EntrepreneursHub

HOW TO AVOID THE PITFALLS WHEN SELLING A BUSINESS

Why read this?

Over 70% of business owners fail to sell their businesses. Surely you want to know why so many fail. What did the 30% do right that the 70% didn't?

This eBook will highlight 5 key areas that will not only improve the saleability of your business, but will also significantly increase your shareholder value and ultimately the eventual price someone is prepared to pay for your business.

Malcolm Murray, Director

Introduction

If you are considering selling your business, either now or in the future, you will be pleased that you chose to download this eBook. Although there may be some sections you read that you are already familiar with, I am positive that this eBook will highlight certain key areas that you have not considered previously.

Every business owner will one day need to exit

As a business owner you must consider your exit options and prepare well in advance. It is inevitable that one day you will have to shut your business down, pass it on to family or entrust it to new owners.

For a moment I am going to take you down memory lane. If you are like most entrepreneurs I meet, you will have an interesting story to tell. You started, perhaps with very little, partnered with a friend, took some risks, walked through numerous recessions. No doubt you will have invested a lot of sweat, energy, time and maybe even some tears. Along the way, you most likely employed some great people and fired some not so good ones - hopefully you still managed to have an enjoyable experience overall. Now here you are today, with a business that has provided financially for you, your family and your lifestyle, considering your exit options.

Just the mere thought of exiting the business or even reading this may be stirring a whole mix of emotions, or complete happiness or sadness! In fact, you may have had enough and just cannot wait to get out. On the other hand, perhaps you enjoy running the business and, therefore, do not really feel ready to hand it over to someone else. Unfortunately, the latter is the reason what most business owners put off reviewing their exit strategy and leave it far too late. Many owners when asked will state, "We are a long way off from selling to worry about an exit strategy." May I be frank with you? If tomorrow morning you were taken out of your company due to a major health issue and were never to return, where would that leave your business and staff? Most importantly, what would the impact be on your family? For many owners a swift exit would leave their business, their staff and their family in dire straits. You must, therefore, have an exit strategy. In fact most, if not all, experts firmly recommend that your exit strategy should have been clearly defined when you first set your business up.

Let's now consider the alternative and assume that you are interested in exiting your business. You will have a number of exit options. There are over 10 which we highlight in our eBook – '10 Exit Options for Business Owners' – if you would like a copy of this then please do contact us.

However, let's assume your chosen route is an outright sale to an external buyer. If you were to ask any business owner who has sold their company, they will tell you it was probably one of the most stressful experiences of their life. Many will make statements such as:

- "The process went on far too long (sometimes years)."
- "We lost a number of interested buyers."

- "Our legal fees were a lot higher than we anticipated."
- "We didn't get as much as we wanted but it's enough."
- "We never got paid on all of our earn out."
- "If I knew then what I know now I would never have tried to sell at the time."

Many profitable businesses fail to sell

Business brokers will wave the flag of success on all of the above. Unfortunately, most will not openly communicate the fact that for every 3 businesses that are sold, there are 7 businesses that failed to sell.

The title selected for this eBook is not only attention grabbing - it represents the absolute reality that on average over 70% of owners fails to sell their business at the first attempt.

Every year, thousands of business owners with very profitable businesses are left disappointed and frustrated because their dream of selling their business has not materialised.

Failure to sell a business is expensive, emotionally very draining and an extremely painful learning experience for any owner. The sad reality for most owners in this situation is that such failure and negative repercussions are totally unnecessary. All this could have been avoided if the owners had taken some time to plan the journey and avoid the pitfalls, including brokers encouraging them to go to market when they or their business were not ready.

If the odds of failure are high, why do owners go to market?

Most owners are lured with very good marketing and sales techniques that lead them to believe that the broker/advisor will sell their business for the highest value. Please don't misinterpret my statement - I am not implying that there are not good business brokers, advisors or corporate finance houses out there – everyone has to sell themselves to win. However, in my experience most owners get carried away with the glossy brochures, success stories (many of which are out of date), and the idea that their company will sell for a high multiple. Please be aware that even if a broker has sold one of your competitors' or a friend's company, it does not guarantee that they will generate interest and sell yours.

