of the cash producing ability of your business and is referred to as owner's discretionary cash flow (ODCF).

You should have a cash flow worksheet prepared for each of the last three years, plus an interim worksheet for the current year. If you're using a business broker, he has a form and software for quickly producing this report. But he'll need your help in identifying the items on your P&L that are not strict business operating expenses, so plan on sitting down with him and assisting in this project.

There is one more point I need to make here before we leave the subject of cash flow. If you have had cash income that you cannot prove, just remember that this is part of the owner's income that you have already benefited from and, if you can't prove it, then it cannot be reflected in your selling price.



## CHAPTER 3:

# THE QUESTION OF PRICE

Nothing causes the buyers and sellers of businesses more anxiety than the problem of valuation. The question of selling price haunts both parties. The seller doesn't want to price his business too cheap and "leave money on the table." On the other hand, the buyer of the business is afraid he'll pay too much and not get the best possible deal.

The most common mistake that I've seen in my years as a business broker, is that owners overprice their business. It's quite natural to do so, particularly if you've started the business from scratch and grown it into a successful company. You quite understandably have an emotional investment in the business in addition to a financial interest.

It's the same phenomenon that most of us have experienced when we sell our home. I thought my first home, with all the improvements my wife and I had made, was worth much more than it actually was. I soon learned that the market, not the owner, dictates price.

The disadvantages of overpricing a business are serious. As we discussed, the first question most business buyers ask is "Why is the business for sale?" Frequently the second question is "How long has the business been for sale?" If the business has been on the market for a long time and hasn't sold, it raises real doubt in the buyer's mind, which is hard to overcome.

Another problem with an overpriced business is that if you're using a business brokerage firm, the agents in the office will immediately recognize that the business is overpriced and give it very little exposure. Most business brokers work strictly on commission. They don't get paid until the business is sold, and they will not waste time on a business that will not sell because it is overpriced.

And today's business buyers are pretty savvy. All of the appraisal guidelines and rules-of-thumb on valuing businesses are available on the Internet to anyone who will take a little time to find them. So most buyers will have a fairly accurate idea of what a particular business is worth. If a business is grossly overpriced, the buyer prospect will not even look –

and you've lost some of your best prospects who will go on to buy another business for its fair market value.

So, if you don't retain anything else from this booklet, let it be this from the voice of experience and the school of hard knocks: Nothing is harder to sell than a business that is overpriced.

The appraisal of privately held businesses is not an exact science but there are guidelines and rules-of-thumb that can be used for a quick approximation of value. And formal business appraisals are now readily available. The professional firm that my office uses for formal business appraisals produces a quality 40-page report on the business with the conclusions of value thoroughly supported and documented, all done for a very reasonable fee.

Certain situations require a formal business appraisal such as the larger merger-acquisition situations, large loan applications, management performance tracking, estate planning, divorce and the most dreaded of all -- IRS issues. And you might want or order a formal appraisal of your company. After all, it certainly takes the guesswork out of the situation.

However, what we will discuss here is not a formal appraisal but rather the informal methods of quickly approximating the value of a business entity. All of the guidelines we'll quote are averages derived from thousands of completed transactions reported to national and regional databases.

### Let's First Define What You're Selling

Most small business transfers are asset sales. This means that the buyer of the business buys certain assets of the business – usually the furniture, fixtures, equipment, inventory, the business name, and goodwill. These assets are transferred to the buyer at closing free and clear of any financial encumbrances. Generally not included in an asset sale are the cash on hand and the accounts receivable. These two items are usually retained by the seller.



The opposite of an asset sale is a corporate stock sale. In this case the purchaser buys the outstanding shares of stock in the corporation, thereby taking control of all the assets and debts of the business.

And a basic word on business value might be in order here. An on-going business entity that is earning a profit is worth more than the sum of its tangible assets. What is really being transferred in the sale of a business is an income stream. Business appraisers seek to put a value on that income stream.

