

Grooming a Business for Sale

Expert knowledge means success

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Note: This publication has not been updated since it was last published. Some of the hyperlinks may have changed and may need updating. In addition, some of the information in this publication may be out of date.

Introduction

Selling a business is all about timing and presenting information in the right way. It's also something like selling your home - it needs to be tidied up before you can sell it. A good polish, some fresh paint, or even replacing old fencing can make a big difference to the sale price. Tidying, or grooming a business for sale, which can take place over a few months or even years before the sale takes place, has two particular aims: first, to maximise recurring profits; second, to present the business in a clean and organised manner. For example:

- Reduce or stop proprietorial or non-business expenses.
- Ensure the balance sheet is clean, e.g. remove non-business assets.
- Consider proposed expenditure on marketing - will it pay off in the short term?
- Without compromising profitability, maximise sustainable sales levels.
- Where possible, secure long-term contractual relationships with suppliers and customers.

In this publication “business” is taken to mean a company although many of the matters covered relate equally to an unincorporated business.

Maximising the Sale

The aim of grooming a business for sale¹ is to present your business in a highly marketable way, which will attract prospective purchasers, whilst at the same time maximising your selling price.

If you are thinking about selling your business, you might consider the following questions:

- Who might be interested in buying the business?
- Is there a sound management team in place and a plan to deal with any skill or resource gaps?
- Have you produced financial projections to show the potential of the business?
- Do you have good internal control and financial information systems that are able cope with the purchaser's due diligence?

- Is there any outstanding or threatened litigation which should be resolved before a sale can take place?
- What is the business worth: (a) now, and (b) by the time it's put up for sale?
- How can I increase the sale price of the business and make it more attractive to a purchaser?
- What is the best time to sell the business in order to pay as little tax as possible on the proceeds?
- What do I need to do next in order to sell my business?

To maximise the value of a business, the areas covered in this publication should be considered.

Margins

Whilst a business may historically have priced its products with its long-term future in mind, and in particular to keep out predators, could a period of higher margins be sustained?

Could this produce immediate benefits in improved profitability – thus increasing the potential sale price?

Staffing

Any redundancies made once negotiations with a third party have commenced will normally be treated as unfair dismissal by an industrial tribunal. Accordingly, staffing levels should be reviewed before the sale exercise starts. Staff who would not be required by a purchaser might be employed elsewhere in a group.

Review of Other Costs

A review should be undertaken to highlight non-essential costs that reduce current profitability and costs that would not be incurred by an incoming purchaser. Whilst a purchaser might be persuaded that these costs should be added back to determine the underlying profit, the argument is always stronger if the business can be run for a period with these costs removed.

Any costs being incurred for future benefit should be reviewed, such as the launch of a new advertising campaign – might there be benefits in delaying such expenditure?

Assets

Assets not required by the business or by the purchaser, such as surplus property, investments, or indeed surplus cash, could be removed prior to a sale exercise.



The key question: why do you want to sell?

One of the most important questions you'll be asked by every potential purchaser is: Why do you want to sell? To succeed, you'll have to have a good answer to this question. The process for getting out of business successfully requires the same amount of planning as going into business.

Remember that selling a business doesn't happen overnight. It requires planning and coordination as well as a clear mind to handle decision making during the transaction.

To enable a pre-sale dividend or other cash distribution to be paid out of the business prior to the sale, liquidity should be maximised and policies concerning stock holding, debtors and creditors reviewed at an early stage.

All major property assets should be valued independently - particularly if these assets are to be extracted pre-sale.

Management Review

Most purchasers are seeking to acquire high quality management. Frequently, second tier management exists but is not properly recognised by the existing owners. Where second line management are taking executive decisions and influencing a business, this should be documented. It may help to recognise their input by:

- Minuting management meetings.
- Issuing formal job descriptions.
- Considering job titles and organisational structure.

Some purchasers prefer to see management tied to the business with service contracts. These should be issued in a form that is likely to be compatible with a larger organisation.