It doesn't matter how good the broker is...

The truth is, it doesn't matter how good their marketing and research is, or how great their dealmakers are. If your business is not ready for sale you will end up disappointed with one of the following:

- Low valuation placed on the business which will reduce further as you go through due diligence.
- The broker may tell you that this is the most that they can achieve for the business and you,

therefore, are forced into a corner - take it or leave it approach!

- You sell at a much lower value than you were ever led to believe you would achieve.
- You are tied in to long term earn outs, perhaps on terms over which you may have little or no control.
- You join the 70% plus club of business owners who failed to sell and incur significant fees.

The value and the saleability of your business will ultimately be dependent on the level of risk the buyer perceives in the acquisition. In essence, the higher the risks then the lower the offers, and an increased chance of a failed or protracted sale.

Removing the risk will make a huge difference

Low risk opportunities significantly increase the speed at which a deal progresses, the value a buyer places on your company, and a much higher probability of the transaction completing.

So how do you avoid the mistakes? Pitfalls are like pot holes – when you know where they are you can avoid them, and being an avid cyclist I know how important that is!

Avoiding the pitfalls are key to success

The reason why so many business owners fail to sell their businesses is because their businesses were NEVER ready for sale, and they took them to market without preparing fully (not highlighting the pitfalls and eliminating the risks).

Just because your business is profitable doesn't mean it is valuable. Even if you have personally accrued significant wealth from it, this doesn't guarantee a successful transfer to a new buyer. If profit was simply the main factor, a much larger percentage of business owners would sell their company at the first attempt.

Pitfalls that will affect the saleability and value of your business

Assuming your business is already making consistent profits, we have identified 5 pitfalls you must be aware of that will affect the saleability and the value of your business.

1. S.P.O.F.'s

You may or not have heard of the term 'SPOF' - single point of failure. When a buyer reviews your business, they look for single points of failure. These are areas in your business that are high risk and could negatively impact your business if they failed.

Let me highlight a few of the more common SPOF's:

A. Suppliers – If you can only source key products or services from a single supplier, what would happen if they went bust? Do you have alternatives? Do you have a contingency plan? If you don't have options, this will be seen as a risk and almost certainly raise questions and require assurances.

B. Employees – every company has key employees. How much would it impact your company if one of your key employees left tomorrow? Are they incentivised to stay with your company? How well is the role they are responsible for documented? Good succession planning is essential for protecting the future of your business.

A company we are aware of recently lost one of their senior non-shareholding directors. The company didn't anticipate him leaving - it had a massive impact on business which significantly hurt the business.

Key employees must be incentivised

C. Clients – Do you have all your eggs in one or a few baskets with your customers? Of course you don't want to turn work away. You have probably built a great relationship with them, you may have been working with them for years, and it may even be difficult for them to change to an alternative supplier. However, if you are heavily dependent on one or two clients, your business is vulnerable. It will be seen as a significant risk to a buyer, and most definitely the lender (if the acquirer is looking to borrow funds to buy you).

There are other SPOF's and I am sure you can think of a few in your business. It is imperative that you highlight the single points of failure in your business. If you don't, I guarantee your potential buyer and their advisors will.

2. Issues with Contracts

During the due diligence phase, your buyer's lawyers will review every contract/document with a fine-tooth comb. Contracts with your staff, suppliers, customers and the owner of your buildings must be reviewed in advance of this process.

Were they poorly prepared? Are they non-existent - maybe just a gentlemen's agreement? Lack of contracts with clients and suppliers, especially those with whom you are heavily reliant on for business will be seen as a significant risk.

Are there clauses that will affect change of ownership? Recently, I spoke to a broker whose client had the completion of the sale of his business held up for months because there were issues in a change of ownership clause in the contract.

