Ten common mistakes when selling a business

Be sure to avoid the following ten common mistakes when selling your business.

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Many small business owners adopt an informal approach to future planning and few plan for exit until the point at which they are ready to sell. This often results in a difficult, frustrating and lengthy sale and in not realising full value for the business.

1. Not knowing the value of the business

Ultimately the value of a business is the sum that the seller finds acceptable and the buyer is willing to pay. This definition, however, doesn't help with the evaluation of a business during a price negotiation.

There are many approaches to valuing a business and all have a subjective element. The most widely used valuation methods are based on cash flow and profits. These are affected by the size of the enterprise and the risks associated with it.

A small business will be priced on different ratios and parameters to a medium-sized business, which in turn will have a lower comparative value than a listed company even if they are similar businesses and provide products or services at a comparative price.

Reputable business brokers are a useful source of information when valuing a business. They are close to the market and know what buyers are prepared to pay and what financiers are prepared to lend. But beware - there are many incompetent brokers out there. Some may even place an unrealistic value on your business in the hopes of getting your mandate.

Often the most cautious value comes from the financial institution that will be financing the buyer. Sometimes these values are excessively conservative, as financiers want to limit their exposure; often at the seller's expense. So, if your buyer is getting the majority of their financing from a financial institution, expect a conservative value to be placed on the business.

Considering terms of payment for the purchaser can potentially increase this value, but can also bring its own set of problems.

2. Setting an unrealistic price

Unfortunately many sellers look at what they need to retire on when determining a value rather than on how the business is performing. They use models that aren't applicable to their industry or follow the advice of people not actively involved in the selling of businesses. Ego can also play a large part in determining perceived value. Sellers also look at what they would do to improve the business and then value the business as if they had implemented the improvements.

Buyers look at proven profit to determine a price. This is normally based on what you have declared to the taxman as profit.

Many sellers try to restate these figures to reflect what they have taken out of the business in various forms such as cash sales or non-business related expenses.

But you can't have the historical tax advantage and then expect a revised situation when valuing the business for sale.

Other sellers use future projections to determine a value. But why should the buyer pay a figure based on unrealised numbers - especially when they will have to put in all the hard work to achieve these numbers.

A last word on under declaring turnover or inflating expenses: It always amazes me the lengths we go to save 29 cents of tax in every rand of profit and never think that this is at the expense of your businesses selling value.

3. No proper documentation

Nothing forces the price of a business down like a lack of proper documentation. This is especially so with a lack of historical numbers (preferably verified) as well as recent management accounts.

A good broker will prepare a summary report of the business. Initially this will briefly explain the business without divulging the identity of the business. This helps in sifting out to the real buyers. As a buyer shows further interest, so more information is released.

Information required could include:
- A business profile
- Details on products and services
- Information on the premises and production facilities
- Production technology
- Business past achievements
- Management and staff
- The market - industry and market analysis
- Sales and marketing strategy
- Financial statements and projections including details where necessary
- Legal and statutory requirements of the industry.

4. Not positioning for sale

Like selling a house, there are many things that can be done to maximise the value of your business before putting it up for sale. Some of these would include:
- Optimising cash flow
- Normalising the financials
- Purging redundant assets
- Succession planning
- Not introducing new staff incentives
- Ensuring information systems excellence
- Positioning leases or contracts for future sale
- Minimising legal contingencies
- Cleaning everything
- Considering BEE implications
- Making sure you want to sell.

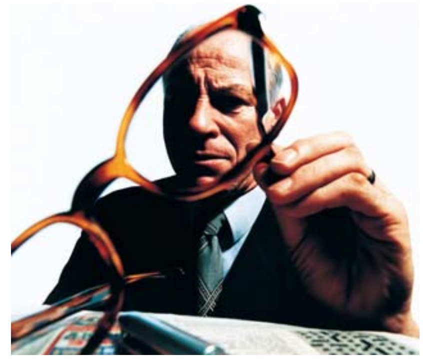
Addressing these points can be difficult as you are no doubt already running the business to the best of your ability. You may be too close to the business to see where improvements can be made. Outside assistance may be useful at this point. Buyers will not adjust their valuation by what you say can be achieved. They want proof that improvements are possible. Operating for a few months with these changes in place, should be enough to show that improvements are achievable.

5. Not asking for help

Selling a business can be an intimidating exercise even with the help of the professionals. A broker once told me that half of all deals end in some unpleasantness between the buyer and seller. And I consider him to be one of the better brokers out there. The better prepared you are before you sell your business; the less likely you are to experience this situation.