There are two kinds of business appraisal guidelines. The first one -- and the easiest to use -- says that a business should sell for a certain percentage of annual revenue. The other formula works off of the cash flow of the business. These guidelines include all furniture, fixtures, equipment and inventory needed to do business. However as stated above, the sellers of most small-to-medium size businesses do not include in the sale any cash or accounts receivable. Hence, the guidelines do not include these items.

Nor do the guidelines include any allowance for real estate. The guidelines assume that the business is in a leased location at a competitive lease rate. If real estate, cash or accounts receivable are to be included in the sale of a business, their value should be added to the guideline results.

And these guidelines assume that the business is making a net profit percentage that is average for the type of business. If the business is above or below average in profit percentage for its category, the resulting values would need to be adjusted accordingly.

If, in the worst case, the business is only breaking even or losing money, even after the adjustments used to determine true cash flow, then these guidelines do not apply. If the business has no positive income stream to sell, then about the best price a business owner could hope for in this case would be the discounted value of the inventory, furniture, fixtures and equipment.

## **(1) Value as a Percent of Annual Revenue**

First, almost all profitable privately held businesses with annual sales under \$5 million will sell for somewhere in the range of 20% to 80% of annual revenue. In one large database, the average price in the year 2000 of 3,8000 transactions was 44% of revenue.

Exactly where in this range of 20% to 80% of revenue the selling price of a specific business falls depends on the kind of business. Convenience stores, for example, are at the low end of the range and dry cleaners are at the high end. If you're selling an auto parts retail store, as another example, you should expect to get about 45% of the business' annual revenue. Let's say you have a tire store with auto service. You should be able to sell it for somewhere around 40% of sales. Other examples: dress shops sell at around 20% of sales, coin laundries at 75%, franchised fast food outlets at 50%, print shops at 50%, vending routes at 65%, video stores at 55% and restaurants at somewhere between 20 to 40% of sales depending on type. Manufacturing operations sell for somewhere in the neighborhood of 65% of revenue depending on the product and other factors.

## **(2) Value as a Multiple of Cash Flow**

The other set of guidelines seeks to approximate the value of a business by applying a multiple to the cash that a business generates. This second guideline states that most businesses will sell for between one to six times owner's discretionary cash flow. Exactly where in this range that a specific business falls, again, depends on the type of business.

From the database of completed transactions, we know that an air conditioning/heating contractor would sell for somewhere around 1.5 times ODCF. Beauty salons go for about 1 times ODCF. Day care centers that are licensed for 100+ students sell for around 4 times ODCF. A hardware store is worth approximately 1.2 times ODCF. Other examples: Home health care is 3 to 5 times, janitorial services are 1.5 times, jewelry stores are 4 to 6 times. Manufacturing operations will sell for between 3 to 5 times ODCF, depending on size and product. Wholesale distributors in general can be bought for 1.5 to 2 times ODCF.

## **In Summary**

Remember, the market determines price. Make sure that you understand the market for your kind of business. It's a sure bet that your prospective buyers will.

And finally, if you are using a business broker in the sale of your business, work with him. If the type business you're selling was not mentioned in

----->

this chapter, ask him for the appraisal guidelines. He has access to myriad resources for all types of businesses. And as mentioned above, your broker can assist you in obtaining, if you desire one, a professional and fully documented, independent third party written appraisal of your company that will take any doubt out of the situation.

After you've come to a fairly accurate conclusion of your company's value, then you need to price

the business for sale. Because all buyers will want to negotiate from whatever price you quote them, you need to add in a "fudge factor" for negotiating purposes. I usually suggest 10% to 15% "padding." Then you can use this margin as "wiggle room" as the negotiations proceed. The negotiation scenario is similar to procedure you went through when you bought your home.



## CHAPTER 4:

# THE QUESTION OF FINANCING

Financing is always an issue in selling a business. Almost all business buyers will need some amount of financing to complete the transaction. Of all the business sales that I've seen, over 90% involved financing of some description.

Very few business buyers are sitting on enough cash to buy a business without financing. People with that much money are usually "clipping coupons" and not interested in jumping into the challenges of daily business management.