Review your contracts – ensure that they are fit for your exit. You should examine:

- Shareholders' Agreements
- Memorandum and Articles of Association
- Service Contracts
- Employment Contracts
- Supplier Agreements
- Leases

Issues with contracts will almost certainly protract the process. If a buyer has to wait too long while you sort out contract issues which should have been resolved earlier, you risk 'buyer fatigue' setting in. So much can change in a few months - markets change, staff leave or sales decline.

Make sure your contracts and documentation are all in place, have been reviewed by an expert as being 'fit for purpose' and are up to date.

3. Poor financial controls

Ensure you have accurate annual, financial, and monthly management accounting and controls. It is vital that you or someone in your business understands your numbers and can explain them with confidence.

During the due diligence your buyer's advisors will scrutinise your financials in detail.

Has there been any 'cooking of the books'?

Areas that may concern a buyer could include:

Good financial controls are key to success

- Suppressing profits
- Undervaluing and over valuing stock and work in progress
- Undeclared cash payments to the business
- Directors' private expenses running through the business
- A lack of, or inadequate reporting, budgeting and forecasting processes

I have met a number of business owners who have what initially appears to be great businesses. However, because of underhanded financial practices they have devalued their businesses, with some even making them unsaleable.

During the due diligence, your buyer's advisors will be checking for discrepancies and confirmation so that there is nothing that will come back to bite them in the future, such as issues with corporation tax, PAYE, VAT and your accounting policies. Make sure all the filing of returns and payments are up to date.

It would be wise to have dry run on the financial due diligence and to request your accountants to prepare fully audited accounts. Remember, if your numbers are wrong, it will put your buyer on edge - alarm bells will start to go off. Consequently, the buyer will either look much closer at all aspects of the business, or they won't inspect any further and will declare that this acquisition is not for them.

It is always best to be open and transparent if you have issues, but be prepared - some buyers will run a mile as they don't want to take the risk.

I have met many owners who are suppressing their profits to reduce their tax bill. However, remember most buyers will calculate value on the average sustainable profit over a 3 year period. If you are serious about selling your business, paying a little more tax for a few years and tidying up your financials will be a good investment for you in the long run.

Paying a little more tax will be a good investment

4. Unprotected Intellectual Property

Securing and protecting Intellectual Property (IP) is key to not only maximising value, but can also contribute to the long term success of your company. All businesses have some form of IP - this could be your brand, logo design, or something you have invented e.g. a product or a process.

IP in a business can be a double edge sword. It can significantly increase the value of your business if protected well. However, it can equally detract if it is not, and result in a buyer revising their offer or walking away from the deal.

Another area to consider is whether you are infringing someone else's IP. Do you have third party IP that is critical to your products?

We would highly recommend you review the IP in your business, which could include:

- Patents
- Trademarks
- Registered designs
- Copyrights
- Design rights
- Trade secrets

Protect your valuable assets

Many business owners are dismissive about IP and are, therefore, missing out on a huge opportunity to protect a valuable asset.

We regularly meet with business owners that have significant un-protected IP which leaves their businesses very vulnerable.

If it is well documented and protected, you will build the buyer's interest and confidence in the acquisition. However, poorly protected IP or lack of understanding regarding it will concern your buyer.

When we review IP, a common response from our clients is their failure to realise that they could protect it. A while back, Andrew Shepperd – Co-Founder of the Entrepreneurs Hub, was reviewing IP with one of our clients. During the review, Andrew identified and highlighted the fact that our client had a unique manufacturing process which resulted in significant cost savings, and felt that it was protectable. It was recommended that the client had a free 'Intellectual Property Review' with one of our trusted partners. A few weeks later it was confirmed by our partner that the client's IP was valuable and worth protecting. This will significantly increase the value of their business.

Recently I met with a business owner who said that he never protects any of his IP because he would never be able to afford to challenge the larger organisations who are most likely to infringe it. This is not uncommon, many owners think the same. However, what they are unaware of is that there are insurance companies who will provide cover to challenge an infringement of intellectual property.

Protect your IP and increase the value of your business

Please remember that well protected IP will build the buyer's interest and confidence in the acquisition, and secure you a much higher price for your business.

