THE COMPLETE GUIDE TO SELLING A BUSINESS

A ROADMAP TO THE SUCCESSFUL SALE OF YOUR BUSINESS

JACOB OROSZ
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# Table of Contents

COPYRIGHT ...................................................................................................................................................... 1

ACKNOWLEDGMENTS .......................................................................................................................................... 4

INTRODUCTION ................................................................................................................................................... 5

CHAPTER 1 – PREPARING FOR THE SALE ........................................................................................................ 10

CHAPTER 2 – VALUING YOUR BUSINESS ........................................................................................................ 35

CHAPTER 3 – FINANCING THE SALE ................................................................................................................ 50

CHAPTER 4 – FINDING AND WORKING WITH A BROKER .............................................................................. 62

CHAPTER 5 – ATTRACTING BUYERS ............................................................................................................... 71

CHAPTER 6 – SCREENING BUYERS ................................................................................................................ 96

CHAPTER 7 – MEETING WITH BUYERS .......................................................................................................... 105

CHAPTER 8 – NEGOTIATING AND ACCEPTING AN OFFER ........................................................................... 112

CHAPTER 9 – PREPARING FOR DUE DILIGENCE .......................................................................................... 121

CHAPTER 10 – CLOSING THE SALE ............................................................................................................... 125

POST-CLOSING – WHAT HAPPENS AFTER THE SALE? ............................................................................... 136

RECOMMENDED READING .......................................................................................................................... 138

CHECKLISTS .................................................................................................................................................. 140

APPENDICES .................................................................................................................................................. 141

ABOUT THE AUTHOR ..................................................................................................................................... 151

ABOUT MORGAN & WESTFIELD .................................................................................................................. 152
Acknowledgments

The purpose of this book is to equip entrepreneurs with a complete system for planning for their exit and selling their businesses. Writing a book is a team effort, and without the significant contributions from several amazing people, this book would never have come into existence.

This book is dedicated to the entrepreneurs who demonstrate the imagination, focused preparation, hard work and courage necessary to create and grow the businesses that drive our economic engine. You are a precious resource that should be recognized and rewarded.

We are grateful to all of the people who generously gave their time and provided us with information for this book, including small- and medium-sized business owners, lawyers, accountants, partners at private equity groups, industry analysts, and others with specific knowledge of issues we address.

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-Jacob Orosz
Founder and President
Morgan & Westfield
Introduction

“An entrepreneur is someone who will work 24 hours a day for themselves to avoid working one hour a day for someone else.” – Chris Guillebeau

“I’ve missed more than 9,000 shots in my career. I’ve lost almost 300 games. 26 times I’ve been trusted to take the game’s winning shot and missed. I’ve failed over and over and over again in my life and that’s why I succeed.” – Michael Jordan

“When everything seems to be going against you, remember that the airplane takes off against the wind, not with it.” – Henry Ford

“Nothing is a waste of time if you use the experience wisely.” – Auguste Rodin

Selling your business will be one of the most stressful events in your life, period. Make no mistake about it — selling a business is not an easy task. Nor can you hire an expert and expect them to handle the entire process for you without an immense amount of effort on your part. Not only is the process stressful, it is also tremendously complex and filled with potential landmines and other setbacks.

When I began helping entrepreneurs sell their businesses over 15 years ago, I scoured the market for useful information on the topic. Once I began my career, I discovered that most of this knowledge did not deal with real-world problems I encountered when helping my clients sell their business. Rather, it was theoretical knowledge or was directed at large, publicly traded companies. Many of the books available on the topic were a random collection of insights that were difficult to apply in the real world.

Whether you are searching online for general guidance or browsing books for a useful, concise description of the process, you will have a difficult time finding valuable, actionable information. There is a lot of useful theoretical information that is specifically helpful for academics; however, if you own a small business with less than $5 million in annual revenue, then most of the advice in these books will not be useful for you. Additionally, most books on the topic are written by academics, accountants, attorneys, financial planners, or business appraisers who have the knowledge, but may not necessarily have real-world experience in selling businesses.

This book offers a solution to this problem. If you are looking for clear, concrete and practical advice grounded in real-world experience, then this book is for you. This book walks you through the entire sale process and offers advice based on my 15 years of experience in helping entrepreneurs successfully sell their businesses.

How this book can help you

Selling a large, established $50-million company requires an entirely different process from selling a small business. This book is written for owners of main street businesses — these are the small businesses in America that keep our economic engine running. They are the retail businesses, dry cleaners, bars,
restaurants, auto repair shops, construction businesses, senior care companies, franchised businesses, small online companies, wholesale or distribution businesses, manufacturers, small professional practices, medical practices, and other small businesses with fewer than 50 employees.

Through my years of experience exclusively devoted to helping people buy and sell businesses, I realized that most business owners do not want answers to technical questions. For example, most business owners do not want to read lengthy articles on how to allocate the purchase price between the various assets. Rather, they want straightforward answers to such basic questions as:

- Should I take my business off the market when I accept an offer?
- What should I do if the buyer says they have an investor and they won’t let me talk to the investor to verify whether they are financially qualified?
- What should I do if the buyer refuses to sign a non-disclosure agreement?
- How long will it take to sell my business?
- Should I tell my employees I am considering selling my business?
- Do I need to prepare my business for sale, or can I put it on the market now without preparation?
- What documents do I need to prepare before I put my business on the market?
- Can I sell a portion of my company?
- Do I need a business appraisal?
- How do I price my business?
- Should I finance a portion of the price?
- Can the buyer get a bank loan to buy my business?
- Do I need to hire a business broker?
- How do I find and hire a broker?
- What should I look for when signing a listing agreement with a broker?
- How do I find buyers?
- How do I quickly and easily screen potential buyers?
- How do I handle the initial meeting with the buyer?
- What is the difference between an offer and a letter of intent?
- How can I prepare for due diligence?
- Do I need to hire an attorney for the closing?
- What is escrow?
- Do I need an escrow agent to handle the closing?

On this book, I offer pragmatic advice that even the busiest of entrepreneurs can apply in their hectic lives.

*Why I updated ‘How to Sell a Business’ and what you can expect from ‘The Complete Guide to Selling a Business’*
Five years ago, I wrote a short book titled ‘How to Sell a Business.’ Frankly, I was shocked at how many calls and emails I received from small-business owners telling me how helpful the book was for them. Despite the short length of the book, many said it was the most useful book they had read on the subject. They said it offered real-world advice and was easy to follow and execute.

I have dramatically improved this book over the past five years. The result is a book that is jam-packed with advice based on real-world experiences in successfully helping our clients sell hundreds of businesses. I have added the following highly useful content to this edition:

- **The value of preparation** - Many business owners don’t have the time to prepare their business for sale. Can you skip this step?

- **How to increase the value of your business by making yourself replaceable** - Most small business owners are critical to the operation of their business. What effect does this have on the value and salability of the business?

- **Statistics on how long it takes to sell a business** - It is critical that you have realistic expectations before committing to this process. This section describes in detail the factors that influence the timeframe and also includes statistics from our analysis of more than 10,000 transactions regarding how long it takes to sell a business.

- **Can I sell a portion of my business?** This is a common question we receive at our company. If you are considering selling a portion of your company, you should explore up front if this is a viable option before you invest the time.

- **Do I need a business valuation?** Before you spend thousands of dollars on a business appraisal, you should decide whether an appraisal is even necessary.

- **Can you give me a quick opinion of value?** What is involved in receiving a quick opinion of value from a broker, and how accurate is this opinion?

- **Are free valuations too expensive?** Many business brokers offer free valuations. Is this a viable option, and why is this service being offered for free?

- **Additional tips on seller financing** - Over 90% of small businesses that sell include some form of seller financing. This part educates you on the basics of seller financing and offers useful insights for deciding if you should consider carrying a note.

- **Accessing the buyer’s retirement funds to sell your business** - This is a hidden secret for buyers to finance the sale. Accessing this resource can enable you to get a deal done that otherwise may be impossible to close.

- **Types of listing agreements** - Educate yourself before committing to a broker. This chapter educates you on the essentials of listing agreements and allows you to intelligently decide how to properly structure an agreement with a business broker.

- **Is it possible to sell a business without a broker?** Many business owners prefer to avoid brokers. When is hiring a broker necessary, and when can you get by without one?
• **Attracting buyers - fishing vs. hunting** - This chapter explains how small and big businesses are sold and offers advice on what methods to use to sell your company.

• **How long do buyers stay in the market?** This section helps you discern how serious a buyer may be and how to quickly assess how motivated they are to buy a business.

• **The importance of persistence when selling a business** - The one common ingredient that all of our clients possess is persistence. What role does this play in the process?

• **The purpose of due diligence** - Many business owners allow buyers to perform due diligence before they accept an offer. This chapter helps you fend off requests from buyers and advises you how to encourage a buyer to make an offer before beginning due diligence.

• **Qualifying the buyer before accepting an offer** - Ensuring the buyer is qualified is paramount to the process. Mess this step up and you can waste months.

• **Tips on accepting an earnest money deposit** - Never accept an offer without an earnest money deposit. We explain when and how to accept a good faith deposit.

• **Using legal templates** - Should you download templates online, or should you pay your attorney to draft the documents that are needed?

• **Advice on the closing process** - Properly coordinating the closing is a complicated endeavor. We break the process down into its component parts and offer advice for ensuring a smooth transaction.

• **Overview of a definitive purchase agreement** - We thoroughly educate you on the essentials of the definitive agreement you will sign at closing.

• **A detailed explanation of the benefits of escrow** - What is escrow? Is it necessary? This section explains the role of escrow and when it may be necessary.

• **Tips for after the sale** - The transition process is critical and is the most underlooked step. We offer frank advice on how to manage transitioning out of your business and moving onto the next phase in your life.

This book offers simple, actionable information you can take to sell your business. Whether you are considering the sale of your business now or in the future, this book will provide tremendous benefit to you.

The past 10 years of my life have been exclusively devoted to streamlining and simplifying the process of selling a business. I have created a simple framework for selling a business that enables even the busiest entrepreneurs to accomplish this seemingly overwhelming task.

If you approach the process of selling a business as a series of distinct steps and break the sale down into concrete, manageable tasks, then the sale can be executed more easily. That is exactly the goal of this book.

The sale of your business will be one of the largest transactions of your life. We hope this book makes this transaction a successful one!

**Jacob Orosz**
"Twenty years from now, you will be more disappointed by the things that you didn't do than by the ones you did do, so throw off the bowlines, sail away from safe harbor, catch the trade winds in your sails. Explore, Dream, Discover.” - Mark Twain

Good judgment comes from experience. Experience comes from bad judgment. – Jim Horning
Chapter 1 – Preparing for the Sale

Congratulations on the decision to sell your business. As in any complex multi-step process, you should begin the process with preparation. Some business owners do not have the time or patience to adequately prepare their business for sale, yet despite a lack of preparation, they still successfully manage to sell their business.

If you have the time, patience and dedication to prepare your business and you do not need to sell right now, then jump right into this chapter. If, on the other hand, the sale of your business is urgent, then you may simply preview this chapter and take note of any quick fixes you can make while your business is on the market. We highly recommend, however, that you fully prepare for the sale to both maximize the value of your business and increase the chances of a successful sale.

Part 1: Preparation vs. Execution

How important is preparation?

In 1997, a famous bank robbery in North Hollywood, California, forever changed the history of law enforcement in the U.S. The 44-minute North Hollywood shootout, as it is popularly known, left the two perpetrators and 11 police officers dead and wounded six innocent bystanders.

This incident, in which the perpetrators outgunned police officers, prompted the Los Angeles Police Department (LAPD) and other cities to upgrade their police armament, enact their own gun control measures, and change their tactics in dealing with similar incidents. This shootout unfolded on national television, so the entire country witnessed how prepared the two armor-clad perpetrators with assault rifles (two Norinco Type 56S, Norinco Type 56S-1, HK91, Bushmaster XM-15 E2S Dissipator, Beretta 92) were compared with the police officers who were equipped only with 9mm pistols and 12-gauge shotguns.

The popular shootout demonstrated the value of preparation. The two robbers’ preparation, which took months to complete, was highly documented by the media. With preparation, the two robbers easily outgunned police officers and the SWAT team. While we don’t recommend showing up to meetings in body armor and armed with AK-47s, we do recommend preparing for what will be one of your life’s most important transactions.

In selling your business, which is more important — preparation or execution?

As with most things in life, preparation makes execution look effortless. Meticulous preparation can remedy mediocre execution; however, impeccable execution can never conceal imperfect preparation. Considering that the sale of your business will be the largest sale you will ever make in business, it is foolish to neglect preparation.
Unfortunately, only a few business owners plan their exits by giving this major life decision the thought and attention it deserves. Why? The lion’s share of entrepreneurs has a strong bias toward action. Once they have decided on a course of action, they prefer to dive right in and figure things out later.

You must realize, however, that a lack of preparation will extend the time frame of the sale, reduce the cash you put in your pocket, and lower the chances of a successful sale.

What can you do to prepare yourself and your company for sale?

