
# Changing Lanes

*Transition planning for entrepreneurs and family businesses*

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*with compliments from*

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## The Entrepreneur's Fantasy


Most of us have been here. Whether it was moving to a bigger house to accommodate a growing family, or downsizing because the kids have all flown the nest, selling the family home would have caused some conflict between the left brain (our logical side) and the right brain (our feeling side).

The real estate agent undoubtedly recommended a number of changes (some minor, some major) to increase interest in the property. While our left brain would have agreed that an investment of time and money prior to listing could pay dividends later, our right brain was likely somewhat indignant that prospective buyers would find our home lacking – or perhaps beyond indignant that anyone would think the house wasn't functional because it didn't have a fourth bathroom, or that people couldn't just imagine how the red dining-room might look with a different colour of paint on the walls.

Business owners who are preparing their company for sale face this same dilemma. Unfortunately, too many live in **the entrepreneur's fantasy** – I don't need to do any preparation because when I am ready to sell, the right buyer will come along with a suitcase full of cash and pay ten times what the business is worth. That's the right brain thinking – my business is just fine the way it is and the perfect buyer is out there.

Just like getting a house ready for market, there are times when we need to swallow our pride and engage in some left brain thinking. We need to look at the sale through the eyes of a buyer and then identify the steps required to make the business more attractive than the competition and ultimately a good investment for the purchaser.

This issue of Changing Lanes continues the focus on selling your business by exploring ways to attract the right buyer.

### *Inside....*



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## Who is the Right Buyer?

If your goal is to sell the business on your terms, you will first need to be very clear about your own objectives. What are the preferred outcomes from the sale? For example, is it important to you that:

- You obtain the highest price? No doubt you want to realize a substantial return on your years of investment.
- The business continues to provide ongoing employment within your community. Ask yourself if you would be content to sell to a major competitor whose sole purpose is to shut down the operation and remove the opposition.
- You make a clean break from the past with a deal that does not include an earnout or ongoing participation in the transition or growth of the firm?

By examining these and other possible outcomes, you will have a better idea of the type of purchaser you want for your business. While there will be many different motives for acquiring your business, your potential buyer will broadly-speaking fit in one of the following camps:

- The Internal Buyer who is either a member of your management team or the next generation of your family. It is someone who already has a passion for the business and sees how they can continue to run it as a viable operation that can benefit all stakeholders.
- Financial Buyers who are looking for attractive growth opportunities. They typically target those businesses that will afford them the opportunity to quickly increase the value with the goal to re-sell having realized a favourable return on their investment.
- Strategic Buyers who see a synergy that will allow them to grow market share in the same or similar industry over the long-term. This group comprises outsiders like suppliers or customers who already own complementary businesses and want to run it as a going concern, or competitors who want to gain market share and may choose to dismantle the newly-purchased operation.
- Strategic/Financial Buyers who are a hybrid of the above such as Private Equity Groups (PEGs). Similar to financial buyers, PEGs invest for higher returns and have a pre-determined exit strategy. Like strategic buyers, they tend to invest in markets where they can accelerate growth and profitability through the synergy with other entities owned by the private equity fund.

Turn to page 3 to learn more about what motivates each group of acquirers and what you can do to attract the type of buyer that meets with your objectives.

## Hour Three of the Countdown

The ideas outlined in each hour on the countdown clock are designed to help you plan ahead to ensure you have the choice to sell your business under your terms by preparing for **both** an internal sale to your family or management team, **and** an external sale to a strategic or financial buyer.

**Hour One** addressed the longer-term process for transitioning the knowledge, wisdom and decision-making to ensure you have strong leadership to succeed you. The previous edition, **Hour Two,** explored the steps to ensuring you have a clear purpose for your life following the sale of the business. This edition reviews **Hour Three**.

### Hour Three

***Purpose***

To make your business attractive to both internal buyers and external investors.

***Process***

Look at your business through the eyes of an outsider and identify all the benefits and drawbacks that might influence a buyer's decision. Implement changes that will ensure the business is sustainable over the long term and therefore a good investment for future owners.

***Payoff***

You will be confident that your business is not only ready for sale but also of interest to more of the right type of buyers.

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## What Buyers Want to Know

Inventory, equipment and other tangibles are easy to value, but the things that aren't so visible will have a bigger impact on the final price and the overall terms of the sale. The decisions you make in the years leading up to the sale can increase or decrease both the appeal and the value of your company so getting advice from experts in the area of dispositions is critical.

If you believe that companies are bought, not sold, you will definitely want to get inside a buyer's head before you list your business for sale.

The number one question from a potential buyer is whether or not the business will be profitable going forward. They want to know that there is an onging stream of both revenue and profit. You must be able to show the actual profitability and also prove that this trend can continue beyond your involvement. Here are some of the key indicators for current and ongoing profitability:

- Past history of revenue and profit growth.
- A good debt to asset ratio.
- Strong sales and a positive cash flow.
- A solid team that can run the business well without you.
- Experienced employees that are guaranteed to stay.
- An industry that is in growth rather than decline.
- Products or services that are consumable or renewable, with little likelihood of a market saturatation.
- A target market that is growing and not negatively impacted by changing demographics or a recession.
- Loyal customers that provide recurring revenue, such as those with long-term contracts.
- A growing customer base that is not overly dependent on a few major players.
- An absence of overpowering competitors.