5. Business is dependent on you

If your business is heavily dependent on you, then you have what we call at the Entrepreneurs Hub a 'D.O.T.O' business (Dependent On The Owner). Buyers will see this as a serious risk for them going forward.

Furthermore, trying to sell a DOTO business can also be a huge risk to you. This is a serious issue and it is imperative that you as a business owner understand the implications, the risks, and most importantly the rewards associated with addressing this.

Now I'm quite certain that you are thinking back to all those seminars you attended, the books you read and the podcasts that you listened to which emphasised the fact that buyers will buy businesses that are dependent on the owners. In the past, I was also led to believe that this held true. However, as mentioned at the beginning of this eBook, over 70% of business owners fail to sell their company at the first attempt. There are lots of reasons why business owners fail to sell but I guarantee many of the 70% plus will be DOTO businesses.

Don't believe it! It will cost you dearly

Unfortunately, there is a lot of poor counsel in our industry regarding a DOTO business. You will be familiar with statements such as:

"You can work with the buyer for a few more years."

"It doesn't matter if the business is dependent on you because a buyer will want to bring their own person in."

"You can stay with the business and help them recruit the new MD or Sales Director" etc.

I would like to caveat this; I am not saying that you can NEVER sell a business that is dependent on the owner. However, it will not be easy. I would almost guarantee that you will NOT achieve maximum value for your business, and there will be conditions which will not be in your best interest. I will cover some of those a little later on.

Of course, I understand there may be situations where you have no choice but to market your business for sale. This could be due to an unforeseen health issue, where you don't want to leave a problem with your family or staff. Alternatively, your business may be struggling, the numbers may be going backwards, and you might feel the need to get out ASAP.

My advice to business owners in such a scenario is that if they feel they can't turn their business around or have lost interest in it, then they should take it to market while they still have something to sell - but they must be prepared that the buyer will be seeking to purchase the business at a significant discount.

Beware if you have a DOTO business

If you are in a similar situation, I would encourage you to contact an advisor ASAP to receive a second opinion as things may not be as bad as you think and there may be other options.

So how is the sale process of a DOTO business likely to unfold?

Let's continue with the DOTO – I will explain how it will unfold if an owner takes the business to market without addressing this major issue.

Hypothetically, let's assume you have a business that is generating profits of around £1m per annum. You have just returned from your holiday, or discovered that a good friend is very unwell. It might even be the case of simply arriving home from another bad day at work, dealing with staff issues where you feel more like a counsellor than a business leader and think that it is time get out.

You look at your email or open your personal post and there it is, the lifestyle picture – a couple on a beach or a sailing boat with a quote "sell your business now, your business could be worth more than you think, we have buyers waiting for companies like yours." They got you!!!!

You talk to your partner and explain that you are going to sell the business and spend more time with them. I personally agree that family should be the most important people in our lives. After all, none of us will at the end of life state that we wished we had spent more time at work.

Anyway, back to the business - you have made your mind up to sell. Your accountant may have valued it at £4m, a business broker in the past may have told you it's worth £5m. If you are like many owners, you believe and probably know that it is worth more.

You meet a business broker who may or may not provide a valuation. However, you believe that if you achieved £5m that would do just fine. You then appoint a broker. The business broker markets your business for sale. A business making £1m profit per year will almost certainly attract some interest – this is looking good and you are flattered.

People are interested in buying your business, your mind wanders a bit and you begin to think about what you will do with the money. You may have even had a quick glance at the 'Sunseeker Boats' or the 'Country Homes' websites. You may well be thinking about upgrading your boat or the house you will buy. Even if that's not you, I bet your family have a few ideas on how they can help you spend the money.

Anyhow, going back to your prospective buyers – they are buzzing around your business like bees around a honey pot, lots of them have now signed a non-disclosure agreement.

You start meeting the buyers, and you feel quite optimistic. However, it's then that the questions begin: "Tell me, how dependent is this business on you?" You reply "Not that much at all, I take holidays you know."

They then ask a few more probing questions:

"What about key client relationships?"