- Document and protect your intellectual property.
- Inform your key employees in advance and incentivize them for deciding to stay with the new owner.
- Perform pre-sale due diligence. This is similar to the due diligence a buyer will perform on your company and helps you anticipate and solve problems before beginning the process of selling your business. This is primarily financial, but you can also perform legal and operational due diligence.
- Meet with your tax advisor to discuss and analyze the tax implications of the sale.
- Explore all your available exit options. Should you sell your business to an employee, to a family member, to a competitor, to an individual or to a private equity group?
- Build a management team. This is not always possible for small businesses; however, doing so will greatly increase the value of your business.
- Document your operations. This is difficult for small business owners. We recommend building a management team first to assist you with this.

Every exit is different. No two are alike. Each exit must be planned. There is no templated process you can follow to prepare your business for sale. Rather, the preparation stage involves reviewing a number of steps, prioritizing those steps, and then taking action on those steps.

**The bottom line**

Regardless of your position, reach out to a business broker or M&A advisor as soon as possible, and be frank with them regarding how much time you can spend preparing your business for sale.

If you are willing to prepare, be sure the brokerage firm also assists in preparing business owners for the sale, which is formally known as “exit planning.” Many business brokers, M&A advisors and investment banking firms are heavily biased toward action. They prefer to put a company on the market and sell it as quickly as possible. They may not be as concerned with maximizing the sales price and investing the hard work necessary to ensure a successful exit.

If you are not willing to spend time preparing your business for sale, then be honest with your professional advisors and your broker. We are accustomed to selling businesses in an urgent situation or one in which the
situation is far from ideal, so we welcome a business owner who is honest with us regarding how much time they can invest in preparing their business for sale.

The important thing is to be honest regarding your expectations, the condition of your business, and your level of preparation. Your team will eventually learn the truth, so it is best to be honest and upfront to maintain a relationship based on trust throughout the process. Remember, this may be the largest transaction in your life, and maintaining trust with your advisors is key to ensuring this transaction is a successful one.

**Part 2: Make Millions by Making Yourself Replaceable**

If you own a business, don't make it difficult for a successor to replace you. The more valuable you are to the business, the less valuable your business will be.

The ideal situation is one in which you are 100% replaceable. Unfortunately, many business owners try to make themselves irreplaceable. But remember that making yourself irreplaceable not only decreases the value of your business but also makes it much more difficult to find a buyer for your business when it comes time to sell your company.

For example, Michael Jordan is difficult to replace. The maestro of The Cleveland Orchestra, on the other hand, is equally valuable, but replacing the maestro would not be as difficult as replacing Michael Jordan. There is only one Michael Jordan; however, there is more than one human on the planet who can play the role of the maestro in an orchestra.

The easiest businesses to sell have a wide universe of target buyers, can be relocated anywhere in the U.S., and do not require its operator to have highly specialized skill sets.

Imagine you are selling your business, and the buyer must have highly specialized or unique skills to operate your business. Imagine further that only one in 1,000 has this unique combination of skills, abilities and talents. How hard do you think it would be to find and persuade this person to buy your business?

If the skills needed to operate your business are not easily found in groups of people who can be readily identified and targeted, selling your business will be harder. If running your business requires a rare blend of soft skills or personal attributes, finding a buyer will be more challenging. Hard skills are simpler to target because most of the groups of people who possess these skills have already been corralled in some form — for example, engineers would be easy to target through trade publications.

For this reason, absentee-owned businesses are worth much more than an owner-operated business. Most absentee-owned businesses are successfully run by a team of core employees or a management team, and assuming the employees will stay after the sale, then nearly anyone is qualified to purchase the business from an operational standpoint.

You may realize that you want to keep your business once you streamline the operations. Don’t worry about that for now. Focus on streamlining your business. You can always decide later if you wish to keep your company.
**Important note:** Streamlining your business is not a weekend job. Doing this properly may take you several years; however, once you’ve implemented these steps, your skills as an entrepreneur and manager will increase, and your business will be much more valuable as a result. As you streamline your business and make yourself replaceable, you will build a business that is inherently more scalable. This scalability will lay the groundwork for you to continue increasing the value of your business or will make your business much easier to sell.

However, before streamlining your business, you need to satisfy these two prerequisites:

**Prerequisite 1 – Recognize the importance of marketing in scaling your business**

Unfortunately, we run into a lot of business owners who have spent years streamlining their business while neglecting spending time marketing their business to improve its value. As a result of a lack of investment in the marketing functions in the business, they lack the revenue to pay competent employees to help them with the streamlining processes.

By focusing on marketing and growing your company, you will help grow revenues, which will afford you the opportunity to hire a team to help you with the other tasks involved in scaling your business. Marketing your business properly, like running other functions in your business such as HR or finance, requires building systems.

**Prerequisite 2 - Learn to manage yourself before managing others**

One cannot manage others without learning to manage oneself. Managing yourself requires five things:

1. Learning new skills and improving existing skill sets (e.g., management, time management, sales, marketing, hiring, etc.)
2. Setting clear goals based on a sound strategy and then consistently staying focused on those goals
3. Time management skills
4. Energy management skills
5. Setting priorities based on the big picture

Goal setting, time management and energy management skills can be learned just like any other skill. Fortunately, learning is also a skill that can be developed. Learning is the master skill that allows you to master all other skills. The essence of gaining knowledge is to use it. The goal is to learn and create change in your life. Becoming an excellent learner allows you to learn goal setting as well as time and energy management more quickly.

**How to streamline your business: build, document and automate**

To streamline your business, you have to:
1. Build a strong team of core employees or management team. For recommendations on building a strong team, please see our list of recommended readings, specifically the book ‘Scaling Up’ and ‘Carrots and Sticks Don’t Work’.

2. Build systems into your business and document your operations.

3. Automate processes in your business using technology or other systems.

These methods of streamlining your business involve using either human talent or technology. However, don’t make the mistake of trying to rely solely on either people or technology. Most businesses must use both.

**Option 1 – Build a strong team of core employees or a management team**

Streamlining a business, whether through technology or people, takes an enormous amount of time. Some entrepreneurs are not good managers and are not able to successfully do this. That is why their companies never grow from a small company to a mid-sized business and beyond. Management is a skill that is difficult to learn, but again, if you are a proficient learner, you can improve your skills in less than one year of intense and focused practice.

If you can build a strong team, they can help you build systems and automate processes in your business. Remember that building a management team or a team of core employees starts with hiring the right people and learning how to manage yourself first.

**Option 2 – Build systems and document operations**

Building systems — processes, procedures and policies within your company — and documenting operations are almost impossible to do solo and are much easier to do with the help of a team. Involve your team in building systems and documenting the processes in your business. Be sure to hire employees who are willing to help you build systems (see “Carrots & Sticks Don’t Work” and “How to Hire A-Players” on the Recommended Readings section).

A lot of employees are reluctant to build systems because they do not want to make themselves replaceable. Yes, employees can be as guilty as you in trying to make themselves irreplaceable — if you allow them to. Ironically, an employee who can build systems is *irreplaceable*, and a rare employee at that. It is important to make your employees understand the irony in the link between building systems or documenting processes and being irreplaceable, i.e., that their initiatives in helping you build systems will, in fact, make them more valuable to the business.

Run a lean business (see “Running Lean” on the Recommended Readings section), iterate fast, hire a strong first team, build and improve systems over time, and have your team help you document your operations.

**Option 3 – Automate processes using technology or other systems**
Have your management team or team of core employees do this for you. They should understand that their job is not to work in the business as ‘technicians,’ but rather on the business as ‘entrepreneurs,’ as what Michael Gerber explained in his book, “The E-Myth.”

Part 3: How Long Does It Take to Sell a Business?

One of the most frequently asked questions we receive is, “How long will it take to sell my business?” You should consider this critical question when planning to sell your business as many factors affect the time frame.

Business sales represent a bell curve, which indicates a normal distribution depicted in a bell-shaped line, with most sales — or the peak — taking between three months and one year. In a good market with a business priced fairly and without major roadblocks, you should be able to sell your business in an average of 6 to 12 months.

Unfortunately, the bulk of business sales experience at least one major roadblock in the process. If you assume this is going to be the case, then deal with it before it arises, and you'll do fine.

An in-depth understanding of the factors that have an impact on how long it takes to sell a business will help you plan your exit more intelligently. Depending on whom you ask, you will be given a variety of answers. For instance, your accountant, who may have their own financial interests in mind, may suggest it will take a long time, while a business broker, who wants you to sell, may say that it will not take much time at all.

There are, however, a number of variables that affect how long it will take you to sell your business. I've discussed here the most salient variables along with recommendations regarding how to speed up the process.

Statistics on How Long It Takes to Sell a Business

BIZCOMPS — BIZCOMPS is a database of business-for-sale transactions. The database includes information from more than 13,000 transactions dating back to 1996. Most transactions in BIZCOMPS are smaller businesses priced at less than $1 million, and almost all transactions were completed with the assistance of professional advisors, primarily business brokers. Based on the BIZCOMPS database, several factors account for the length of time a business stays on the market.

Data from BIZCOMPS suggest that for all transactions from 2000 to 2014, the average time that businesses were on the market was 200 days or approximately 6 to 7 months (see Chart 1).
According to BIZCOMPS data, the average time to sell a business from 2002 to 2012 has increased from 6.1 months to 10.8 months (see Chart 2.1). Although businesses have been sold more quickly in 2013 than in 2012, the uptrend during the previous 10 years — from 2002 to 2012 — shows how selling a business has taken longer through the years.

**Chart 2.1. Average Number of Months to Sell a Business by Year - BIZCOMPS**
These results tend to support the Business Brokerage Press survey indicating that businesses were sold at an average of 6 to 11 months. The said survey asked business brokers, middle-market intermediaries and other advisors, “How many months is the average period between listing and sale?”

BusinessForSale.com, however, found out in another similar survey that businesses took around 9 to 12 months to sell from the time they were listed on the market (see Chart 2.2). Only about 18% reported that selling a business took six months or less. Note that BusinessForSale.com primarily operates in Europe, and this can skew statistics for companies operating in the United States. Nonetheless, they also generate significant activity in the U.S.

**Chart 2.2. Average Number of Months to Sell a Business - BusinessForSale.com**

Part 4: Factors that Influence the Time it Takes to Sell a Business

Before exploring the industry factors that have come into play and increased the time it takes to sell a business, let’s consider how financial variables, including the selling price, the asking price and the financing, can impact the length of time a business stays on the market. These variables are significant, as they often compound the problems the industry is facing.

**Financial Variables**

Based on the BIZCOMPS data, selling price and region have the biggest impact on the time it takes for a business to sell (see Chart 3). Other financial variables that can affect the length of time a business stays on the market include the industry, financing and down payment, multiples of seller’s discretionary earnings or SDE, and the difference between the asking and selling prices. Whether the business is a franchise or an independent business also has an impact on the time it takes to sell a company.
Let us discuss each of these variables in detail.

**Variable 1 - Selling price**

Selling price is the final offer that a seller accepts, which is often different from what a seller initially asks for the business. Based on BIZCOMPS data, larger businesses take longer to sell. While many brokers agree that smaller businesses sell more quickly than larger businesses, this remains a point of debate for most business brokers and deal-makers.

Smaller businesses used to sell more quickly in the past, but that trend has been reversing. Since the 2008-2009 period, the market has had an excess of smaller, unprofitable businesses. Until these businesses are sold off, it will take longer to sell smaller businesses, especially if they are unprofitable.

**Variable 2 – The difference in percentage between the asking price and the selling price**

The more reasonable the initial asking price is — i.e., the smaller the gap between the asking and the selling price — the more quickly the business should sell. Businesses priced at over 76% of the ultimate selling price take 40% longer to sell than businesses that sell at the asking price, according to BIZCOMPS data.
Variable 3 - Multiple of the seller's discretionary earnings (SDE)

This variable is an indication of how reasonably priced the business is. For example, a business with an SDE of $100,000 that ultimately sells for $200,000 has a multiple of 2.0.

This data (see Chart 4) can be misleading, as a direct correlation between the multiple at which a business is sold and the attractiveness of the business may not exist. However, an indirect correlation may exist. For example, businesses sold at less than 1.0 multiple may be highly unattractive and may take longer to sell, while businesses sold at a high multiple may represent more attractive businesses, such as manufacturing or technology companies.

Multiples may also be highly skewed for lower-priced businesses. For example, a business with an SDE of only $20,000 that sells for $80,000 can distort the data. Also, bear in mind that this data only uses the selling price and does not consider the initial asking price. Despite these challenges, we chose to analyze the data to examine the correlation, whether it be direct or indirect.

**Chart 4. Average Number of Months to Sell a Business Based on the Multiple of the SDE - BIZCOMPS**

The correlation between multiples and the number of days the businesses were on the market is small. There is also no indication whether the correlation is direct or indirect.
Variable 4 - Franchise

BIZCOMPS data suggest that non-franchised or independent businesses took an average of 226 days to sell, and franchised businesses were sold more quickly, at an average of 216 days.