Accounting Policies

A review should be undertaken of the following:

- How is profit recognised in the accounts, particularly for a contract related business?
- Are depreciation policies reasonable, both for tangible and intangible assets?
- Provisions - high provisions against stock or debtors frequently accumulate in private companies. These may need releasing over more than one accounting period.
- Revaluation policies for properties and investments?
- Research and development may well drive the purchaser's interest in a private company. Small companies are frequently sought for their innovative skills and development of new products or methods. Where all research and development costs have been written off in the past, this should be identified, reviewed and highlighted.
- What is the accounting treatment of any rent-free lease agreements?

Tax Review

Make sure that all PAYE, VAT and corporation tax matters are up to date or that the reason for any delay is acceptable.

Ensure that tax allowances, if appropriate, are maximised, and that tax computations are agreed with the Inland Revenue. Tax losses, previously ignored, may now have a value.

Tax Planning Review

Whilst this is a large subject and one which cannot be fully addressed here, the following issues need to be considered:

- Sale of assets or shares? The vendors will usually prefer to sell shares whilst purchasers prefer to buy assets.
- Availability of roll-over relief, hold-over relief and retirement relief.
- Dividends prior to sale. What needs to be extracted?
- Availability of tax losses for future purchaser.
- Possibility of a top-up of the proprietor's pension fund.

Legal Review

This could be carried out in conjunction with the vendor's legal advisors but, at a minimum consider the following:

- All leases and title deeds are located and reviewed.
- Trading contracts are examined to ensure that no change of control prohibition applies.
- Trade marks and patents are properly filed and up to date.
- Agency agreements are renewed, particularly in the light of recent European legislation, to determine the cost of cancellation.

Look at it from the Purchaser's viewpoint

Here is a checklist of some of the matters you should consider as being important to any purchaser:

- The purchaser would want to be sure that the existing owner is not crucial to the continued success of the business.
- The purchaser needs no special industry experience that is generally unavailable.



- Are customers and suppliers bound to the current owner either by contract or otherwise? In addition, are there any terms or conditions of trade that need to be protected?
 - The management, operational and information systems are effective, well documented and well established - thus reducing reliance on key employees and principals where possible.
 - The purchaser wants to know that key employees and management are in place and are committed to the business and its future.
 - Are restraints of trade clauses in place for both key employees and the vendors?
 - Are there current valuations of any significant property and/or plant and equipment assets? In addition, are there any immediate capital requirements?
 - Intellectual property is properly protected and transferable to the purchaser.
 - The market in which the business operates is stable and has some growth potential. For example, what are the immediate future business prospects, quotes and tenders?
 - Legal and contractual arrangements are properly set up
 - Past performance is credible and there are no "skeletons" (unidentified liabilities) lurking in the background for an unwary purchaser.
 - The business offers opportunity for growth and enhanced profits.
4. Taxation – keep your VAT and PAYE up-to-date and, when or if due diligence takes place, immediately disclose any previous difficulties to your advisors. Managing any taxation issues up-front is the best way to prevent them sabotaging the sale process.
 5. Forecasts/actual budgets – always produce regular, realistic forecasts for your business. It's best to beat them by a small margin than consistently fail them to beat them at all.
 6. Development – always have a strategic plan in-hand with which to excite a potential buyer. If necessary, invest in someone who can help you achieve this. It's much more than just window-dressing.
 7. Accounting policies – make sure you're using the standard procedures for your industry and that they consistently present the best picture of your business according to acceptable accounting practice.
 8. Accounting information – even if a sale is a year or two away, you'll need to demonstrate favourable trends, so regular monthly accounting information is vital. Each set should be up to date and informative.
 9. Contracts – do current contracts underpin your sales forecasts and are they with the existing business (not with a previous owner, for instance)? Do any major contracts have onerous terms that should be eliminated and do all contracts provide a potential buyer with good security?
 10. Assets – are you carrying non-business assets which should be stripped out? Equally, are your assets fully valued but not overvalued?
 11. Staff – Do all staff have current contracts of employment and do they protect future business or leave a buyer with possible complications?
 12. Proprietors' benefits – you'll eventually need to list these for the purposes of disclosure and for adjusted profits. You also need to feel sure that, whatever the benefits, they will not cause you or your buyer a potential tax problem.