"Who is responsible for the sales?"

"Who runs your operations?"

"What about the development of new products?"

You response: "Well to be honest, some if not all of those areas are managed by me. However, that is not a problem because I am willing to work with you to ensure there is a smooth handover."

Here is the first risk for you. I have met many business owners claiming that they would be happy to work with the new buyer for a few more years.

My initial reaction to the business owner is always – "Please can I ask you a question? You have been running your business for the last 15 years or so as the sole shareholder or joint shareholders. How are you now going to feel about working for someone else again?"

Are you ready to be an employee again?

The most common response is "I am unemployable" or "there is no way I am going to work for someone else again."

If your business is dependent on you then it is highly unlikely that the buyer will let you walk away quickly. Unfortunately, you will revert back to the world of employment, board meetings and explaining the monthly results.

Even if you do agree to work for the new owners, we now have to agree the deal which is going to be impacted by your over dependency and all the other pitfalls.

I don't think you will like the deal

We have agreed that your business has a lot of pitfalls and I am not convinced that you will find the offer appealing or agree to the deal.

The buyer will rarely pay maximum value - The £5m price that you thought you would receive is only £3m, since the higher the risk, the lower the price a buyer will pay (this may be even lower after they have gone through due diligence).

Earn out deal is almost guaranteed - The £3m is not all cash up front – it is now on a deferred basis subject to some very strict conditions (often around the performance of the business); £1.5m on completion and the remaining £1.5m over the next 24 months.

Guaranteed that your deal will have an earn out

Your Buyer walks away - The buyer puts you through all of this stress in agreeing an offer but as they start to dig deeper in the due diligence other issues begin to arise. Subsequently, they start to chip away at the price again, the relationship becomes strained and the buyer walks away.

You walk away - You begin to ask yourself whether this is what you really want – do you really want the deal? You start to question the deal as the buyer will - that this just does not feel right. Even if the buyer is still interested in acquiring your business, you decide that you don't want to sell to them.

Many businesses that fail to sell or undersell do so because the owner has built a business that is profitable and assumes it is ready for sale, but unfortunately they fail to address the real value drivers that motivate a buyer.

If you are looking to sell your business, one of your primary goals must be to ensure that your business can operate without you and that you identify and address the barriers to sale. Even if you are not ready to sell for a few more years, I guarantee it will be a much easier and more enjoyable business to run.

Final thoughts

I trust you have found the areas highlighted helpful. If you have already been involved in the 'fail sale' attempt, you know it is a painful and expensive learning experience. However, like I explain to anyone with regrets - we cannot change our past, but we can change our future.

Seek advice: 'we don't know what we don't know!'

Hopefully you are now more motivated. You may be thinking that all you need to do is address the 5 pitfalls and then you are ready. However, this is not the case. There are many more areas that you will need to consider and review before you are fully prepared for exit. A useful analogy would be a car getting its MOT. The tester will look at over 25 key areas - your car will fail if it doesn't meet the minimum standard. Similarly, a buyer interested in purchasing a business will closely examine numerous other critical areas.

My advice to any business owner who is considering selling their company is to seek specialist Exit Planning advice. We don't know what we don't know! A modest investment earlier in the process will reap significant benefits in the future.

Whatever you do, please don't rush into marketing your business without having a full exit review. At the Entrepreneurs Hub, I or one of my team members would be only too pleased to give you some honest and frank feedback on your current situation. I guarantee you will find the meeting extremely beneficial in helping you consider your options:

- How saleable is your business today?
- What are the potential obstacles to selling?
- What are the risks?
- How long will it take to get you company ready for exit?
- How much could your business be worth? Will the proceeds from the sale allow you to live the same lifestyle if you sold up?
- What can you do to increase your sale value?
- When is the right time to sell?
- What is your tax position?
- What are your exit options? (There are over 10)
- What do you need to consider when selecting your advisory team?
    - Exit Planners
    - Business Broker
    - Lawyer

Questions that you will need answered. TALK to EH

A final piece of advice: I recently received a call from a Director and part-shareholder of a business that I have been talking to about exit planning for over a year. They have a great, fast growing business. I told them that it wouldn't be long before buyers started knocking at the door. The call was exactly about that – they now had two approaches to buy the company. However, they are nowhere near ready to sell. They are currently in talks with these buyers and are now realising how unprepared and vulnerable they are.