Franchised businesses sell, on average, 4% faster than non-franchised businesses. Although our experience in selling independent businesses and franchises confirms this is true, it is hard to be certain what causes this difference. Reasons could be the increased attractiveness of a franchised business, the increased support for selling a business within a franchise network, the fact that information is organized better in franchises, or any number of other reasons.

Variable 5 - Region

Businesses for sale in areas with high population growth tend to sell faster, according to BIZCOMPS data.

For instance, selling a business in Orange County, California took 211 days, which was 16% faster than in Iowa where businesses were sold at around 252 days. Many people who are looking to buy a business will consider relocating. In fact, a substantial portion of businesses sold in the Southwest and Southeast are sold to people who are moving to the area. The fact that people are willing to relocate opens up a large number of potential buyers looking to buy your business, which effectively speeds up the selling process. Having more buyers means the business will be easier to sell and will often sell faster.

Variable 6 - Financing and down payment

It is a long-held belief by virtually all business brokers that a business is easier to sell when the owner is willing to finance a portion of the sale. The statistics on chart 5 include transactions in which bank financing was involved. Most deals on BIZCOMPS with 20% to 30% down payment likely involved some form of bank financing, which can cause statistical errors, as deals involving bank financing take an extra 30 to 90 days to close. Also, all-cash deals are generally quicker to close and often represent lower-priced businesses in which due diligence is expedited.
The more financing the seller offers, the quicker the business should sell. Most probably, the deals in the database with a down payment of less than 30% involved bank financing, which lengthened the amount of time to close the transaction.

*Variable 7 - Industry correlation*

Only a small correlation exists between the industry type and the number of days a business is on the market (see Chart 6). However, much of this data seem to defy conventional business broker wisdom.
Most brokers believe construction-related businesses are difficult to sell, and the data supports this long-held belief. However, most business brokers believe manufacturing-related businesses are easier to sell, and the data does not support this belief.

Limitations of the surveys

The industry of selling businesses is a highly inefficient market with limited resources, especially for those selling smaller businesses. Almost no surveys are validated, and most producers of surveys lure participants with free results if they complete the survey. This type of incentive can result in inaccurate data.

Just like any other studies, these surveys have their own limitations, so it is important to maintain a balanced viewpoint. An average is just an average. The actual time period can vary from one day to over three years.

Conclusion

Most of the factors that increase the value of a business will also have a direct positive correlation on the amount of time it takes to sell the business. Industry type, geographic area, reasonable asking price, seller financing offered, and a reasonable valuation based on a multiple of the seller’s discretionary earnings are the factors that will increase the value of a business and, statistically, increase the speed at which a business is sold.
**Process of Selling a Business**

The following are the steps, along with brief descriptions, involved in selling a business:

**Preparation** – Less than 1 month

Preparation is often a controlled and predictable step. When interviewing brokers, ask them how much time it takes to prepare your business for sale. Many need two to three months to put a business on the market.

*What this step involves:* valuation, writing a business summary and creating other key documents

*Time frame:* Ideally less than one month; some need up to eight weeks

*Biggest bottleneck:* receiving financial statements from sellers

In our company, we can prepare all documents and have a business on the market in one to two weeks once we receive the needed information from the seller.

**Advertising the business for sale** – 1 to 12 months

*What this step involves:* advertising and marketing the business for sale; meeting with buyers

*Time frame:* Not definite; can vary from 1 to 12 months

*Biggest bottleneck:* long ‘waiting time’

This time period is often frustrating for the seller who may feel like nothing is happening. However, it is important that the seller remains focused on the business and maintains consistent revenues or growth.

**Negotiation, due diligence and closing** – 1 to 3 months

*What this step involves:* negotiating, doing due diligence and closing a deal

*Time frame:* one month for each of the three stages involved

*Biggest bottleneck:* delay in due diligence

What causes a delay in the due diligence process?

- Slow process in obtaining bank financing
- Inaccurate financial information
- Delays from third-party transactions handled by attorneys, accountants, franchisors and banks
- Delay in license transfer approvals

These are rough estimates only, and you should be prepared for the transaction to take significantly longer.
Industry Factors

General factors that affect how long it takes to sell a business change over the years. However, we believe the following factors have had the most significant impact on lengthening the time it has taken to sell a business in the previous 10 years.

The Internet

The internet has provided more options for buyers of goods and services. Before the internet became popular, most businesses had been sold through newspapers. This type of selling created a highly inefficient market, and comparing options was more difficult for a buyer. Ironically, businesses then were easier to sell and often sold more quickly probably due to a lack of qualified alternatives and businesses for sale.

Information

The internet has also provided a wealth of information on buying or selling a business. As a result, a modern-day buyer is more educated and is often considering more options.

More businesses for sale

Since 2008, the number of businesses for sale has steadily increased. This increase has resulted in a larger number of options for buyers and depressed prices with the possibility of a protracted sale.

Demand or level of interest

Google Trends recorded in February 2017 the highest interest level in the search phrase, 'buy a business' in the U.S. in the last 12 years — from Jan 2005 to April 2017. The lowest level of interest during the same period was observed on February 2006 (see Chart 7). The dips in the interest level as seen on chart 7 could have had an impact on the length of time businesses were sold.

Chart 7. Search Volume for the phrase, “Buy a Business”

![Chart 7](image_url)

Source: Google Trends (Interest Over Time in the U.S.)
Economic factors

Economic factors have also adversely affected the rate at which small businesses sell. The primary factor that has slowed the speed at which small businesses are bought and sold is the overall confidence in the economy. Many economic factors affect small business sales, such as unemployment and interest rates.

In 2008 and 2009, small-business optimism was at an all-time low. The situation has since improved, and by March 2017, small-business optimism was recorded at “one of its highest readings in 43 years” (see Chart 8).

Chart 8. Small-Business Optimism Hits All-Time Low in 2009, Now at One of Its Highest Readings in 43 Years

Source: National Federation of Independent Business, National Bureau of Economic Research

As more people leave the workforce (see Chart 9) — many of them are retirees — more buyers are theoretically available to purchase businesses. Many believe a correlation exists between the unemployment rate and small business sales.
Brokers Can Help and Hurt You When Selling Your Business

**Why do business brokers often require a 12-month exclusive contract?** The listing contract length often coincides with the average length of time it takes to sell a business. Half a century ago, listing contracts were 30 to 60 days in length, and businesses were often sold within that time period. The time it takes to sell a business has increased steadily over the past 50 years, along with the exclusivity period that most brokers require. Most business brokers invest a substantial amount of time when initially placing the business on the market, and absent a retainer fee, a contractual commitment ensures the broker that they will have the exclusive opportunity to recapture their initial investment of time and money.

When talking with a broker who works on a commission basis and who also requires an exclusive contract, a natural conflict of interest exists. The broker may be tempted to tell you to sell your business for a lower price than what your business is actually worth to facilitate a quicker sale. They may also be unrealistic with you regarding how long your business may take to sell.

**Summary - What Can I Do?**

You can take specific actions to ensure your business sells as fast as possible:

**Valuation** – If you are serious about selling your business, then we recommend obtaining either an opinion of value or a formal business valuation.

**Exit strategy** – Planning the sale of your business is critical.

**Keep your business on the market** – Keep advertising your business, even if you have an offer. Don’t take your business off the market until you have a signed definitive purchase agreement and a nonrefundable earnest money deposit.
Financing – Either preapprove your business for bank financing or offer seller financing. Our exit strategy includes a list of financing options for your business, along with specific suggestions.

Reasonable price – Set a realistic asking price for your business based on the valuation. Do not set a higher price in hopes of getting lucky. Doing so may preclude many buyers from ever looking at your business.

Prepare for due diligence – Prepare for due diligence by organizing a list of documents most buyers will request. Doing so speeds up the sale process and increases the chance of a successful sale. Our custom exit strategy includes a list of dozens of documents and a timeline of when a buyer is likely to request them.

The business of selling businesses is a highly inefficient market. Data regarding business sales are sparse and often inaccurate. However, with our suggestions, you will not only accelerate the process but also raise the chance of a successful sale.

Prepare Your Financial Statements

You have invested many years in starting, running and operating your business. To maximize the value of your company, you must position it in the best light. One of the most important things you can do to maximize the value of your company is to organize and reconstruct your financial statements.

Nearly every buyer will ask to see your financial statements at some point during the process of examining your business. This typically happens early on, so be prepared.

How do your financial statements look? Are they straightforward, accurate and easy to understand? If you’re like most business owners, you probably haven’t prepared your financial statements with the goal of selling your business.

A price must be established for your business before we begin the sale process, and financial statements are the basis of all business valuations. But if you’re like most business owners, you’ve operated your business in a way that’s designed to minimize taxes. You may have given yourself and family members as many perks and benefits as possible, kept offspring on the payroll, and written off other expenses through your business, which result in decreased earnings, and therefore a lower value for your business. These and other common practices are designed to keep your profits and your taxes low, perhaps artificially so.

To properly value your business, these financial statements must be “normalized,” or “adjusted.” Financial statement normalization involves making numerous adjustments to your financial statements so the true earning capacity of your business can be identified. Common expenses that could be eliminated include the following:

- Your salary and perks
- Family members’ salaries and perks
- Expenses or income that would not be expected to recur or continue after the sale
- Personal expenses such as personal auto, insurance, cellphone, child care, medical, travel expenses
- Depreciation
- Amortization
• Investment or other non-operating expenses or income
• Interest payments on any business loans
• Other one-time or non-recurring expenses

Removing owner-specific perks, benefits and expenses will make your company look as profitable as possible. Adjusting your financial statements is necessary to show potential owners the actual cash flow available to them if they buy your business.

It also allows you to compare your business with other businesses using common financial metrics, such as seller’s discretionary earnings (SDE) or earnings before interest, tax, depreciation and amortization (EBITDA). SDE is the most common metric used by buyers, business brokers and many other professionals for valuing companies with annual revenue of less than $5 million. EBITDA is the most common metric used for valuing businesses with more than $5 million in annual revenue.

Many business owners’ financial statements are inaccurate, full of contradictions, incomplete and, most importantly, are not designed to help sell a business. Most financial statements don’t show the real profits of a business and don’t include unreported income or unrelated expenses; all of which lower its value.

What can you do about it?

The first step in preparing your business for sale is normalizing or adjusting your financial statements. This involves adjusting them as if you had originally prepared them for the sole purpose of selling your business.

Most business owners deduct excessive, unnecessary expenses when they operate a business, which, unfortunately, lowers the net income on financial statements. Doing this also lowers the value of your business. Many of these expenses are personal in nature. Normalizing your financial statements involves removing these expenses to increase the value of your business.

In addition, many business owners don’t report all their income. While you may be reluctant to make this type of adjustment in writing, there are specific strategies for dealing with unreported income, which we’ll discuss more in depth later in this book.

What do we mean by financial statements?

Financial statements refer to your balance sheets and income statements or your profit & loss (P&L) statements, which show the income, expenses and net profit of your business. Most small business owners do not prepare a cash flow statement so we will not cover that here.
The process involves the following steps:

**Step 1** - Enter your financial statements from the past three years into a spreadsheet, such as Excel.

**Step 2** - Be sure your financial spreadsheet has three columns: original, adjustments and adjusted.

**Step 3** - Make the necessary adjustments to your financial statements.

Here are examples of adjustments that can be made to your financial statements:

- **Depreciation** - A non-cash expense that should be added back.
- **Interest** - If the buyer is not assuming your debt or loans, you should add back this expense.
- **Owner’s salary** - If you are drawing a salary from the business, add this back too. This ultimately goes into your pocket anyway, so you should add this back.
- **Amortization** – Just like depreciation, amortization is a non-cash expense, although this is for intangible assets. Add this back as well.
- **Taxes** - You can add income taxes back if they appear on your financial statements.
- **Non-recurring or one-time expenses** - These may include investments in new equipment, development of a new website, non-business-related attorney fees, or any other unusual or one-time expenses.

The result is an Excel spreadsheet that shows the original financial statements along with the adjustments and the adjusted figures. Instead of net profit, you will now have a figure called adjusted net or discretionary earnings.

For an example of an adjusted financial statement along with a template for normalizing your financials, please visit the resources section on our website and click on “Forms” at [www.morganandwestfield.com](http://www.morganandwestfield.com).

**What should I do if I have a cash business with unreported income?**

If this is the case, you have a few options. This can be sticky, but hang in there, we get these deals done all the time.

Only give the buyer verbal information and offer the buyer an observation period during which they can observe the business and determine the cash flow for themselves. This is practical for retail businesses with consistent cash flow, such as liquor stores or restaurants.

Give the buyer a projection or pro forma financial statement. If you do this, be careful. State clearly at the bottom of the document that the financial details are an estimate and that the buyer should not base their decision to buy your business on the document. Most sellers prepare a projection that depicts the actual situation and clearly mark the document as a “projection” to limit their liability.

Again, if the financials are not accurate, tell the buyer upfront that they can spend time in the business to gain a full understanding of how the business operates financially.
What kind of financial information do buyers ask for?