Keep to "Good Practice" Principles

According to Clive Parritt², if you're thinking of selling your business, grooming it for sale simply means running everything according to 'good practice' principles. Keep a finger on the facts in three main areas - financial, commercial and customers - and you will be well placed to smooth the sale process and to realise maximum sale value for your business when the time comes:

1. Debtors – maintain good credit control and make sure that sums outstanding are ultimately collectible.
2. Customers – work to keep your best customers loyal (due diligence procedures will soon find out if they're not!). 'Know why they stay and why they pay'.
3. Property – review your lease arrangements intermittently and ensure that commercial terms for related

How to identify potential purchasers

Take time to identify potential purchasers. You can help potential purchasers to be aware of the business by raising its profile through good PR. A network of contacts established while participating in local business associations and community organisations may help identify potential purchasers but try to think more broadly than the business' immediate competitors, customers and suppliers. Professional advisers, such as business brokers or accountant's networks, may also help identify potential purchasers.

Sales Memorandum

Potential purchasers will need several documents to make their decision. The documentation (usually called a Sales Memorandum) will also be necessary if a bank is providing part of the funding for the purchase. Any information that is passed to the purchaser or its agents should be carefully recorded as it will form part of the warranties and indemnities that purchasers ask for at completion – however, before passing over any information, a confidentiality and non-disclosure commitment from the purchaser should be obtained.

Among the documents to have available for the purchaser are:

- Identification of the owners.
- A history of the business.
- A description of how the business operates. This may include policies, procedures, accounting methods and instruction manuals.
- A description of the facilities. This includes equipment as well as space.
- A list of suppliers.
- A description of the competition.
- Details of insurance coverage.
- Employee information including length of service, current salaries (and benefits), job descriptions and responsibilities will be needed. Buyers will want to know if employees intend to stay on after the sale.

- Details of pension arrangements.
- Discussion of any pending litigation or contingent liabilities.
- A compendium of three to five years' financial statements will be needed to determine the trends the business is experiencing.
- A review of marketing activities including a sample of brochures and advertising contracts.
- A compendium of tax information including tax, capital allowance and deferred tax computations.
- Stock, work-in-progress and asset lists will be needed to verify collateral to a banker and for justification of the price for the buyer.
- Current list of accounts receivable and accounts payable to compare to the balance sheet.
- Customer list if the business has long term relationships and if part of the price is dependent on those customers returning.
- Interim financial records including balance sheet, income statement, cash flow and ledgers will be used to determine recent changes in the business, seasonal fluctuations, selling patterns and cash demands.
- Inspection reports, licenses, permits, leases, contracts, diagrams and surveys if they are available can be helpful for determining a value for the business.

Timing

The following Table³ shows the steps involved in a sale exercise and a guide to the likely timescales involved:

Stage	Months From Start
Appointment of advisors	Zero
Preparation of information memorandum	1
Agree list of potential purchasers	1
Commence marketing	2
Initial meetings with potential purchasers	3
Receive indicative offers	4
Draft Heads of Agreement	5
Completion	6 to 7

Further Information

The warning is - don't lose sight of running the business; the sale may never happen and then the same team have to keep managing it. It's important to remember that grooming a business for sale takes time, but with the right advice and assistance it's possible to maximise the sale value of your business and secure an exit route from your business in a way that suits you as regards timing and convenience. Grooming a business for sale in an over-zealous fashion will backfire, as an experienced purchaser will detect too much interference in the normal procedures of the business.

This guide is for general interest - it is always essential to take advice on specific issues. We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

References:

¹ This publication was inspired by an article written by Howard Leigh of Cavendish Corporate Finance Limited. As a point of principle, Cavendish only ever acts for vendors in the sale of their businesses. They can be contacted at 40 Portland Place, London, W1B 1NB. Tel: +44 (0) 20 7908 6000, e-mail: info@cavendish.com, web: www.cavendish.com

² Based on a Press Release dated 22nd April 2002, issued by The Business Exchange Plc.

³ According to Cavendish Corporate Finance Limited (see contact details above).

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