Be prepared for the knock on the door

My concern for the shareholders is that despite the company having a significant opportunity (very fast growing and could be highly valuable), if they try and sell now they will get detracted and focus on the wrong things. Based on my experience, it is highly unlikely that they will achieve what is the true worth for the business and the years they have invested in it.

Almost every business owner has the opportunity to successfully sell their business, but it requires careful planning and seeking the support of an advisor who will help you implement a plan and keep you on track.

The net result is that you can realise that dream of selling your business on your terms and achieve the value that you want. Furthermore, if you are like many other business owners, you will want to ensure that the team that helped you get to where you are today are well looked after in the hands of the new owner.

Wishing you every success with your plans.

Malcolm

Feedback or questions

If you have any feedback or questions about this eBook or would like to meet with one of our team, please contact us at:

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Next Step: If you are considering an exit have a free review

About the author

Malcolm is a Co-Founder and Director of the Entrepreneurs Hub. An established entrepreneur and accomplished motivational speaker, he is passionate about helping people to grow and develop in business and life. He has delivered seminars/talks to over 50,000 people; he speaks on topics such as 'Selling a business to maximise value', 'Preparing a business for sale' and 'Selling skills and Managing and motivating people'.

Malcolm has worked in Business Growth roles and the Mergers & Acquisitions (M&A) sector for almost 30 years. He has consulted with over 1,000 business owners who were considering selling their businesses.

In 2012, Malcolm launched the Entrepreneurs Hub (EH) to address a significant issue in the Mergers and Acquisitions industry - the fact that over 70% of business owners failed to sell their business. With a team of experienced entrepreneurs and industry specialists, Malcolm successfully designed a unique approach to Exit Planning for business owners.

Previous roles included working with a leading international M&A business. During his time as Senior Manager and Group Board Director responsible for growth, the company grew significantly and achieved success in the UK, America, Mainland Europe and Africa.

Malcolm was also a founder member of a business with James Caan (Ex. Dragons Den) as well as a founding member of a business that started in his parents' garage – this grew to 165 people operating in the UK, US and Germany; 27% of the business was eventually sold off for $10.8m.

Away from the office, Malcolm is a volunteer coordinator and trainer for Basingstoke Street Pastors, a national initiative that supports the night-time economy. He is also a member of a local church. Malcolm is a family man with 3 grown up children. He enjoys spending time with his family, eating out, going to the cinema with his wife Julie, playing golf (not so good at times!), cycling on his road bike and watching Southampton Football Club.

About Entrepreneurs Hub Limited

Entrepreneurs Hub (EH) is a market leader in supporting business owners throughout the lifecycle of owning a business. It has been founded by leading business professionals who are passionate about, and committed to ensuring that business owners build robust and valuable businesses which will aid them in realising their dreams. Therefore, whether you are a start-up or a fast growth seeking support, a mature business struggling to grow, or are looking to raise capital, buying or selling a business or in search of a successor, our experienced team of experts are on hand to coach you along the journey.

We specialise in helping business owners grow their businesses, increase profit, develop/expand their executive team, and most importantly, increase their shareholder value by ensuring their business is prepared for sale.

EH is defining the way business owners approach and prepare for growth and exit. We have a unique approach to business improvement which emanates from years' of experience of being part of successful start-ups, growing mature businesses, and managing and motivating people within the SME and blue-chip organisations. As business owners and experts, we can identify with the challenges you may be facing and will do our utmost to encourage and empower you to achieve the success you truly deserve and desire.

Through our sophisticated 'EH4™' model, we provide a unique business preparation for 'Growth and Exit' process that makes a business more robust, valuable, saleable and highly attractive to potential buyers, hence building shareholder value.

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