So where do business buyers get the necessary financing? There are three sources.

### Banks

Although most people seeking a loan to buy a business will think first of banks, I can tell you from

years of business brokerage experience that banks generally do not make business acquisition loans.

That statement will surprise most people. Once you're in business, banks will compete for your patronage, but most will not stick their necks out in the beginning to make you a business acquisition loan. Bank advertising would lead you to believe they would do so, but in more than 90% of the cases, they will find some reason to decline the business acquisition loan application.

The exception might be if you have a strong, years-long relationship with a bank and you can offer some other collateral such as Certificates of Deposits. Or if the bank participates in the SBA loan program, they might be able to approve a SBA guaranteed loan (see next section).

So don't be surprised if a bank turns down your buyer. And don't take it as a reflection on your business or the buyer. It's just the way things are. Now this is the humorous part of the situation. It's ironic but it has happened more than just a few times. After your business buyer been in business for a number of months or a year or so, the same bank that turned him down for a loan to buy the business may come calling on him soliciting his banking business. One of my buyers in this situation responded to the banker by assuming a serious air and in a somber tone, said, "Well now Mr. Banker, we'll be happy to consider your application for our business. Let's see, we'll need your financial statement and a list of references and your business plan for five years into the future. Once we have your completed application, I'll be glad to take it before my committee and let you know of our decision." The banker was taken aback.

## SBA

The Small Business Administration (SBA), an agency of the federal government, provides for business acquisition loans through its approved lenders. The SBA generally does not make direct loans, but rather the agency guarantees the loan that is made by the approved lender. It's known as the SBA 7(a) program.

The SBA list of approved lenders includes many banks and some non-bank lenders such as CIT, GE Small Business Lending, and AT&T Finance. Some of these lenders will include in the loan total an amount for working capital in addition to the price of the business. Down payment requirements range from 20% to 35% plus there are usually up-front fees paid by the buyer for various requirements. Interest rates are competitive with the marketplace.

Your business must be growing and profitable to be approved by the SBA. A downward trend in gross revenue or profits will usually disqualify a business. And another disqualifier of the SBA, is the requirement that the business buyer have experience in your industry. This requirement pretty severely limits the pool of prospective buyers for your business who can use SBA financing.

The SBA route for a business acquisition loan is sometimes frustrating because of the time, detail and documentation that are involved. If your buyer goes this route, be patient. And stay on top of the SBA requests for information. The quicker you can

get the information and documentation to the SBA underwriter, the quicker your loan will close.

## The Seller

In the majority of the business transfers that I handle, the owner of the business finances a portion of the purchase price for the buyer. Some sellers are initially reluctant to offer financing. However, with a strong down payment from a buyer with a good credit bureau report and personal financial statement, the advantages to a business seller can be significant.

Not only is the tax bite usually lower for a seller who finances, but national surveys consistently show that businesses with seller financing (1) sell for more money and (2) sell in a shorter time frame.

In one recent survey of 3,965 business sales as reported by Toby Tatum in Transaction Patterns, the median selling price of businesses with seller financing was 15 percent higher than those without it. The average down payment on seller-financed businesses was 37 percent.

And of course, there is the obvious benefit to the seller of additional income from the interest charged on the note. The going rate as this is being written is around 6½ percent. This is significantly more than you could earn if you invested the money in a Certificate of Deposit.

And keep in mind, we're not talking about you financing just anybody. We're talking about a buyer whom you have approved after checking his credit report and references, and who has made a down payment of usually between 25% and 50% of the selling price of the business. Plus, you have a mortgage on the business and all its assets for the term of the note and the personal guarantee of the buyer.

Most owner financing – though not all -- is in the form of a balloon note. The balloon note solves two opposing desires. The buyer of the business wants to keep his payments low; however, the seller usually wants his money as soon as possible. By amortizing the note – calculating the payments – on, say, a 12-year payback schedule, the payments are kept low. But the inclusion of a 5-year balloon requires that the remaining balance be paid off at the end of five years.

