

SELLING YOUR BUSINESS

If you are selling a business, obtain a copy of the SCORE/SBDC handout *Buying A Small Business* to learn what buyers of your business are going to be demanding from you, the seller.

How much time will you need to get ready to offer your business for sale? Don't think in terms of months, but rather *years*. The planning phase is very complex. Especially if you decide to do it by yourself, recognize that you'll need to dedicate vast amounts of time to the process. Even with the help of advisors, (e.g., accountant, attorney, tax consultant) some issues will still take lots' of time and careful thought. For example, the tax aspect is just one important consideration --to determine how to avoid giving the IRS a large percentage of your proceeds, you'll want to investigate family foundations, charitable trusts, gifts to family members, like-kind exchanges, and other alternatives.

Getting Ready

1. Prepare a written prospectus and include the following:

- a. a complete detailed **asset list** (see itemization on page 2 correlated to the Balance Sheet. It should include the current inventory listing.
- b. a history of the business outlining the evolution of its products and services.
- c. your data base of customers.
- d. documentation of ownership (consult your attorney, if a husband and wife business, but operating as a sole proprietorship).
- e. the last three years Profit and Loss Statements and tax returns, and the current Balance Sheet.
- f. the selling price.

2. Contact SCORE or SBDC for counseling and review of your prospectus.

3. Know your reason for selling and stand by it.

4. Before announcing that your business is for sale, make an assessment of:

- a. retention of key employees
- b. potential loss of major customers
- c. startup of competing business (es) due to sale
- d. advisability of engaging professionals to handle the sale

5. Clean up the premises. Get rid of junk and dispose of obsolete and unsalable merchandise.

The Asset List -Your complete asset list should include

Land and Buildings: Have available your recorded title deed, the latest property tax bill, and your latest mortgage statement for each property owned that you are selling.

Leases and Leasehold Improvements: The longer the term remaining in your lease(s), the more valuable it is to a buyer, providing the lease is transferable. Any improvement you made to the property is a separate asset to be itemized when the business is sold.

Machinery, Equipment, Furniture, and Vehicles: Each should be separately described and itemized. The description should include whether items are operable or in need of repair. Show the Cost and the Current Market Value.

Accounts Receivable: If any are past due, you need to determine how collectable they are

Franchises: When you're ready to sell your business, including your franchise license, you must consult with the franchisor. Though your written agreement may permit the franchisor to terminate the franchise, most franchisors want the business to continue, and will cooperate with you in making the transition to a new owner. Your franchise license will have a value: the total cost you paid for the franchise less any amortization of cost you have taken on your income tax return. Your pricing of the franchise to your buyer may be higher or lower than your adjusted cost.

Patents and Copyrights: You must decide whether you are going to sell these or license their use

Licenses/Permits: These are an asset if there is life remaining on them. For example, a liquor license often has a value in excess of its original cost, but generally cannot be transferred.

Contracts: Document all written contracts. Contracts under which products or services are being provided to your business (employment contracts, maintenance contracts, security contracts, vendor contracts, insurance contracts) are assets in that you have already negotiated their terms. Contracts under which your business is to provide products or services over an extended period of time at an established price constitute sources of income that your buyer can rely on. The value of these contracts is often stated as the commission that a salesperson would receive for obtaining the contracts.

Customer Lists: This is an extremely important asset. If possible, make a list of your customers for the past three years, showing how much each has purchased in each of those years. This list is a very convincing selling point. Often, such a list is valued at what commission would be paid to a salesperson to generate the same amount of business.

Intangibles: This includes things like trade names, logos, package designs, and advertising slogans. Unless an intangible asset has a definite economic value, it is usually included in the calculation of goodwill.

Goodwill: Due to IRS involvement, a seller should try to calculate goodwill in a manner that will withstand any post-sale litigation by the buyer. Because most small businesses are very sensitive to competition, the buyer will probably want you to agree not to start up a new business in the vicinity. From the seller's point of view, such an agreement is a form of goodwill.

There are many methods of determining goodwill. The two most commonly used formulas are

- a. **Income Capitalization:** for businesses in existence for five years, an average annual rate of return (generally 8-10 %) on the tangible assets of a business is deducted from the pretax earnings. The remainder is capitalized (generally at 15-20%) to determine the goodwill value.
- b. **Profit Opportunity Method:** Involves projecting an average annual income stream at least ten years out, based on the past five years, taking into consideration the increases that have occurred in those five years. You apply present value tables to your projected ten-year income to determine the goodwill value.

Calculating Your Selling Price

1. In most cases, it's best to engage a professional appraiser

2 There are several ways to calculate selling price, including

a. **Net Book Value Plus:** For example, say the net book value (assets minus liabilities) equals \$300,000 and the rate of return over 12 years has been 8%. This compounded would come to 2.5 and, as a starting price, the business would be worth \$750,000.

b. **Adjusted Book Value:** All assets are examined to determine whether they are worth more or less than the book value. For example, depreciation amounts may be added back, land values usually appreciate over time, and inventories may have higher values due to the accounting method used for tax purposes.

c. **Multiple of Earnings or Capitalization-of-Income Method:** Look at the income generated by the business and determine what amount of capital would have to be invested to obtain that amount of return in today's market.

d. **Full Replacement Cost.** List every asset and determine how much it would cost to replace it at **current** cost

The Negotiation

This sale won't be accomplished in one or two meetings. There are financial terms to be worked out; tax considerations to be clarified; a detailed asset list to be verified; regulatory requirements to be fulfilled; legal documents to be completed; and consultant and appraisal fees to be paid.

In preparing for and completing the sale, there are at least three types of advisors you should work with

Financial Advisor: checks the calculations of your asking price, checks on the credit worthiness of the buyer, and keeps you advised of the financial reality of the terms of payments.

Tax Advisor: Should advise you on the tax consequences of each asset you are selling, and suggest how to reduce the amount you will have to pay in taxes as a result of the sale. He or she may also advise how you can assist the buyer tax-wise.

Legal Advisor: Reviews all titles to property, existing leases and contracts, product and service liability claims, environmental liabilities, and any pending litigation possibilities. Also prepares the sales contract.

Check the credentials of interested buyers. Don't waste time with those unable to provide proof of financial stability. Be clear about what consultation and guidance the purchaser expects from you after closing, particularly if he or she is first-time business owner. Get all agreements in the contract.

Most negotiations involve stages where the seller discloses certain information. As the buyer becomes more committed to purchasing the business, more information is provided by the seller. During each stage there is give-and-take negotiation. Though there is full disclosure by the buyer to the seller in the end (assuming a successful sale), some information is not disclosed initially, as it is confidential and could be passed on to competitors. Passing it on *only* to a new owner makes the best sense for everyone involved.

Conclusion

Every aspect of the sale must be fully reviewed, understood, and documented by contract. Have your accountant, attorney, and tax consultant explain each detail. The cost will be fully justified. Your SCORE and SBDC advisors can provide assistance as well, and their cost is even easier to justify --because it's free!