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Who Do I Want to Sell My Business To? (Part 2 of 2)

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As mentioned in Part 1 [1], most business owners will leave substantial dollars on the table when they sell their business, and less than one-third of business owners will be able to successfully transition out of their business. As a business owner who wants to get full value from a sale, identifying your most likely target buyer will both guide your transition planning while also helping you to determine the likely terms of your eventual sale. Broadly speaking, there are two types of potential buyers. The first group is an outside third party, such as another business or private equity, while the second group consists of insiders, such as family members or key employees.

Studies have shown that approximately 60 percent of owners planning an exit identify a third party as their preferred target buyer. There are several good reasons for this: First, it generally poses less risk for an owner because these “third-party” buyers tend to pay more cash than insider sales, which tend to involve more owner financing. These transactions often incorporate many competing buyers which tends to result in a higher price. And finally, third-party transactions tend to be much faster (usually 12 to 18 months) than insider transactions which can take several years to successfully complete.

Understand the Terms, Just Not the Price

But selling the business to a third party can also have expensive pitfalls for business owners. The first pitfall is when owners hyper-focus on the sales price and lose focus on the other terms of the deal. These terms may include (but are by no means limited to):

- **Earn-out Provisions** where the owner receives additional compensation that is contingent on the company's achieving future financial goals.
- **Reps and warranties** that determine the assertions made by the buyer and seller during the sale agreement.
- **Indemnification clauses** that describe how one party will compensate the other for any harm, liability or loss arising as a result of the sale.
- **Tax liabilities** that result from the sale
- **Working capital agreements** where the seller agrees to leave enough "working capital" in the business so that the buyer can continue to operate the business during the transition period.

Deal terms have significant implications for the ultimate value the seller receives. Neglecting these details can have a dramatic impact on the success or even cause the failure of the deal.

Buyers Have Sophisticated Teams

Another problem for business owners is that most third-party buyers are much larger than the company they are acquiring. As such, they have highly experienced deal teams negotiating on their behalf. Business owners who have never experienced the transaction process are thus at a distinct disadvantage, and to succeed, they must acquire an equally experienced team to represent them through the process.

Recently, I worked with a business owner whose business was expanding rapidly, and because of this growth, the owner was exploring his options for selling. Since the most attractive option was a sale to a large public company, one of our first recommendations was to build out the deal team to ensure his goals were achieved. In this case, we added an Attorney, a CPA and an investment banker to the team; all of whom had substantial deal experience.

The CPA and the Attorney were able to structure the business and the transaction to smooth the sale process and to minimize taxes; saving the owner millions in extra costs. The investment banker, who had significant experience in that market, understood the motivations of the buyer and was able to negotiate a price that was 20% higher than what the owner was anticipating. In addition, their negotiations relative to the working capital adjustment alone added nearly $500,000 owner's net proceeds! That's the value of a great team!

Selling to Family Members and/or Key Employees

Selling to insiders such as family members or key employees can prove far more treacherous than most business owners anticipate. In my experience, one of the more common obstacles for an owner trying to sell to family members or key employees is the lack of effective communication.

For example, I recently worked with an owner who is the family patriarch. He built the business, owned it for over 30 years and wanted to sell it to his children who worked in the business. However, in discussing the potential sale, he learned his adult children had no desire to be in business together once their father retired.

In another instance, I worked with an owner who wanted to sell to a trusted manager he had worked with for decades, only to learn that she had no desire to own a business. In both instances, the owners had to change the course of their exit planning which ultimately slowed their ability to successfully exit their business.

An important note is that owners should treat insider transactions the same as third-party transactions and bring in transaction experts, such as transaction CPAs and Attorneys, early. Employing these professionals in structuring and communicating the transfer will help to ensure that issues such as taxation, control of the company, and who each person is accountable to, are appropriately addressed. In doing so, both delays and hurt feelings can be avoided.

Lack of Financing Can Often Derail Insider Sales

Most often, owners are trying to sell to family members and key employees who are younger and substantially less financially established than the owner. These buyers simply don't have enough assets to buy or finance the purchase of a multi-million-dollar business. This reason alone accounts for many businesses failing to transfer from the original owner to the next generation.

The good news is that this obstacle can be overcome with time and effective planning. For example, I recently worked with a company that has been actively transferring ownership to younger key employees for the past decade. Consequently, when the owner is ready to exit the business, these next generation owners will have the financial resources to purchase the remaining company at full value

Once you've identified your target buyer, you'll be prepared to address the third critical question: When do I want to sell my business? And that will be the subject of the next blog…

Part 3: When Do I Want to Sell My Business?

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