Buyers typically ask for two to three years of P&L statements indicating your income and expenses. Some buyers also ask for balance sheets. Most buyers will request to see these documents before making an offer. Experienced buyers want to know how the business is currently doing and ask for a year-to-date P&L statement, as well.

Should I just give the buyer the raw financial statements?

Never.

You should reconstruct the financial statements to accurately reflect the true profitability of your business. If you are like most business owners in the U.S., you hate paying income taxes. Very often, business owners write off expenses, such as their cellphone, gas for their car, vacations, which they think might be legitimate expenses deductible by the business. Because of their personal nature, these items should be adjusted (i.e., removed) from your P&L.

Recasting or normalizing your financial statements is simple in theory; however, it requires some experience and knowledge if you want to get it right.

What backup material should I prepare in addition to my financial statements?

Most buyers will ask to see bank statements in addition to your financial statements. The bank statements should match your financial statements. Some buyers hire an accountant or a certified public accountant (CPA) to perform the financial due diligence. You can be sure that the accountant will reconcile the financial statements with the bank statements, and possibly, your business’s invoices or receipts.

If you are serious about selling, then we recommend organizing your business’s financial backup data for the past two to three years. Organizing the data by month is best. Assemble the bank statements, invoices, receipts, etc. for every month either in a hard folder or in an organized folder on your computer. You should also document any add-backs or adjustments to the financial statements. For example, if you added back $1,500 from the telephone line expense on the P&L statement, then you should organize documents to back up these claims.

Prepare Key Documents

Below is a list of additional documents you should organize before putting your business on the market.

Lease agreement - Find your lease agreement. Many buyers ask specific questions regarding the terms indicated in the lease agreement. Prepare to answer the buyers’ questions by reading this document. You should have answers to the following questions:

- Is the lease assignable?
- Are you a personal guarantor on the lease, and if so, are you willing to remain as guarantor after the business is sold?
• What is the start date of your lease?
• What is the expiration date of your lease?
• Do you have options to renew?
• Are the renewal options automatically transferred with the lease? Be careful with this one — renewal options don’t always transfer when the lease is assigned.
• What is the base rent?
• Does the base rent include maintenance, insurance and property taxes, or are these in addition to the base rent?
• Does the base rent increase annually? If so, by exactly how much?
• How much are the triple net charges? Are they included in the rent or in addition to the rent?
• What are permitted uses?
• Many buyers want to offer a new product or service. Is this allowed in the lease?
• How much is the assignment fee?
• What are the minimum requirements for a new buyer to be approved by the landlord?

Equipment list - If equipment is important to your business, prepare a detailed list of equipment included in the sale. The list should include the major pieces of equipment you use in your business. Titled equipment, such as vehicles, should include serial numbers or other identification numbers. We caution you against including the value of each specific piece of equipment, as doing so can later be used against you in litigation or for tax matters. Providing specific values also limits your tax planning and can increase the amount of taxes you may have to pay on the sale.

Seller’s disclosure statement - The main reason buyers don’t buy a business is their fear of the unknown. This document discloses any potential issues with the business upfront and helps calm a buyer’s anxieties.

To see a sample equipment list or seller’s disclosure statement, please visit the resources section on our website at www.morganandwestfield.com.

Part 5: Can I Sell a Portion of My Business?

Unlike what most people believe, selling a business is not always an all-or-nothing situation.

While deciding upon the sale of your company, selling only a portion of your business may cross your mind. You may have questions about the process, such as: Is it wise or is it common to sell only a part of a business?

Below we’ll explore the decisions you will have to make when planning to sell your company, including whether selling only a portion of your business is a wise decision.

Why businesses sell part of their companies

The sale of a portion of a business is called a divestiture. This typically happens when the management of a company decides they no longer want to operate a business unit or asset. So, why do businesses sell part of their companies?
First, a divestiture is a strategy in focusing on the core competencies of the company while spinning off business units that don’t align with the strategy. In other words, a business may divest divisions that are not part of its core operations to allow the company to focus on what it does best. Small businesses can do this by getting out of one of their product lines to focus their energy on their best-performing products.

A company’s strategic development plan may involve divesting or spinning off non-core businesses while perhaps strengthening core operations through disciplined acquisitions.

Second, companies sometimes make acquisitions and must later divest those investments if they don’t work out as planned. The buyer may be too large, and the new company may get lost after the acquisition and suffer from lack of intention. Sometimes, poor management decisions lead to a need to divest non-performing business units. Selling a weak division is a straightforward management decision.

Third, selling non-core divisions is also a commonly used method to raise funds. A divestiture generates cash at the sale, and that cash is invested in more promising opportunities that yield higher returns. Also, a company’s individual pieces are sometimes worth more than the company as a whole. Therefore, breaking up the company and selling its individual pieces can yield more value than if the business was sold as a whole.

**So, should you sell a portion of your business?**

The truth is, as a business owner, you don’t need to sell your entire company should you decide to retire or cash out. Oftentimes, with proper strategic planning, you can sell only a piece of your company, allowing you to generate additional funds for your retirement or to provide you with growth capital to reinvest back into your business.

The decision that you need to make, as a small- or mid-sized business owner, may not be as straightforward as it is for the management of large companies like General Electric or Hewlett Packard Enterprise. In deciding whether to sell the whole company or only a portion of it, you should first examine the overall value of your business and of each division. Lower middle-market companies with annual revenues from $1 million to $50 million sometimes sell in pieces to extract the most value possible.

You have two main options in selling a portion of your business:

1. **Selling a percentage of your company** - This choice involves selling a percentage of your entire company, usually structured as a percentage of the stock. This type of sale is often called a recapitalization, which is used by business owners who are contemplating retirement but are not ready to fully retire yet. These business owners may want to take some cash off the table. In most cases, this investment is a majority equity investment, which gives the buyer effective control of your company.

2. **Selling a division, unit or any part of a business** – This structure involves selling a division, unit or category of your business. Many companies are being bought for strategic purposes. It is possible for a buyer to see a tremendous value in one division of your company while they wish to stay away from the other divisions. If this happens, you may consider a spin-off of one division.
Let your company grow by selling a part of it

Many business owners have all of their wealth tied up in their company, even though doing so is risky. Selling a piece of your company allows you to create liquid assets while still maintaining complete control of the remainder of your business. It also allows you to focus your talents on a division that you think has the greatest potential.

Publicly owned companies, which are usually under intense pressure to meet projected quarterly earnings, commonly sell non-core divisions.

Former General Electric (GE) CEO Jack Welch was well-known for divesting businesses as a way of “pruning” the company to give way to the growth of the remaining business units within GE. In his first four years as GE’s CEO, he divested over a hundred business units, accounting for approximately 20% of GE’s assets. Welch had eliminated more than 100,000 jobs through layoffs, forced retirements and divestitures. During Welch’s tenure, GE’s revenue had an outstanding growth from $26.8 billion to $130 billion.

Another example is a web-based business that started with a retail store and then gradually transformed into a web-based operation with several retail stores. Splitting the business into two divisions — an online business and a retail division — may make the company easier to sell. Many buyers have a strong preference for online-based businesses and a strong aversion to retail businesses. Other buyers have a lack of experience and expertise with online businesses and prefer to stick with retail.

Selling your company’s divisions separately not only makes your business easier to sell but can also increase the total selling price.

Many companies develop additional product lines as a part of their overall corporate growth strategy. In the process, many business owners create product lines that they later regret pursuing. The product line may not fit in with the overall operations or may make the business owner lose focus on their core business. In that case, selling the product line can make sense.

Additionally, many buyers search for strategic acquisitions and have specific criteria regarding which businesses they will consider. They may be interested in just one component of your business and may not pursue your business as a whole because your other divisions do not align with their strategy.

Recent popular divestitures include the decision of Hewlett Packard Enterprise CEO Meg Whitman to spin off and merge its non-core software assets with Micro Focus. This transaction was valued at about $8.8 billion.

Even small businesses can benefit from splitting up their company into separate divisions and selling them individually. For instance, some businesses require special licensing, and splitting the business into two divisions may be prudent, as some companies may only be interested in the divisions that don’t require special licenses.

Business owners sell portions of their company for many reasons. Selling just part of your business can be wise. It is a fairly common practice, and it can free up cash for you to use as you see fit.
Nonetheless, you should have a business broker or M&A advisor examine your business, so they can give you advice about the best way to proceed.

In your case, selling your business as a whole may make more sense. It depends on a number of factors, which a professional can help you evaluate, including how much stake you want to have in the future of the business. Also, having your business valued as a whole and in pieces can help you decide what makes the most financial sense for your business. Either way, a professional can assist you with selling your business in the way you want to do it, so don’t be afraid to seek professional advice.

Remember that selling a portion of your business doesn’t mean giving up something; it only means letting go of a “part” to let the “whole” thrive. After all, the cost of keeping a non-performing or non-core division could be much higher than the returns it is currently yielding.

Summary

Planning is essential to successfully exiting your business. The steps involved in preparing your business for sale include the following:

- Build a management team or a team of core employees.
- Document, streamline and automate all processes in your business — marketing, HR, finance, etc.
- Inform and incentivize key employees.
- Perform pre-sale due diligence.
- Assemble and meet with your team, including your accountant, attorney and financial planners.
- Explore all exit options.
- Adjust or normalize your financial statements.
- Prepare key documents.
- Decide if you should sell your entire company or a division or portion of your business.

Selling a company generally takes 6 to 12 months; however, by performing the steps above, you can help speed up the sale process. Hiring a business broker or M&A advisor to help you plan and execute these steps can simplify the process and help you maximize the value of your company.

*Morgan & Westfield* can help you navigate one of your life’s most difficult, yet significant events — selling your business.

Don’t leave money on the table.

*Call us today* for a 30-minute call to see how we can help you.
Chapter 2 – Valuing Your Business

Set a realistic asking price.

Part 1: Do I Need a Business Valuation?

As a business owner, one of the most important questions you need to answer is: What is my business worth? However, that question is not necessarily one that you can or should answer by yourself. When contemplating your exit options, you should consider receiving the advice of a professional.

At this point, you may find yourself asking a number of questions, such as: What is a valuation? How much does a business valuation cost? Should I have an appraiser, a broker or my CPA value my business? Do I really need a valuation for my business? What is the process of determining the value of my business?

This chapter addresses these questions, as well as others, and guides you through the critical decisions you need to make when planning to sell your business.

What is a business valuation?

A business valuation is a process used to determine how much a business is worth. The end result can range from a verbal opinion of value to a short written report that estimates the value of your business to highly complex formal reports that exceed 200 pages. These types of appraisals range in price and can cost anywhere from nothing to tens of thousands of dollars.

Business valuations are used for many purposes. The value of a business is often required in divorce proceedings, tax planning, bankruptcy proceedings, litigation, buy-sell agreements and strategic planning. An appraisal may also be needed when arranging financing and assessing economic damages for litigation. Most appraisals are performed for legal purposes, and receiving an appraisal in this format is of limited use to you if your intent is discovering the value of your business to sell it. That is because the appraisal may not reflect the actual market value of your business for the purpose of selling your business.

For whom is a valuation written?

Unfortunately, most business appraisals are written for those involved in litigation or other legal matters. Therefore, most use complex language that is difficult to understand and include formulas that are of little use to a business owner wishing to sell.

For example, most appraisals contain an in-depth analysis of national and local economic factors that affect the value of a business, which is required for appraisals intended for legal proceedings. However, most owners are already familiar with the economic factors that affect the value of their business and do not want to pay an expert to prepare a report to discuss these factors. Appraisals must follow guidelines and standards, and many of these standards require the appraiser to analyze these factors when preparing the report. These
guidelines are in place so that appraisals comply with the specific requirements for different types of legal proceedings. For example, an appraisal for a divorce may require a strict definition of value, such as “fair market value,” whereas an appraisal for another purpose may require the standard of “fair value.” Such differences may seem minute, yet appraisals must follow these exacting standards if the purpose is for litigation or other legal matters.

As the business valuation industry has progressed, these standards have become more complicated, and thus, the standard business valuation report has lengthened over the years. Following these standards results in more time to prepare a report and therefore an increased price. As a result, most business valuations are of little use to a business owner because they are too esoteric and confusing, and thus have little practical value.

Additionally, many business brokers and mergers and acquisitions (M&A) intermediaries do not have an in-depth working knowledge of these standards, so they decide not to offer business valuations as a service. Subsequently, most of the people offering business valuations are business appraisers and CPAs, many of whom have never sold a business in their life. Few have an understanding of the process of buying and selling a business, and few understand the marketplace for the exchange of companies. This raises the question: Would you pay an appraiser thousands of dollars to determine the value of your business if that person has never sold a business?

Software

As a result of these complicated legal standards, most business valuation report software is specifically designed to produce valuations for legal purposes. Nearly all appraisers use commercial software when preparing a valuation, while some have produced their own software. You will have difficulty finding an appraiser who uses valuation software designed for the purpose of selling a business. Unfortunately, the reports produced by most valuation software are highly technical and not of much use to you as a business owner. We recommend seeing a sample report from an appraiser before engaging that appraiser. Read it and see if you can understand it. If you cannot, then you are wasting your money. Remember, the appraisal is designed for you, and if you cannot understand it, then you are throwing your money down the drain.