Financial buyers will most definitely field the above left brain questions but strategic and right brain thinkers may have additional considerations. They will likely want to know:

- The reason for the sale.
- That there isn't a complicated ownership and legal structure to unwind.
- About any past or impending litigation.
- That you have clear ownership of all intellectual property.
- You have a strong culture within the organization.
- That customers and suppliers don't have any concerns.
- If there are any upcoming product or industry restrictions or regulations.

Investing the time to ensure you can meet the expectations of prospective buyers is a vital step to ensure you have a greater choice of both internal and external buyers, and at the same time maximize the value of your business.

## Deal Breakers

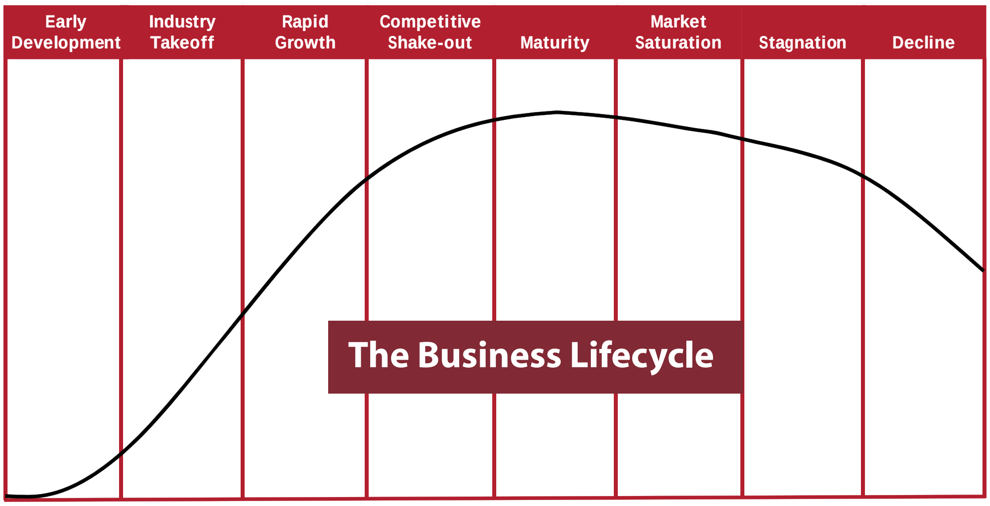
When looking at your business through the eyes of a buyer, be sure to consider all the issues that could make or break a sale. After price, here are four of the top deal breakers to be aware of. With your trusted advisor, discuss strategies to avoid these pitfalls.

1. **Where the business is in its lifecycle.** Remember that the goal for most buyers is continued profitability so they will first want to see that the business (i.e. the operation, the industry and the marketplace) is in a growth stage rather than nearing decline. See page 4 for more about your business expiry date.
2. **An asset versus a share sale.** Most likely you plan to sell the shares of your company. However, often prospective buyers will prefer to acquire your assets rather than inherit all the potential liabilities that come with a share purchase. Besides, an asset sale can often be more tax-friendly for the purchaser. Be sure to consider the pros and cons of each.
3. **The cash cow.** Many businesses have a cash cow - a dominant customer that has contributed significantly to the company's profitability over the years. The longer this cash cow is milked, the more difficult it can be to sell the business. Such a dependency is often a red flag for a potential buyer, so check your customer base years ahead of the sale.
4. **An earnout.** It is very common for buyers to reduce their risk by holding back some of the payment (sometimes a significant amount) until the vendor or business meets specific terms or financial goals. Unfortunately, many entrepreneurs have lost out because they couldn't meet the agreed terms of the earnout. Be sure you have a strategy to deal with proposed earnouts.

## Business Expiry Date

While there will always be ups and downs in every industry and in the economy in general, timing is everything when it comes to selling your business under your terms. The more time allotted to prepare the business for sale, the more opportunities there will be to optimize both the price and the terms, and ultimately achieve your goals.

Getting the best price and the right terms will depend on where the business is in its lifecycle. To quote Tom Deans, *every business has an expiry date*, so it makes sense that the business would be more attractive to a buyer if it's in a growth mode than if it's in the stagnation or decline stage.




To ensure you don't leave the decision to sell too late to capitalize on the potential buyer market, M&A advisors suggest starting three years ahead. Three years are recommended to not only determine the right time to sell, but also to implement those action items that will attract the right buyer.

You can use the three years to prepare the business for sale and enhance the growth and profitability outlook by:

- Revising the long-term vision and strategy.
- Identifying key performance indicators.
- Implementing ISO or other efficiency systems that will enhance productivity and professionalize the operation.
- Managing the intellectual capital by getting the right people on the bus and in the right seats.

> **Every business has an expiry date.**
>
> ***Thomas W. Deans***
> ***Author of Every Family's Business***

- Securing a commitment from key employees that will give potential buyers confidence that the management team is intact.
- Promoting good governance with a more formal board of directors and/or advisory boards.
- Reinventing for the future and ensuring you have a sustainable product line.
- Enhancing customer demand and diversifying your consumer base.
- Ensuring compliance with all regulations including federal, state /provincial, occupational safety, environmental, and other regulatory policies.
- Cleaning house to address all legal and financial issues such as impending litigation, outstanding shareholder agreements, and / or debt management issues.

Remember, this may be the biggest deal of your business career so be sure to invest the time to plan it well and get professional advice every step of the way.

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