After the new owner has been in business for five years and has built a track record for himself at the bank, he should have no trouble going to his bank and refinancing the balloon. In the low interest rate environment of recent years, I've seen new owners refinancing the balloon even before it came due to save money. The balloon note has been a win-win vehicle for both buyers and sellers.

To recap, if you are willing to consider financing the sale of your business to a credit worthy buyer after an appropriate down payment, the advantages you can usually expect are:

- A lower tax on the proceeds of the sale
- A higher selling price
- A shorter time frame to close the transaction
- Additional income from the interest on the note

## CHAPTER 5:

# TAKING YOUR BUSINESS TO THE MARKET

Please keep in mind that selling your business is not an overnight project. It takes time. My experience has been that six to eight months is about average. You are now ready to take your business to the market. So let's first discuss a couple of documents you'll need to have handy.

### Confidentiality

As you are already aware, confidentiality is important in the sale of a business. If word gets out that the business is for sale, bad things can start to happen. Employees start looking for other jobs, fearing that the new owner may not retain them. Customers may wonder about the business and start shopping elsewhere. Suppliers can get nervous.

So first, you'll need a confidentiality agreement already drawn up and ready for execution. This is a must. Anyone who replies to a generic ad for your business must sign a confidentiality agreement before being furnished any identifying details of the business. This enforceable contract is also referred to as a non-disclosure agreement.

If you're using a business broker in your sales effort, he already has a strong non-disclosure agreement drawn up and rigorously enforces the requirement for getting it signed before disclosure of any specific information.

And if you don't mind me slipping in a commercial here for business brokers – remember, that's the

way I make my living – it is much easier to maintain confidentiality by using a business broker than by trying to advertise and sell the business yourself. And national statistics show that business brokers will sell a business quicker and for more money than owners trying to do the job themselves. But hey, you already know I'm prejudiced!

The confidentiality agreement should require the name and home address of the person making the inquiry plus contact information including phone numbers and email address. In my business brokerage practice, I also require that the prospect give me some information on his finances and business experience. I've never had a legitimate prospect who was sincerely interested balk at signing the agreement. If a person balks, it's almost always an indication that he or she is a gossipy "tire kicker" who's looking just out of curiosity.

### The Business Profile

The next document you'll need to have ready is a one-page summary of your business. This summary should include a brief history of the business, a description of your current operation and a recap of the financial numbers. We call this one-page summary the Profile of the business.

The Profile serves as a brief but accurate and informative synopsis of your total business operation and is very important in the process of selling your business.

Once a prospective buyer expresses a sincere interest in the business, has signed a confidentiality agreement and passed a preliminary screening, he is then given a copy of the Profile.

The Profile serves two purposes. First, it allows the prospect to make an informed judgment as to whether he is interested in pursuing the business after reviewing the information contained in the Profile. And secondly, the Profile provides a yardstick that the prospect will use in a more thorough investigation of the business during the due diligence phase of the sales process.

The prospect will quite naturally be checking the numbers and information provided in the Profile. For this reason (and other good reasons), it is extremely important that no erroneous information be included in the Profile. Even an honest mistake on the Profile can arouse suspicion and kill the transaction.

While it's important to paint as favorable a picture of your business in the Profile as the facts will allow, it is imperative that you don't step over the line and make any false representations. Any erroneous information in the Profile will definitely come back to bite you!

## Advertising

Now that we have the confidentiality agreement and the Profile ready, we can start the advertising phase of marketing your business.

In the past, my office obtained most of our buyer prospects from our classified advertisement in the Sunday newspaper. However, technology has changed the world, and we now receive the majority of our inquiries from the various websites we use on the internet. These websites are particularly important for obtaining out of area prospects, but even local folks here in town will pull up the website and call to inquire about a business that interests them.

But we have not abandoned the newspaper. It still produces some local buyer prospects. To keep the ad fresh and of interest to readers, we rotate our listings in and out of the ad on a weekly basis. Sunday is the only effective day to advertise businesses for sale. Any other day is a waste of time and money.