Fair market value vs. strategic value

Most business appraisals use fair market value (FMV) as the standard of value. Fair market value is the price at which a business would sell between a willing buyer and a willing seller, without taking into account the strategic value to the buyer.

Strategic value, also called investment value, is the value of a business to a specific buyer. It can represent the added value to a potential buyer who is in the market for a specific type of business or who is interested in being the owner of a particular brand, patent or other forms of intellectual property. For instance, a buyer who already owns a business in one area of the market may want to buy a similar business to reduce competition. Therefore, similar businesses to that of the buyer will have a higher strategic value to that buyer. Unfortunately, you cannot measure strategic value until you know who the buyer is because every buyer is able to extract a different amount of value from the transaction.
For larger companies, a valuation will only serve to establish a floor or a minimum price at which the company may sell. It is possible that your business may sell for more if it is purchased by strategic buyers.

Three main types of business appraisals

When considering whether you should have your business appraised, you have many options. The various types of business valuations do not have standard definitions, so it can be confusing. You have many choices, and below are descriptions for each option. Most reports fall into three main categories: a verbal opinion, a written report for non-legal purposes (such as a business sale), and a written report for legal purposes.

1. **Verbal opinion of value** – A verbal (technically “oral”) opinion of value is recommended for any business owner who does not need a formal report. This style of report usually involves the appraiser, broker or CPA reviewing the owner’s financial statements and then offering an estimate of value. Sometimes business brokers or M&A intermediaries will charge for this opinion, and sometimes they will not.

   A verbal opinion of value is appropriate when your financial statements are inaccurate or incomplete, or if you have large amounts of unreported cash in your business. It may also be appropriate when you do not want to invest too much money on a formal report. These types of reports are also useful if you are in the planning stages of selling a business and would like a ballpark idea of what your business is worth before committing substantial time, money and effort to the process.

   It is common for us to provide a verbal opinion of value to a client without preparing a formal report. We ordinarily have a 30- to 60-minute conversation with a client before advising the client on what type of report we believe is necessary. A formal report is not necessary for most small businesses valued at less than $500,000. In some cases, however, a formal report may be required.

2. **Written report, not complying with appraisal standards (Restricted Appraisal Report or Calculation of Value)** – These reports do not comply with appraisal standards and cannot be used for legal purposes. We generally refer to these reports as a “business valuation, not for legal purposes.” The format of these reports varies tremendously. Some are simple and straightforward, and others are long, formal and confusing. Categorizing the types of reports found in this category is nearly impossible.

   A “calculation of value” is the industry’s attempt to offer a simplified report for business owners. Pricing can range from free to tens of thousands of dollars. These reports are useful for business owners looking to sell a business, and may not be used for legal purposes, such as a partner dispute, bankruptcy, or divorce. These reports are strictly advisory in nature and are not intended to be used for legal purposes.

3. **Formal appraisal (Self-Contained Report)** – This type of report is necessary for any legal purpose, such as a divorce, tax matter or bankruptcy. These reports are often hundreds of pages in length and
are of little use to a business owner who is looking to sell a business. The format of these reports tends to be more consistent than the other formats because they comply with the appraisal standards. These reports usually cost $5,000 or more.

**Who can value your business?**

**Business broker** - Many business brokers offer to prepare a business valuation for prospective clients. Most brokers offer a free report to lure prospective clients their way. Unfortunately, you may not know what you are getting because these types of business valuations are not required to follow standards. More experienced brokers charge a fee for a valuation. However, if the broker is working on commission, then a conflict of interest exists because the broker is initially tempted to provide you with a high opinion of value so they can obtain you as a client. The problem is that few business brokers have more than a rudimentary understanding of business valuation.

**CPA** – Accountants and CPAs sometimes offer valuation services to their clients. Some CPAs are also licensed business appraisers. While accountants have a stronger grasp of the numbers than other professionals, few have sold a business before. On the other hand, larger accounting firms have dedicated M&A professionals on staff and may be more qualified to prepare a valuation.

**M&A firms** – Most M&A firms specialize in selling businesses with $5 million - $100 million in annual revenue. Many mergers and acquisitions firms also offer valuation services to their clients. A number of these firms will offer a simple valuation report and focus on the value of your business in the context of a sale. These firms have experience in assisting their clients in buying and selling companies and are well qualified to advise you on the value of your business. Additionally, the values of most middle-market companies are established through an auction process. M&A advisors are intimately familiar with this process. They can advise you on the relationship between the price you may achieve through an organized auction process and the number shown in a valuation report.

**The third-party valuation myth**

Several business appraisers offer their appraisals through a network of business brokers. These networks actively market their services to business brokers, charging as little as a few hundred dollars to the brokers, while the brokers may charge their clients what they please. One major franchised business broker network actively convinces all of its franchisees to market their third-party appraisal services, and these are often sold at a markup of 2x to 5x above cost.

Brokers make this recommendation because they can sell the valuation at a large markup and do not need the expertise required to appraise a company. Many franchised business broker offices push their franchisees to sell third-party appraisals, which are simple to sell but difficult to prepare, hence the reason they convince their franchisees to sell them but not prepare them. The drawback is that you never interact directly with the appraiser and many brokers do not understand the contents of the report. While the report may be valuable, many brokers may incorrectly explain the elementary assumptions and components of the report, thus rendering the report useless for most business owners. After all, what good is a valuation if you cannot understand it and ask the appraiser basic questions regarding the assumptions and results?
Small market vs. middle market

The methods used to value a small business (less than $5 million in revenue) are different from those used to value a middle-market business (more than $5 million in revenue). Unfortunately, most valuation software does not make this distinction, and you sometimes end up with a report that is not suitable for your specific business. When obtaining a business appraisal, be sure to ask the appraiser which industries and size of businesses they value on a regular basis. You can also ask for a short list of their recent engagements to obtain an idea of the types of businesses they usually evaluate.

Opinion & the inefficient market theory

When obtaining a business valuation, you are simply paying for a professional’s opinion. This opinion is always subject to change. That means that the value they give you is not the definitive value of your business but is rather a subjective opinion from an independent professional. This represents the professional's opinion as to what a hypothetical person or company is likely to pay for your company. Because the marketplace for the sale of small- and mid-sized businesses is highly inefficient, values vary wildly. Therefore, the market can greatly affect the final selling price of your business.

In reality, the appraiser is attempting to conjecture how a diverse audience with wildly differing preferences, views and perspectives will behave. Doing so is inherently difficult and is the reason the range of values for businesses is wider than for other assets, such as real estate. Additionally, some markets such as real estate have a ready supply of highly comparable transactions. The market for businesses, on the other hand, is private and it is highly difficult to obtain meaningful, comparable transactions.

Nonetheless, an appraiser's opinion is valuable and can be a realistic starting point for planning your exit. One of the most important roles an appraiser will play is identifying the factors that will most heavily influence the value of your business.

Do buyers follow valuations?

 Buyers do not always follow valuations. An appraiser is making an educated guess as to what a hypothetical buyer might pay for your business. That task is difficult, especially if your business has potential buyers for your business are unsophisticated. It is inherently difficult to predict how unsophisticated people behave, whereas it is easier to predict how sophisticated people will act. Sophisticated investors, after all, enlist professionals who share the same training and education, and often share uniform perspectives regarding what makes an intelligent investment. Their behavior and perspectives fall along a narrower band. Buyers of small businesses are mostly unsophisticated, whereas buyers of mid-sized and larger businesses are usually highly sophisticated. Therefore, estimating the value of a small- to mid-sized business is difficult because you are conjecturing regarding how an unsophisticated investor thinks and behaves. That is an inherently difficult task regardless of one’s expertise and knowledge.

Process

Most appraisals start with an analysis of your financial statements and a company questionnaire. This data-gathering process is the most time-consuming step for you because it involves gathering a large amount of
financial and operating information on your company. An appraiser typically needs three to five years of your company’s profit and loss (P&L) statements and balance sheets, in addition to specific information on your company.

Once the appraiser has this information, they will then normalize or adjust your financial statements. This step involves adjusting your financial statements so they can be compared with others within your industry. The appraiser will need to communicate with you during this process, and your involvement is key to the accuracy of the appraisal. Don’t be afraid to speak up and ask questions during this process.

Once this step is complete, then the appraiser will perform their own independent research on your industry and business before compiling the final report.

Pricing — Our industry research

We asked a random sample of 44 appraisers, CPAs and M&A intermediaries what their fees would be for appraising a small manufacturing company with $5 million to $10 million in annual revenue. We also asked them whether it was necessary to have the company appraised before selling it. Here are the results:

Most respondents charged between $5,000 and $20,000 for a business appraisal (see Chart 10). Approximately 29.5% of respondents did not recommend an appraisal for owners looking to sell their companies.

Chart 10. Survey on Business Appraisal Fees

Note: The number of respondents does not total 44; six respondents provided two answers or their answers are within two fee ranges.
Half of the respondents who did not recommend an appraisal suggested other courses of action such as achieving a strategic value, resorting to an auction process, or obtaining a “broker opinion of value.”

*Can You Give Me a Quick Opinion of Value?*

A valuation is based on both qualitative and quantitative factors. One must examine both factors before arriving at the estimated value of a company. You cannot simply look at a P&L statement and assess the value of a company in a few minutes’ time. Properly determining the value, or range of values, for a company takes time because there are dozens of qualitative factors to consider in addition to the quantitative factors (financial statements). Compiling and assessing these qualitative factors takes a considerable amount of time.

Understanding the value of a company requires examining where the company fits relative to the industry. One must also understand the growth prospects and risk factors of the business. One seemingly small factor can impact the value of a company by over 50%, so a thorough investigation is paramount.

Below is our process for arriving at an opinion of value for a small- to mid-sized company. Note that this process normally takes us 5 to 10 hours to complete:

1. We first request financial statements from a potential client. This normally includes the following:
   a. Three to five years’ P&L statements
   b. Three to five years’ balance sheets
   c. Current accounts receivable and payable aging schedules
   d. List of monthly revenues for 5 to 10 years

2. We send the client a detailed questionnaire that we have designed to identify the factors that positively or adversely affect the value of the company. After receiving the completed questionnaire, we then discuss this with the client for 30 to 60 minutes.

3. We then normalize or adjust the financial statements. Once the owner sends us a list of adjustments, we review them and verify them for accuracy. Often, we must educate the owner regarding which adjustments are allowable and which are not.

4. Once we receive the financial statements, we “spread” the numbers (put them in our internal spreadsheet so we can analyze them). This process, including the analysis, takes a minimum of two to three hours. Doing so helps us spot trends in the business that may negatively or positively impact the value of the company. We also prepare a comparative P&L that enables us to analyze the normalized P&Ls from year to year to spot trends and consistencies. We then discuss a couple dozen questions regarding the financial statements. This helps us understand the company, its operations, and its unique competitive advantage.

5. We then research the industry, including comparable transactions, industry rules of thumb, and
other valuable industry information.

6. Finally, we put the finishing touches on our financial model and send it to the seller. We normally spend several hours discussing the spreadsheet, the multiples and the factors that affect the value of the company.

Once we have completed the process, the owner should have a firm understanding of both the factors that affect the value of the company and wherein the range of values their business fits and why. This helps the owner crystallize the decision to sell or hold off on the sale and prepare the company for sale in the future, thus increasing its value, before exiting.

This level of analysis helps us understand the factors that affect the value of our client’s business. Taking a structured approach is critical. We have examined several hundred transactions and have produced a checklist and questionnaire that help us quickly identify the salient factors that have the largest impact on the value of a company. Having a checklist is important, regardless of how long a professional has been in the industry, as missing one critical question can have a substantial impact on the valuation.

Note that we do not request tax returns until later in the process. Tax returns are used to verify the accuracy (to some extent) of the financial statements. Altogether, this process may take us one to three hours for a small business and 5 to 10 hours for a mid-sized company.

The following are some questions that must be addressed to properly assess the value of a company:

All of these factors below can impact the value of a company:

The company

- What are the growth prospects for the company?
- What are the risk factors for the company?
- How does the company’s financial performance compare with its peers?
- How long has the business been in operation?
- Is the business seasonal, cyclical or counter-cyclical?
- How scalable is the business?
- Can the marketing methods be automated and reproduced, or has the business depended too much on the owner’s personal selling, networking or marketing efforts?
- Does the business have any products currently in development that can add significant value to the business?
- Can pricing be increased? (Price increases fall straight to the bottom line.)
- Does the company own any valuable intellectual property?
- Does the business have any trade secrets?
- Does the business require contracts with customers?
- Does the business carry adequate insurance policies?
- Is there any pending litigation?