You will need a mixed team of advisors. They might work independently, but their efforts should be co-ordinated in some way to ensure you get the best results from selling your business.

Your exit strategist will help you review your business and determine the areas that need to be addressed to maximise the attractiveness of the business. He will help you throughout the sale process.



A broker, on the other hand, does not want to wait whilst you prepare your business for sale, but would rather sell your business immediately. They would also want to close any deal as soon as possible. This is understandable as they make their money from commission on sales and not on advising.

Your accountant should be able to help you structure the ownership of your company to help minimise any tax payments. They will also help in ensuring the credibility of your past financial performance.

A professional business broker will help in putting a value on the business, assist in determining a sales strategy, prepare sales documentation, find qualified buyers, assist in negotiations and advise in meeting legal requirements. A good broker will continue looking for possible buyers up until a final deal has been signed and the money paid. They should have a plan for the eventuality of a failed sale.

A lawyer is essential to ensure that contracts are fair and protect you the seller as much as possible. They are also necessary to ensure all legal requirements are met.

At the end of the sale process you will hopefully have funds that you will possibly want to invest for your future. A good investment advisor is essential both at the beginning of the process to help you determine what funds you need to retire on and in helping you invest your funds at the end of the process.

6. Trying to sell to the wrong people

Before you find the "right" buyer for your business you are likely to come across buyers who are merely speculating and will waste your time. These "wrong" buyers may not have enough experience to run your business or have insufficient funds. They may be "tyre kickers" who blunder from one business to the next, draining sellers of experience, ideas and energy. Spending time entertaining these "buyers" will only delay the sale.

If your business is on the market for a protracted period, the perception in the marketplace may be that there is something wrong with it. This perception will be heightened if an offer falls through. This could of course happen no matter how much time you spend scrutinising buyers. But a good broker should minimise the chance of it happening to you.

7. Not understanding the buyer's motive

Always ask why is the buyer looking to buy a business and why your business in particular? Are they:

- Dreamers looking for a business but without the ability or means?
- Bored and looking at businesses for sale gives them something to do?
- Competitors looking to understand your business better?
- Looking to buy a salary because they can't get a job elsewhere?
- Risk averse and more the type who should be looking to go the franchising route?
- Your ideal successor?

The better you understand potential buyers, the more likely it is that negotiations will go smoothly.

8. Assuming you have a serious buyer

Many sellers put all their faith in the first potential buyer that walks through the door especially if they put in a conditional offer. But many things can go wrong during the sales process.

Keep your options open. The search for a buyer should continue until the money is in the bank. Always have a back-up plan should the deal fall through.

Even if the deal eventually goes through, this strategy will help keep the buyer honest and keep the pressure on them to sign and pay.

9. Being the first to mention price

The broker will, as part of their shifting strategy, ensure the business is within the price range of the buyer. This should be part of the process when qualifying the buyer. Any sales guru will tell you to sell the product first and the price will automatically follow.

Mentioning a price upfront puts you on the defensive and you have to justify the price from then on in. The buyer will continue to whittle the price down until he gets a bargain and you know you came second.

Sell the business first and the price will follow. Wait for the buyer to put their price down in the form of a written offer. The offer is likely to contain additional conditions and terms. You now have a starting point for negotiations.

Before you go into negotiations know what terms you would ideally accept, what you would be happy to settle on and where you would walk away from the deal.
Be very careful about who you share your negotiation parameters with. You will be surprised how many so called professional brokers I have dealt with who "confidentially" have told me the seller will accept a price 25% below the asking price and that after the first meeting!

10. Not planning for the sale

Selling or exiting your business is never easy. The most important thing you can do to sell your business is to adopt a structured approach. Deciding today to sell your business and hoping to get the money out by the end of the month will only result in disappointment.

It takes time to sell a business at a good price, particularly if the business has not been prepared for sale.

It takes longer to prepare a business for sale at the highest price possible. An honest review of your business, action plans to address problem areas and a well-managed and executed timetable are all required before putting your business up for sale. Preparing well in advance of your sale will ensure a greater chance of you being happy with the final outcome.

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Mike Shorten specialises in exit planning and advises businesses on how to prepare for sale so as to maximise the value received. He also provides add-on services such as coaching, strategic planning, business reviews and improvements. **For more information visit www.exitplan.co.za or call 082 771 4158.**