My office posts our listings of businesses for sale to eight different websites. Among them are our local website, [SunbeltBroker.com](http://SunbeltBroker.com), and Sunbelt's national website, [SunbeltNetwork.com](http://SunbeltNetwork.com). Additionally, we pay several thousand dollars per year in fees to be able to post our listings to six other independent websites that have high traffic counts.

## What's Next

To recap, you have spruced up your business premises, brought the books and records up to date, computed your yearly cash flow, put a reasonable asking price on the business, made arrangements for maintaining confidentiality, drawn up a business profile and placed the business on the market with appropriate – but non identifying – advertising. What happens next?

Let's optimistically assume that a genuinely interested prospect has seen one of the ads for your business and called to inquire. If you're using a business broker, the broker (1) has explained the need for signing the confidentiality agreement and obtained the necessary information and signatures on the agreement, (2) has questioned the prospect on his purchase criteria and (3) obtained some preliminary information on the prospect's financial situation, business experience and his capacity to buy your business, and (4) briefed the buyer on the process – the steps involved – in buying a business. (Most prospects don't have a clear idea of the actual step-by-step process one goes through in buying a business so we spend some time with them doing a little buyer education.)

If all of the above indicates that your business might be a good match for the prospect's purchase criteria and if the prospect is deemed serious and sincere with the financial capacity to make the purchase, then he is given the Profile of your business.

Let's again be optimistic and assume that after reviewing the Profile of your business, the prospect calls back a few days later and says he is genuinely interested in the possibility of buying your company and wants to proceed with a more detailed look at the business.

The next logical step is a meeting between you and the prospect. The next chapter discusses ways to make the meeting a success.

# CHAPTER 6: MEETING WITH PROSPECTS

The meeting with a prospect is extremely important. It's your chance to put the prospect at ease and show off the business in its best light.

You will probably want to schedule the visit after hours so as not to arouse any suspicions among your employees. Or, you can schedule the meeting in your broker's office if for some reason you don't want to host it in your business. However, I think it best, if possible, to hold the meeting at your location. It gives the prospect a better feel for your operation. If you are using a business broker, he will arrive with the prospect, make the introductions and facilitate the meeting.

The first meeting is sort of a "look see" for both parties. The prospect is checking out you and the business while you are sizing him up. It's important to remain cordial and open.

The ideal buyer / seller meeting will go something like this:

- First you welcome the prospect into your office and make sure everyone has a chair and is comfortable. (Of course, it goes without saying that you have cleaned up the place and thrown away all of the old Dominoes Pizza lunch boxes!)
- It's usually best after the initial get acquainted chitchat, to give the prospect a brief history of your business and a succinct description of your current operation. (You might want to even practice this presentation to make sure you cover the important points without rambling. If you're using a broker, he will be with you and will help guide the meeting.)
- Remain friendly and informal, call the prospect by name often, and ask periodically if the prospect

has any questions. Answer any questions openly and honestly.

- Be enthusiastic. Point out how much fun you've had running the business. Let the prospect hear and feel how he could experience the same enjoyment you have.
- As the meeting in your office winds down, offer the prospect a tour of your facility. Give this tour some thought beforehand, so that you can address the points that you want to during the walk-through. Point out anything that will help clarify any points you make in the meeting in your office.
- As the meeting ends, you say something like this, "Well thanks for coming out and taking a look. You'll probably have some additional questions, so don't hesitate to get back in touch with me (or Mr. Broker if you're using one). I know this will be a big decision for you and we have nothing to hide, so just let me know what I can do to assist you with the process." Put these thoughts into your own words and they will leave a favorable impression in the prospect's mind.

From the "school of hard knocks," I can also give you some advice on things you DON'T want to do in the initial meeting with a prospect:

- Don't over-complicate your business. Simplify it. Don't make it sound like the management of the company is so specialized that only a brain surgeon can do it. I'm being facetious of course, but be careful not to scare off the prospect by planting the doubt in his mind that he would not be capable of running your business.
- Don't hide any problems. If there are any problems with the business, get them out up front. There is never a better time to get any problems out on the



table than in the meeting. (See discussion below.)