Company financials
• How much working capital is required to operate the company?
• How much do you spend per year on capital improvements? (Sophisticated buyers subtract an amount for working capital, which includes a deduction for an annual investment in capital equipment.)
• How accurate are your financial and accounting records?
• Is the business using LIFO, FIFO or some other form of inventory accounting method? If so, has this dramatically affected earnings?
• Is any inventory obsolete? If so, has it already been written off the books?
• Is accrual accounting being properly done?
• Are the financials prepared on a cash or accrual basis? If accrual basis, are the accruals being properly done?
• Are the revenues steady, increasing or decreasing?
• Does the business have a recurring revenue?
• Has the business loosened terms to boost revenue in the short term?
• Are gross profit margins holding steady, increasing or decreasing?
• Are the accounts receivable healthy?

Company location and lease

• Is the real estate owned or leased?
• If the real estate is owned, is the business paying a market rate for the rent?
• If the real estate is leased, is your lease above or below market rate? Is the property available for sale?
• Can the business be relocated to another geographic market?
• Is any equipment leased? If so, is it a capital or operating lease?

Employees

• How many hours per week are the owners working?
• Are the owners receiving a salary?
• Are family members working in the business without compensation?
• How strong is the management team?
• What is the annual employee turnover rate?
• Are key employees willing to stay?
• Are wages above or below industry averages?
• Have employees signed non-competition or employment agreements?

The industry

• What are the barriers to entry in your industry?
• How is technology affecting the company and its industry?
• Are you aware of any recent acquisitions in your industry?
• What is the nature of competition in the industry: saturated, consolidated, fragmented or small mom and pops?
• Where does the company fit in the industry in terms of profitability?
• How do average transaction values for your business relate to your industry?
• How do the margins in the business compare with its peers in the industry?

**Customers**

• Is there a large, repeat customer base?
• What is the customer retention or attrition rate?
• Are there customer concentration issues?

**The sale**

• Is the business likely to be sold to an individual, strategic buyer or a financial buyer?
• Do you plan to structure the sale as an asset or stock sale?
• Are you willing to finance a portion of the purchase price?
• Are you willing to sign a non-compete? If so, for how long?

We are approached by a lot of potential clients, and they want us to “quickly” look at their financial statements and give them an opinion of value for free. Unfortunately, it isn’t that easy.

Your business is one of your most valuable assets. Do you really want to try to save a little money knowing that the information you are basing your decision on can be off by over 50%? This isn’t a wise course of action to take for an intelligent entrepreneur. Don’t waste your time on free advice. As what Woody Allen said, “The most expensive sex is free sex.” The same can be said of business valuations and other forms of professional advice. “The most expensive advice is free advice.”

**Part 2: Are Free Business Valuations Too Expensive?**

We often get approached by business owners asking us to do a free valuation for their business. They tell us that other business brokers offer valuations for free. But let me tell you why you, as a business owner, should be wary when you receive a “free valuation” offer from a business broker.

Let’s first examine the use of the word “free,” which often misleads or deceives customers, especially if it’s used as a marketing strategy. “Free” always comes with a catch. Let’s look at the following examples:

• Timeshare companies offer “free” dinners and shows *(if you attend their sales pitch).*
• Restaurants often give “free” samples *(however, they expect you to order something, and you will get booted out if you do not).*
• Many online businesses offer “free” trials *(but most require a credit card and make it notoriously difficult to cancel).*
• Fat-“free” and calorie-“free” claims could just be misleading labels. A fat-free product could be loaded with sugar.
• “Buy one, get one free” is usually a bad deal.

A business that offers something for nothing is usually expecting something in return. Why else would they make such an offer? Are they offering this free product out of the goodness of their heart, or is it a simple business proposition that is primarily intended to benefit them?
The same holds true with a business broker offering a free business valuation. The question is: What are they expecting in return? The answer is simple yet unknown to many business owners: a long-term commitment with a large back-end commission.

What’s the catch with free valuations?

Brokers carefully prepare “free” valuations to ensure that they meet your expectations of value (not the expectations of the buyer). In other words, they tend to artificially inflate the value of your business so they can obtain you as a client.

Brokers tend to openly discuss how “honest” they could be with prospective clients (sellers) whom they did not want to lose as clients. At times, brokers play with the valuation formulas to tweak the results to please potential clients. They openly said things like, “No, we can’t tell them that,” or “Why don’t you try wiggling that formula around a little bit?”

Later on, of course, you will be told that your business is not worth what they initially said because of something you had failed to disclose. But you are already committed at that point, and you have invested a significant amount of time and energy that it does not make sense to wait until the contract expires for you to continue the process with another broker. Many brokers also include a cancellation clause in their agreement indicating that they will receive their commission in full if you attempt to cancel the agreement, so this leaves you with few options other than accepting a price reduction. This is an extremely critical point that you should consider carefully before signing the agreement. In fact, we have seen many owners who have been forced to pay a full commission when they attempt to cancel the agreement.

Artificially inflating the value of your business sets up false expectations for you (you expect to sell your business for more than it is worth) and starts the relationship off on the wrong foot. Don’t do it.

So, why do business brokers offer free valuations?

First, obtaining clients is easy if you offer a free appraisal. There are enough business owners who are willing to be duped by something that is free. Second, the business brokerage industry has a low barrier to entry. As a result, new entrants to the industry offer free valuations, and others blindly follow suit.

The question now is: Are you willing to hand over one of your most valuable assets to someone who is willing to dupe you into a relationship based on a false pretense? A long-term relationship like this should be based on a solid foundation of trust, honesty and transparency.

Through the years, we’ve learned that the more knowledgeable and experienced the broker is, the less likely they will offer anything for free. That is because you are guaranteed to receive sound professional advice grounded in years of experience from hundreds of deals closed.

Are free business appraisals common in the middle market? No. They are rare. The majority of M&A advisors selling businesses valued between $5 million and $50 million do not offer any form of free valuation. In our random survey of 44 CPAs, appraisers and M&A intermediaries, only one offered a free valuation to prospective clients. The rest charged between $2,000 and $40,000 for a business valuation.
How can you avoid the ‘free valuation’ trap?

What can you do to avoid this “free valuation” trap? Should you avoid anything that professional advisors offer for free? No, not necessarily. You should, however, be wary when you see a professional aggressively advertising a free service, especially if that individual also works exclusively on commission.

Here are your options:

1. **Hire a business appraiser for a verbal opinion of value.** This is a good option, but this is only a wise course of action if the appraiser has actual experience in selling businesses. Otherwise, the appraiser's knowledge is largely theoretical. Most business appraisers prepare business valuations for legal purposes and have no experience in selling companies.

2. **Hire a CPA to give you a verbal opinion of value.** Again, this is a good idea only if the CPA has actual deal experience. Your average CPA may not have been trained to perform a valuation, so be sure you know your CPA’s experience. Otherwise, as pointed out above, the advice you will receive may be largely theoretical. When valuing a company, it is critical to have your fingers on the pulse of the market and to understand the subtle nuances that will impact the value of a company. Most professionals without any M&A experience lack this fundamental practical expertise. And you need practical expertise here, not theoretical.

3. **Hire an actual deal-maker, such as a business broker, an investment banker or an M&A advisor, for an opinion of value.** This is your best option; however, if you are approaching a commission-based deal-maker, it is best to tell them that you are considering a potential sale in the future, not now. Doing so will increase the likelihood that you will receive an unbiased opinion on your company’s value. Because of the deal-maker’s real-world experiences, this option is still far superior to receiving a free valuation from an inexperienced broker.

Remember that although valuations are being offered to you for free, you will still have to pay for it in one way or another. A free service always comes with a price — and it’s often more expensive than the paid, transparent service.

**Part 3: How Do I Price My Business?**

Pricing a business is based primarily on profitability. This is the number one item buyers look for and the factor that buyers use to value a business when they make an offer. As always, there are exceptions to the rule; however, they are rare. Some buyers will consider buying an unprofitable company; however, those buyers are rare. If you have a company with limited profitability, please contact us to see if an exception may apply.

There are other variables that buyers consider when they buy a business; however, the majority exclusively look for one thing: profit, which is also called adjusted net, discretionary earnings or EBITDA. What would you look for if you were buying a business? You would probably purchase a business that makes the highest profit or adjusted net possible.
Profit is what you put in your pocket. Other terms for profit include the following:

- **Seller's Discretionary Earnings (SDE)** - The most common term used by nearly every broker, as well as buyers who deal with brokers.
- **Seller's Discretionary Cash Flow (SDCF)**
- **Cash Flow**
- **Adjusted Net Profit or Adjusted Net**
- **Earnings before interest, taxes, depreciation and amortization (EBITDA)**

*Method 1 - Cash flow method*

Here’s how you can price your business using the cash flow method:

**Step 1** - Determine the cash flow, SDE or EBITDA for the previous 12 months or your last fiscal year. This is called recasting or normalizing the financial statements. It involves adding the following back to the profit: depreciation, amortization, owner’s salary, non-cash expenses, non-recurring expenses and other perks.

**Step 2** - Multiply the cash flow by the multiple. Here are the common current multiples:

- **Retail businesses**: 1.5 to 3.0 (i.e., cash flow x 1.5-3.0 multiple)
- **Service businesses**: 1.5 to 3.0 (i.e., cash flow x 1.5-3.0 multiple)
- **Food businesses**: 1.5 to 3.0 (i.e., cash flow x 1.5-3.0 multiple)
- **Manufacturing businesses**: 3.0 to 5.0+ (i.e., cash flow x 3.0-5.0+ multiple)
- **Wholesale businesses**: 2.0 to 4.0 (i.e., cash flow x 2.0-4.0 multiple)

**Example:**

$500,000 (Discretionary Cash Flow) x 3.0 (the multiple) = $1,500,000 (value of business)

This first method is the most widely used for businesses that are profitable since it’s easy to formulate.

**Note:** Multiples vary with the current economic climate and market conditions. How do you determine the appropriate multiple? Unfortunately, this can only come from experience; however, the guidelines above can be a helpful starting point.

**What should the price include?**

The price should include anything used or needed to create the cash flow or profit. This includes all the equipment required to operate the business daily.

**Should inventory be included?**

This is a common debate among experts. You can safely try to get paid for the inventory in addition to the price. It’s going to be negotiated anyway, so ask for it upfront and see what happens.

**What is the difference between SDE and EBITDA?**
SDE and EBITDA are often loosely used terms; however, SDE generally includes the owner's salary, while EBITDA deducts a reasonable amount for a full-time manager.

For example, if the net profit from the business is $500,000 per year and the owner takes a $150,000 annual salary; then SDE would be $650,000 ($500,000 + $150,000), while EBITDA would be $500,000.

SDE is the most commonly used metric when an individual is buying your business, and EBITDA is most commonly used when a company is buying your business. Why? Individuals looking to buy businesses will usually operate the business themselves and will not need to pay a manager to run the business. Companies must usually employ a full-time manager to replace the current owner and must deduct this from the available cash flow.

**Method 2 - Comparable sales approach**

The comparable sales method is a method for pricing your business based on the prices of similar businesses sold, then adjusting the figures appropriately to consider any possible differences.

This approach is often difficult to use because prices of businesses are not public record and only privately disclosed. The best place to get this information is from a broker who has access to private databases. There are three or four databases with comparable business sales; however, the information is sparse and often inaccurate or incomplete. Collectively, these databases probably contain about 100,000 transactions.

If you are interested in obtaining current multiples, comparable transactions or rules of thumb for your business, please email us at info@morganandwestfield.com or call 888-693-7834. We can search our database to see how many comparable transactions might be available for your industry.

**Pricing a business that's losing money**

Let’s say you have a manufacturing business that is breaking even but you invested $1 million in, so surely it has to be worth what you put into it, right? Sorry, but it’s unlikely.

Here’s an interesting fact: Buyers usually consider buying a variety of different types of businesses. For this reason, the price of your business must be competitive with the buyer’s reasonable alternatives.

**Note:** This formula is not true if the buyer is solely interested in buying your specific type of business, such as an IT staffing company. However, less than 5% of buyers want only one type of business. And we don’t recommend that you sell your business based on exceptions.

The price of your business must be competitive with reasonable alternatives. Imagine you’re a buyer, which of these businesses would you buy?

- **Business A:** Asking $1 million - Business is breaking even.
- **Business B:** Asking $1 million - Business is making an annual profit of $400,000.

The answer is obvious: 95% - 99% of buyers will purchase Business B. Remember, most small businesses are priced at approximately two to three times the cash flow. So, if you’re asking $300,000 for your business, most
small businesses selling at that asking price will produce $100,000 to $150,000 cash flow or profit per year. Always keep in mind, the number one thing that buyers look for in a business is profit.

I see businesses for sale that are asking $250,000 or $300,000, yet they’re not profitable. Yes, they are for sale, but not sold. Why do you think you don’t see many businesses priced right that are still on the market? It’s because they are sold — because they are priced right. The fact is 80% to 90% of businesses are probably overpriced, so don’t let this delude you.