- In the initial meeting, it's usually best to stay away from price and terms. If the prospect brings it up, just say, "My broker here has all of that information and if your will, get with him on that later."

The importance of getting any problems out in the open up front cannot be over-emphasized. It's partly a psychological issue. If you bring up a problem right in the beginning and discuss it openly, the importance of that problem is minimized in the prospect's mind, compared to having it pop up later in the process.

For example, let's say there is a tax lien against your business for unpaid payroll withholding taxes. If you bring it up initially by saying something like, "By the way, I do want to mention for the sake of being completely open and honest that we have a tax lien against the business which is being taken care of (or which will be

taken care of at closing) so that you will buy all of the assets of the business free and clear without any liens or other encumbrances."

When you mention it like this, you win points for honesty and openness and it minimizes the problem. I've seen many transactions fall apart when such problems are not disclosed and are later discovered by the prospect. When discovered later – as they always are – the problem will usually "torpedo" the transaction.

This is such an important point that it bears repeating: **DON'T HIDE ANY PROBLEMS. TALK ABOUT THEM IN THE BEGINNING!**

Now that I've been overly redundant, let's move on to the fun part: The written offers to purchase and the negotiations.

## CHAPTER 7: THE OFFER TO PURCHASE & THE NEGOTIATIONS

Congratulations on making it this far. You may have held meetings with several different prospects and let's assume one of them was interested enough in buying your business to make you a written offer.

Ninety-nine percent of all offers will be contingent offers. By this I mean that the offer to purchase your business will contain certain contingencies. The most common contingency contained in almost all offers will make the purchase of the business contingent upon a further, more thorough investigation. This is sometimes called the "Due Diligence" contingency. The wording of the contingency will read something like this:

*This offer is fully contingent upon the Buyer's further inspection of all the books and records of the business and Buyer's satisfaction with the information contained therein.*

Remember when we discussed the one-page profile of the business in an earlier chapter of this booklet. We talked about how important it was to be accurate with the numbers and information contained on the profile. This contingency is why it's so important to be

accurate in the preliminary information that is given to the prospect.

This contingency in the offer to purchase allows the prospect (1) to verify the information he's already been given and (2) to do additional investigation to determine that there are no undisclosed problems.

It's really a win-win situation for both the buyer and seller. The contingent offer solves what could be a real problem for you as the owner of the business.

The problem, bluntly stated, is that every random person that looks at your business (particularly if you're not using a business broker to screen the prospects) is going to want to look through your private books and records, some of which might be very sensitive for one reason or another. There are a lot of "Looky Lous" who would dearly love to paw through your books and records just for kicks with no real intention of ever making you a reasonable offer.

The *contingent* offer solves this problem by separating the genuine prospects from the "Looky Lous." In the contingent offer process, the buyer has made you a

written offer, you have come to an agreement on price and terms (possibly after a series of counter offers) and the buyer has put up some earnest money. The prospect can now be viewed as a genuinely serious buyer and you can feel better about opening up your books and records for his inspection.

There are other contingencies that a buyer might include in the contract. For example, if he is borrowing the money with which to purchase the business, he would include the following language to protect himself in case his loan application was not approved:

*This offer is contingent upon the buyer obtaining satisfactory financing for the purchase of the business.*

And if the business operates from leased premises, he would include the following proviso:

*This offer is contingent upon the buyer's assumption of the existing lease for the business premises or otherwise negotiating an acceptable lease with the landlord for said premises.*

## The Other Issues

The other issues involved in the sale of the business are covered by the sample contract reproduced and included at the end of this chapter. For example, refer to the following paragraphs in the contract:

- **The Closing Date and Place.** The buyer will pick a closing date that will give him enough time to inspect the books and records of the business, get his loan approved and take care of any other issues. If you want a lawyer to close the transaction, it's customary in this area for the buyer and seller to split the closing costs.
- **Inventory Level.** If the business carries inventory for resale, this is where we insert the amount of inventory, at cost, that must be on hand on the date of closing. This should be the amount of inventory normally carried by the business in the normal course of doing business. The purpose of this provision is to prevent an unscrupulous seller, between the date of agreement and the date of closing, from selling out the inventory and leaving the buyer with empty shelves. You and the buyer jointly take inventory (or hire an inventory firm) on the day of closing. If the inventory level, at cost, is below the figure specified in this paragraph, the purchase price of the business goes down by the amount of the shortage. Conversely, if the

inventory is over the specified level, the price of the business is adjusted upward by the amount of the surplus. This is fair to both parties, and if the inventory discrepancy is small, the difference is usually waived, as both parties understand that it is impossible to quote an exact inventory figure in advance for any given day. But the provision is there for protection if it needs to be invoked.

- **Training.** The buyer asks for the number of days training he thinks he will need from you. Normally this ranges anywhere from one week to two months.
- **Non-Compete Agreement.** All buyers will require a non-compete agreement from you. It's usually expressed in terms of miles and number of months.
- **Removal of Contingencies.** Remember all of the discussion above of the contingencies: inspection of the books, the lease and loan approval. At some point, these contingencies are satisfied or waived by the buyer. This is where that date is specified. Ten to 15 days prior to the closing date is customary. After satisfaction of the contingencies, the contract then becomes binding on both parties, and the closing documents can be prepared.
- **Offer Deadline.** This date gives you a deadline for response (acceptance or counter-offer) to the buyer's offer. If there is no response from you by this date and time, the offer is legally null and void. Two or three days are long enough here, unless there are unusual circumstances.

Now, take a deep breath. It's really not as complicated as most folks seem to think. And we're just getting to the fun part – the negotiations.

## The Negotiations

Most likely you've already bought a car and/or a home. The negotiations over the price of a business are similar.

You'll receive an initial offer of some amount, usually substantially lower than you're asking. Most astute buyers will make a low initial offer. Don't be offended. Just realize that it's quite common and keep your cool.

Unless the initial offer is acceptable to you, you will most likely want to make a counter offer. To do so, you simply draw a line through the items on the written offer that you want to change, write in your change above strike-out and initial the change. The buyer can then accept this counter offer or continue the



“ping-pong match” until a number is reached that is acceptable to both parties.

Some advice on the negotiating process:

- The services of a business broker as an intermediary in this phase are invaluable. If the buyer and seller negotiate face-to-face, chances are high that ill feelings will be aroused. Even some innocent comment by one of the parties is often times taken the wrong way and the whole transaction blows up. It's an extremely sensitive phase of the process.
- If you're going through a business broker, use him. He's been involved in similar negotiations dozens of time before. At each step of the negotiations, ask him for his thoughts and feelings. You don't have to take his advice, but asking for his input might be advantageous.
- Respect the other party. Don't make ridiculous demands (i.e.: "This price is good for one hour only, take it or leave it.")
- Don't be "penny wise and pound foolish." (Is that the right cliché? Well anyway, you know what I

mean.) If the buyer has made you a reasonable offer that you can accept, don't run him off by trying to squeeze every last dime out of him.

- Relax as much as possible. You're getting pretty close to cashing in on all your years of hard work.
- Once you and the buyer have come to an agreement, move on to the next phase with all deliberate speed. The next phase is *Due Diligence*.



## CHAPTER 8: THE DUE DILIGENCE PHASE

Due diligence is a fancy term. In practical use, it can be summarized as that phase in the sale of a business when (1) the buyer verifies the accuracy of the information that he's previously been furnished and (2) he makes sure that there are no serious, undisclosed problems with the business.

Remember the contingencies in the offer to purchase that we've already discussed. Due diligence is the phase of the buying process in which the buyer satisfies those contingencies.

In this step, the buyer will inspect the books and records of the company, including the tax returns, to verify the financial information. He will also check whatever appropriate sources are necessary to make sure there are no undisclosed problems lurking around the corner that would seriously affect the business in an adverse manner.

### The "Books and Records"

After agreeing on price and terms in an Offer to Purchase the buyer is entitled to all the books and records of the business including the balance sheets, profit and loss statements and the tax returns. At this point, he can ask you any questions about information contained in any of these records. In fact, he will probably need your assistance in interpreting some of these financial reports. Be prompt in furnishing these records and make sure you explain anything you think might need it.

The buyer may also want to look at other documents such as the monthly sales tax reports if there is a question about sales revenue or the seasonality of sales during different times of the year. Also the quarterly payroll reports should be available for his inspection if there is any question about wages.



Again, this is the time for the buyer to satisfy himself as to the accuracy of the information previously given him and upon which he based his offer to purchase your business.

## The Other Issues

The other points to be covered during due diligence involve questions about key employees, legal, regulatory, environmental issues and the lease.

## The Importance of Being Earnest

Many buy/sell agreements fall apart during due diligence. Just because you've come this far, please don't assume it's a done deal. It's not. It's important to stay on top of the situation. Be responsive to any requests by the buyer or his finance source. Be prompt in producing any records asked for. Stay close to the process. Remain friendly and open with a willingness to "go the extra mile."

The buyer is, at some point, going to start questioning his own judgment. It's sometimes called buyer's remorse. It's that queasy feeling that almost all buyers experience late in the process when they step back and ask themselves, "What in the world am I doing here. I must be crazy!" It's your job – and your broker's job if you have one – to ease the buyer through this emotional time. Anything you can do to affirm his original judgment will help get him through this phase.

For example, you can talk about how you had absolutely no experience in this business when you started/bought the company and if you could make it, you know he can. Or talk about how you're going to be there for him as long as he needs you during the training and transition. And talk again about how much fun you've had running the business and about how many good friends you made through the business.

I think you get the idea here. Do what you can to bolster the buyers confidence in his decision to buy your business. Many sales have been salvaged by an astute seller who recognized buyer's remorse and responded appropriately.

In summary, many transactions fall apart during due diligence. Don't let yours be one of them. Stay close to your buyer and be responsive to his requests. Be friendly, understanding and patient. In short, get it done!

# CHAPTER 9: CLOSING

Closing is the easiest step. You've already done all the work.

Closing agents require a cashier's check from the buyer. The reason for a cashier's check is to allow the closing agent to make immediate disbursement to the seller and any other parties that may be involved. This is particularly important if there are any secured creditors who are to be paid out of the proceeds of the sale in order to deliver "free and clear" title to the buyer.

It is customary in my area for the buyer and seller to jointly choose a closing agent and split the costs. However, sometimes one of the parties insists on using his own lawyer to the exclusion of the other party. There is nothing wrong with this, but then that party should be responsible for his own lawyer's fees. In this situation, it would probably be a good idea for the other party to also retain a lawyer to look after his interests at closing.

Closing documents for an asset sale include:

- The Bill of Sale for the non-realty assets.
- The Deed for the real estate (if there is any)
- The Note (for the loan if owner financing is involved)
- The Chattel Mortgage (making the seller a secured creditor if he's financing a part of the sale)
- A Covenant Not to Compete
- Any other documents as called for by agreement between the parties.

Other matters handled at closing are:

- Any prorating of rent and other similar expenses are handled by a separate check between the parties. For example, suppose you close on the 15th. Most lease payments are due in advance, so if you paid the rent on the first of the month, your buyer would owe for the second half of the month.
- The keys to the business premises are exchanged.
- A plan for the next couple of days is formulated including a decision on how and when to tell the

employees. In most cases the buyer and seller leave the closing and go straight back to the business to make the announcement and begin the transition.

Well, Congratulations!

As the closing agent slides your check across the table, you can take justifiable pride in your years of a job well done in running your business. And you can also take pride in the professional, honest, organized manner in which you sold your business while avoiding the pitfalls that can sabotage even the best of opportunities.





[NDSBDC.org](https://www.ndsbdc.org)