**Multiple for larger businesses**

Most mid-sized businesses are priced at 3x to 7x the cash flow or EBITDA. The multiple varies based on several factors, primarily the industry that a business operates in. Larger businesses always sell at higher multiples. To demonstrate:

- **Business A:** Cash flow of $100,000 per year = 3 multiple, or asking price of $300,000
- **Business B:** Cash flow of $5 million per year = 5 multiple, or asking price of $25 million

This relationship is direct. As the cash flow or EBITDA of the business increases, so does the multiple. Bigger businesses are seen as more valuable by sophisticated investors because they are often more stable, have more professional management teams, and the business is less dependent on the owner. This is a simple, clear relationship that is demonstrated in the transactional databases and widely accepted by both intermediaries and buyers alike.

*Morgan & Westfield* can help you navigate one of your life’s most difficult, yet significant events — selling your business.

*Don’t leave money on the table.*

*Call us today* for a 30-minute call to see how we can help you.
Chapter 3 – Financing the Sale

Part 1: Seller Financing

According to industry statistics, 80% of small business sales include some form of seller financing. Most deals in the middle market include some component of seller financing; however, the amounts are low, often 10% to 20% of the deal size. This chapter will focus on financing for deals under $10 million in asking price.

What is seller financing?

With seller financing, the buyer makes a down payment on your business and then makes monthly payments until the price is paid in full. As a seller, you may think you must lend the buyer money — you don’t. You receive a down payment, and then you receive periodic payments until the buyer pays you in full. It’s a common practice to set up monthly payments.

How can I protect myself from the buyer not paying?

Because you are financing a portion of the sale, you should think and act like a bank and qualify the buyer before committing to them. We recommend obtaining a detailed financial statement, credit report, resume and any other pertinent information you can obtain from the buyer as early as possible in the process. You should also select a buyer whom you think will be successful in your business from an operational standpoint.

If the buyer of your business is another company, then ask the buyer about their previous acquisitions. Talking to the owners of companies they have acquired in the past may also be helpful. Depending on the size of the company, it may be prudent to perform due diligence on the principals of the company who are acquiring you.

Most of the problems we see related to seller financing originate from the seller accepting a low down payment. We consider a low down payment to be anything less than 40% down. We suggest asking for a down payment of at least 40% to 50% of the asking price. Why? Few buyers will walk away from such a large down payment.

Are there any other ways I can protect myself?

Yes. A strong promissory note should be drafted with clauses that directly address non-payment and late payments. A Uniform Commercial Code (UCC) lien should also be filed on the business, preventing the buyer from selling the business or the assets during the term of the note. You may also be able to negotiate to collateralize the buyer’s personal assets, in addition to the assets of the business; however, doing so can sometimes signal to the buyer that you do not have faith in your business. We customarily draft these documents when we handle a closing although these documents can also be drafted by an experienced escrow agent or attorney.

Additionally, you can require the buyer to maintain certain financial benchmarks post-closing, such as maintaining a minimum level of inventory, a minimum amount of working capital, or specific debt to equity.
ratios. We also recommend that you have access to monthly or quarterly financial statements. This should enable you to spot and help correct problems early on.

*What interest rate is fair to charge?*

Over the past 10 years, the interest rates charged on promissory notes have ranged from 6% to 8%. The rate depends on the amount of risk involved, not on the current cost of money. We often tell buyers this, and most understand. Some buyers state that current interest rates on residential real estate mortgages are 4% and that the rate should be competitive with these. We explain to the buyer that such a loan is risky for the seller and little collateral is available other than the undervalued assets of the business. If you default on your mortgage, the bank simply takes your home back. However, if you default on a loan used to buy a small business, there often isn’t anything to take back other than a struggling business.

The bottom line is that you can probably ask 6% to 10%. However, 10% might be a little high, considering the current economic conditions. Other factors that should be considered in determining the interest rate to charge include the total price of the business, the buyer’s credit score, the buyer’s experience, the buyer’s financial position, and perhaps most importantly, the amount of the down payment.

*How do I know how much to finance?*

Your decision regarding how much to finance must make sense from a cash flow standpoint — if your business makes a profit of $50,000 per month, then a note of $40,000 per month won’t make sense. The profit from the business must cover the amount of the note and also pay the buyer a living wage. If it can’t, then it won’t work.

The following information is based on statistics from more than 10,000 business sales:

- **Average interest rate** – Ranges from 6% to 8%, but there’s a small variance. This is based on risk, not prevailing interest rates. Financing a business is risky, hence the relatively high rates compared with interest rates on other assets in the market.
- **Average length of note** - Five years, but it varies from three to seven years.
- **Average down payment** - Usually 50%, but it varies from 30% to 80%.
- **All cash deals** - Less than 10% of businesses sell for all cash.

*Is there anything else I should keep in mind?*

Yes. Make sure you remain on the lease during the entire period of the note. If the buyer defaults, you will need to take the business back and repossess the lease. Alternatively, you can negotiate to take back the lease if the buyer defaults without you remaining on the lease. In other words, in this scenario, you would not remain on the lease; however, you would retain the ability to take back the lease only in the event of a default by the buyer. Again, this should be addressed by an experienced broker or real estate attorney.

*What if I need the money in a year or two?*

You can often sell the note after it has matured for 6 to 12 months. There are many investors who purchase these notes, which effectively cashes you out. Unfortunately, it is often at a steep discount; however, there
are few alternatives other than selling your note. If the interest rate is high enough, this may also incentivize the buyer to pay off the note early and make the note easier to sell to an investor. If you would like to leave this option open, then it is important to ensure the note can be transferred, or assigned to a third-party.

*What are the benefits of financing a portion of the sale?*

- **Lower taxes** - You don’t pay taxes until you receive the money. Be sure that the note is structured so it is "non-negotiable." This is technical and should be addressed by an experienced advisor.
- **Higher selling price** - Businesses that include seller financing sell for 20% to 30% more than businesses that sell for all cash.
- **Faster sale** - Businesses offered with seller financing are easier to sell than a business offered for all cash.

*Should I offer the business for sale with seller financing or wait to see if the buyer requests it?*

It is best to offer specific terms when advertising your business for sale. This sends the message to the buyer that you are serious and realistic in terms of the sale and that you have given the sale careful and deliberate thought. Buyers like to deal with realistic, prepared sellers. You will also receive more responses if you market your business for sale with some form of financing versus for all cash.

*What if I am looking for all cash but might finance the deal for the right buyer?*

In this case, we recommend putting the business on the market without specifying the exact terms under which you would finance the sale. We recommend mentioning in your ad copy that financing is negotiable. This does not commit you to financing the sale; however, the mention of possible financing will not preclude buyers who are only looking at businesses in which the seller would finance a portion of the deal.

The **bottom line**: If you aren’t willing to finance the sale of your business, there’s probably another seller with a reasonably priced business that’s similar to yours who will. Sellers must seriously consider financing the sale of the business if they’re serious about selling, especially if the business is not pre-approved for bank financing.

For a more detailed information on seller financing, including statistics and advice on how to structure the note, email us at info@morganandwestfield.com or contact us through morganandwestfield.com.
Part 2: Bank Financing

Is bank financing available for my business?

Some form of seller financing is involved in 80% of small business sales. Less than 10% of business sales involve bank financing.

Why is bank financing for small business sales so hard to get?

There’s one main reason why bank financing is rarely involved in small business sales. In an effort to boost profits, business owners reduce income taxes by not reporting all their income or by deducting as many expenses as possible. This lowers the income that is reported on the business’ tax returns, which in effect reduces the cash flow available to repay the debt service. Banks are conservative in the adjustments they make to your financial statements. Most banks only adjust, or add-back interest, taxes, depreciation, amortization and owner’s salary. They do not add back other perks you may be running through your business, such as personal travel expenses, meal and entertainment expenses and other discretionary or personal expenses.

Banks start by reviewing the Federal Income Tax Returns for the business. They then add back a minimum number of adjustments, which may include interest, depreciation, amortization and owner’s salary. This resulting number is normally lower than Seller’s Discretionary Earnings (SDE). This number is used to determine the maximum amount of debt service available to repay a loan.

Banks are, by nature, conservative and must follow guidelines and procedures when granting a loan. Banks have a specific process when pre-qualifying a small business loan. The first documents they request are the Federal Income Tax Returns for the business.

An example of how their calculations work:

**Pre-tax net profit from tax return:** $22,200

PLUS:

**Interest:** $6,000

**Depreciation/amortization:** $5,000

**Owner’s salary:** $55,000

**Total income available to pay debt service:** $88,200

MINUS

**Debt service for bank loan:** $23,000

**25% cushion on debt service:** $5,750
Remaining income for buyer: $59,450

Here's the formula:

\[
\text{Total income available to pay debt service} - \left[ \text{Debt service for bank loan} + 25\% \text{ cushion on debt service} \right] = \text{Remaining income for buyer}
\]

Whereas:

Total income to pay debt service = Pre-tax net profit from tax return + [Interest + Depreciation/amortization + Owner’s salary]

This is a typical example for most small businesses. The buyer must be able to live on the income after debt service using the calculation above.

**Will lenders review my tax returns when they consider my business for financing?**

Yes. There are some exceptions, such as medical practices; however, in the majority of loan applications, the lender will primarily base their decision on tax returns. If your tax returns don’t show enough profit after adjustments to cover the debt service as well as enough for the buyer to live on, including a cushion, it's unlikely your business will qualify for a bank loan.

**Part 3: Small Business Administration (SBA) Financing**

**Why do I need to get my business pre-qualified for an SBA loan?**

Shouldn't the buyer get qualified for the loan?

SBA loans are preapproved based on the cash flow that is used to support the debt. The cash flow comes from your business. The preapproval process is, therefore, dependent on the cash flow from your business.

Yes, the buyer has some burden of responsibility; however, the principal responsibility lies with you, the seller. How many cars do you think Ford Motor Company would sell if no bank would finance them? Yes, a valuable criterion for any buyer is whether the asset they are considering purchasing can be financed. Assets that can be financed are more easily bought and sold, and their markets tend to be more liquid. Again, if you offer seller financing or if SBA financing is available in the sale of your business, expect to sell it more quickly and more easily.

**Are there other options besides SBA loans?**

Yes, however, they are rare. We estimate that over 95% of loans made to purchase a small business are the 7(a) SBA loan. For this reason, we recommend first exploring if your business would be qualified for an SBA loan. If it does not, then you may explore other options.
Here's an example:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asking price</td>
<td>$1 million</td>
</tr>
<tr>
<td><strong>Annual cash flow after buyer’s salary</strong></td>
<td>$100,000</td>
</tr>
<tr>
<td>Down payment</td>
<td>$200,000</td>
</tr>
<tr>
<td>Amount financed</td>
<td>$800,000</td>
</tr>
<tr>
<td><strong>Annual payment</strong></td>
<td>$109,008 (10-year term at 6.5% interest)</td>
</tr>
</tbody>
</table>

\[
\text{Annual payment ($109,008) + Additional 25\% debt coverage ratio (a 25\% cushion of $27,252) = $132,260}
\]

This business would not qualify because the “annual cash flow after buyer’s salary” of $100,000 is not enough to support the “Annual payment + 25\% cushion” (technically called “debt coverage ratio”) of $132,260.

When preapproving your business for an SBA loan, the lender may also review additional criteria. For example, if the revenue of your business has consistently declined in recent years, then your business may not be approved.

Additionally, the lender will require that your business be appraised. If the value of your business does not meet the lender’s requirements, then your loan may be denied. For information on deciding what type of appraisal you need, please see Chapter 2, Valuation.

In summary, there are several reasons your business may not be preapproved for an SBA loan. If you are not able to obtain preapproval, it does not mean that the buyer or your business will not obtain an SBA loan. It does, however, mean that obtaining a loan is unlikely. In this case, we recommend checking with several lenders.

If your business does receive a preapproval, then we recommend that the buyer also gets preapproved as early in the process as possible. Remember that both your business and the buyer must obtain approval. The lender will review the buyer’s financial position, credit, management experience and several other criteria.

If both your business and the buyer have been preapproved, then you have a decent shot at obtaining financing for the sale of your business. Note that there is just as much responsibility with you, the seller, as there is with the buyer to obtain financing for the deal.

Do not take the attitude that “the buyer wants to buy my business, so finding the money is their responsibility.” Remember, it is your business that is repaying the debt service. Most denials for SBA financing are related to issues regarding the business, not the buyer.
If your business is not approved for SBA financing, then you have two options:

1. Offer seller financing.

2. Sell your business for all cash and reduce the purchase price by 20% to 30% to account for the fact that you are asking all cash.

If your business has been preapproved for SBA financing, you do not need to offer seller financing as a second alternative. You can limit your search to buyers who are only interested in purchasing your business with SBA financing. In other words, you will “cash out” when you sell your business, with the exception of a small note you may be required to carry from the lender, which is typically less than 10% of the purchase price.

To see if your business might be prequalified for an SBA loan, please send an email to info@morganandwestfield.com. We can help you determine if your business might qualify for SBA financing. If not, we can give you specific advice regarding what to do to position your business to be approved for financing in the future.

**Part 4: All Cash vs. Financing**

Many business owners want all cash for their business. They have no interest in financing its sale.

So, we often get asked, “Can I sell my business for all cash?” The short answer is “yes.”

The long answer is “yes, but your chances decrease and your timeline increases, depending on your asking price.” Let’s explore this further.

*Before we dive into the details, note that this applies only if the buyer of your business is an individual. It does not apply if the buyer of your business is a competitor, another company or a financial buyer, such as a private equity group.*

*Why do your chances of selling your business decrease if you are asking all cash?*

Your chances decrease because buyers always seek other options in the market. In other words, there are other businesses for sale where the owner is offering financing, or where those businesses have been preapproved for SBA financing. Buyers also tend to have less confidence in sellers who are asking all cash. Many buyers worry that the seller may be hiding problems and looking to take the cash and run, so to speak.

Why are options important for buyers and you, the seller? Approximately 95% of the time, buyers of small businesses priced less than $5 million are not looking to buy one specific type of business. They are considering a variety of different industries, such as service-based, retail and manufacturing, among others. Specialty businesses that buyers do target include most professional service firms and other niche businesses that require a unique knowledge base.
Buyers are looking at hundreds of businesses on the market, in which an abundance of choices is available. As a result, they tend to choose businesses that offer financing — either through the seller or those that have been preapproved for SBA financing. Most buyers tend to dismiss businesses that are asking all cash.

First, buyers considered sellers who are asking all cash to be unrealistic, except in some cases such as when the seller is ill or retiring. For the most part, buyers are wary of sellers who want to take the cash and run, figuratively speaking. They see this as a lack of faith in the business from the seller and as a warning sign that something may be wrong with the business.

Second, buyers of businesses prefer to leverage their money. For example, if the buyer has $600,000 in cash to invest in a business, they want to buy a business for $1.2 million as opposed to a business they can purchase for only $600,000. Why? Let’s examine the numbers behind the logic:

<table>
<thead>
<tr>
<th></th>
<th>Business A</th>
<th>Business B</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asking price</td>
<td>$600,000</td>
<td>$1.2 million</td>
<td>Down payment is the same for both businesses.</td>
</tr>
<tr>
<td>Down payment</td>
<td>$600,000</td>
<td>$600,000</td>
<td>Both scenarios assume a multiple of 3.</td>
</tr>
<tr>
<td>Annual cash flow or profit from the business</td>
<td>$200,000</td>
<td>$400,000</td>
<td>Multiple is the same for both businesses.</td>
</tr>
<tr>
<td>Multiple (Asking price/cash flow)</td>
<td>3.0</td>
<td>3.0</td>
<td>Debt service is also tax-deductible, but we did not include this in our calculations. Assumes a seven-year amortization period at 5% interest.</td>
</tr>
<tr>
<td>Annual debt service</td>
<td>$0</td>
<td>$100,000</td>
<td>Note that debt will be repaid in seven years for Business B. After seven years, cash flow will increase to $400,000.</td>
</tr>
<tr>
<td>Annual cash flow after subtracting debt service</td>
<td>$200,000</td>
<td>Years 1-7: $300,000 Years 8-10: $400,000</td>
<td>Note that this is a reverse of the multiple (1.0/3.0 = 33.33%)</td>
</tr>
<tr>
<td>Return on investment (ROI)</td>
<td>33.33%</td>
<td>33.33%</td>
<td></td>
</tr>
<tr>
<td>Cash-on-cash return on investment</td>
<td>33.33%</td>
<td>Years 1-7: 50% Years 8-10: 66.66%</td>
<td></td>
</tr>
</tbody>
</table>
Value of business at 10 years | $600,000 + nominal growth rate | $1.2 million + nominal growth rate

*Note: We have assumed a 10-year ownership period for both Business A and Business B.*

Which business would you rather buy? Business A or Business B? Both businesses require the same down payment ($600,000). However, Business B is offering 50% financing, which is a common scenario, and Business B has a higher cash flow, which means the buyer will put more money in their pocket, even after paying the debt service.

Most buyers would purchase Business B because they are leveraging their investment. In other words, they are buying a business that will put more money in their pockets ($300,000 [for years 1-7] vs. $200,000) for the exact same down payment ($600,000).

Also, because Business B is offering financing, this means that the seller of Business B has more faith in their business, which makes the buyer more comfortable. Hence, Business B may be a lower-risk investment for the buyer.

One additional principle to consider is equity building. Let’s assume that both owners sell the business after 10 years. The owner of Business A would receive $600,000 for the business, and the owner of Business B would receive $1.2 million for the business. We excluded growth to keep the calculations simple. So, the owner of Business B is richer as a result. The buyer of Business B used the cash flow of the business to pay for itself.

The terms are often more important than the purchase price. As with everything in life, there are exceptions. In some cases, those who adhere to their old country’s customs prefer to pay cash.

About 10 years ago, I was selling a gas station for $1.5 million. While structuring the promissory note, I asked the seller, who was from Lebanon, his preferences regarding the interest rate.

He told me 0%. I thought the seller misheard me, so I asked him again. He again told me 0% and that he was forbidden from charging or receiving interest payments.

If your business is the type that is commonly purchased by buyers who, because of culture or religion, are not into conventional financing, then you *might* get away with asking all cash; however, expect a discount. Most of these businesses tend to be retail, specific types of manufacturing and retail distribution. Most are also concentrated in ethnically diverse cities, such as Los Angeles, Seattle or Miami. For these types of businesses, we recommend two prices: an all-cash price and a seller-financed price. The price difference should be at least 20% to make economic sense.

*I still want to ask all cash, what are my options?*

If you still want to ask all cash, then you have two options:
1. Get your business preapproved for SBA financing.
2. Ask all cash, but be prepared to discount the asking price by 20% to 30%.

Timeline for selling a business vs. terms

The time it takes to sell a business depends on several factors. This was discussed in Chapter 1. Two of those factors are purchase price and the amount of financing offered. Assuming all other factors are equal, a business with more favorable price and terms will sell more quickly than one with less favorable price and terms.

Part 5: Retirement Funds

Buyers can also access their retirement funds on a tax-deferred basis to buy a small business.

Why would a buyer consider using retirement funds to buy a business? And why would you, as a seller, prefer a buyer to use retirement funds to buy your business as opposed to other forms of financing?

- **Ease of access** – Buyers can quickly access their retirement funds; whereas obtaining bank financing is costly, time-consuming and difficult. Sellers more readily accept an offer from a buyer who uses retirement funds to buy their business; whereas most sellers are reluctant to accept offers subject to financing due to the traditionally high failure rate of obtaining a bank loan to purchase a business.

- **Cash at closing** – Using retirement funds creates a win-win situation for the buyer and the seller. The buyer can easily access funds to purchase the business, and the seller receives cash at closing.

- **Streamlined process** – The process of accessing a 401(k), IRA or other retirement funds to purchase a business is relatively quick and easy. Compare this with the process of obtaining a bank loan, such as an SBA 7(a) loan, which is time-consuming for the buyer and the seller. When obtaining bank financing, a buyer is often required to prepare a business plan and projections, in addition to dozens of other document requests. These strict requirements are not present when a buyer accesses retirement funds to purchase a business. As you can see, a seller will be more reassured when accepting an offer in which the source of funds is the buyer’s retirement account.

- **High success rate** – Once an initial screening takes place, the likelihood of being able to access retirement funds to buy a business is high, well above 90%. Compare this with the process of obtaining a bank loan to purchase a business, which can take weeks just to receive a preliminary approval.

- **Low cost of funds** – When buying a business, using retirement funds can be less expensive than using bank money. Simply stated, banks charge interest. A buyer can easily pay over $100,000 in interest on a $500,000 loan over the life of that loan. Compare this with the use of retirement funds as a source of financing — retirement funds are the buyer’s own money, and there is no interest to pay. While there are fees associated with administering a retirement fund, they are significantly less than the interest charged on a bank loan.
• **Creative deal structures** – The use of retirement funds allows for creative deal structuring. This structure can combine other sources of financing, such as traditional or SBA bank loans, without causing complications. Because the retirement funds are treated as the buyer’s own money, subordination of financing will not be an issue.

• **Can be used as a down payment** – Retirement funds can be used as a down payment on a business. This can be combined with other forms of financing, such as seller or bank financing. For example, we recently sold a business where the buyer used $100,000 of his retirement funds as a down payment, the bank financed $700,000, and the seller carried a note for $100,000. The deal would have been impossible without access to the buyer’s retirement funds.

• **Credit score not required** – Credit scores are not considered when accessing retirement funds. It is the buyer’s money. The buyer is not borrowing money from a bank, and therefore no minimum credit score is required.

• **Multiple purposes** – The funds, once accessed, can be used for a multitude of purposes, including working capital and purchasing new equipment or other corporate assets.

• **No debt** – Some people seek to avoid debt at all costs. A buyer who uses their own money, such as retirement funds, is not creating debt.

• **Maximizes cash flow** – Less interest to pay equates to higher cash flow for the buyer. This can help justify a higher purchase price if cash flow is strained when preparing financial models that incorporate some form of bank financing.

• **Tax benefits** – The use of retirement funds presents many tax benefits for the buyer of a business, including the ability to set aside additional tax-deductible funds post-acquisition.

If a buyer has less than $50,000 in retirement funds, it is often cheaper to simply take the distribution and pay the associated taxes and penalties. If the buyer has in excess of $50,000 in retirement funds, then the benefits above apply and this deal structure may be used.

Note that this source of financing is available only to individuals. Companies use alternative sources of financing to finance acquisitions.

Although retirement funds have several advantages to both the buyer and the seller of a business, bank financing should not be discounted. In the absence of other forms of financing, bank financing is critical.

*How does the process work?*

The buyer creates a new entity, a C Corporation. The C Corporation creates or issues stock. The corporation then forms a profit-sharing plan. Afterward, the buyer rolls over the retirement funds into a new retirement
account. The funds are subsequently exchanged for the newly issued shares in the new entity. The cash in the corporation can then be used to purchase a business or other corporate assets. One warning — do not do this alone. Always use the advice of a professional when setting up this type of account. Employee Retirement Income Security Act (ERISA) and Internal Revenue Service (IRS) penalties apply if the buyer does not comply with the rules.

**Why do we love this strategy?** Frankly, it is a win-win situation for everyone involved. There are many benefits for the buyer, including ease of access and low fees. For the seller, it creates a simplified and streamlined process with a high success rate. This means that a seller can accept an offer without worrying whether the buyer will be able to obtain financing.

**Have questions?** If you are considering buying a business and have questions about using your retirement funds for this purpose or if you are selling a business and would like to know how you can offer this form of financing to buyers, please send an email to info@morganandwestfield.com.

**Summary**

Buyers have three major sources of funds: bank financing, seller financing or the buyer’s retirement funds. We recommend first preapproving your business for SBA financing. If SBA financing is available, then there is no need to offer seller financing. If SBA financing is not available, then you must offer seller financing or ask all cash and plan on discounting the price by 20% to 30%.

*Morgan & Westfield* can help you navigate one of your life’s most difficult, yet significant events — selling your business.

*Don’t leave money on the table.*

Call us today for a 30-minute call to see how we can help you.
Chapter 4 – Finding and Working with a Broker

Part 1: Types of Listing Agreements

Selling your business is an important decision, and the process can be overwhelming for those who have not sold a business before. After you have decided to sell your business, your first step is to hire a business broker or M&A advisor to assist you throughout the process. Do a simple Google search and you will discover there are many brokers and advisors out there who offer various types of agreements, such as an exclusive listing or an open listing, to help you sell your business.

How do you know which broker to choose and what type of agreement to enter into with that broker? In this section, we will help you understand the basics of the listing contract in all its various forms.

The listing contract

When you work with a business broker, you will sign a listing contract. A listing contract is a legal agreement between you and the broker whereby the broker agrees to sell your business on specific terms, and you agree to adhere to those terms.

The broker will be doing most of the work when it comes to selling your business, including confidentially marketing your business for sale. This can be accomplished in a variety of ways, and before committing to a listing agreement with a broker, you should understand the strategy your broker will employ for selling your business.

Most likely, your broker will use portals and other sources specific to selling a business to source potential buyers. However, before this process begins, you must choose a broker and sign a listing agreement. Brokers use one of three types of contracts, all of which are outlined in detail below.

Exclusive listing

An exclusive listing is the most common type of agreement when selling your business through a broker. This means that the broker you hire is the only broker permitted to actively promote your business for sale. In return, the broker receives a full commission for selling the business. You can also promote your business for sale, but you will still be required to pay the broker’s full fee in the event of a sale even if you bring the buyer to the table.

You can see why most brokers want an exclusive listing. They invest a significant amount of time in packaging, marketing and selling your business, and they want to be paid for the sale regardless of who generates the buyer. Again, if you sign an exclusive listing, your broker will receive a commission regardless of who brought the buyer to the table.

The obvious question that follows is, “Why would I want to enter into an exclusive listing with a broker?”
There are several reasons to list with a broker:

- A broker invests a significant amount of time and money in marketing your business for sale.
- A broker knows how to target the right buyers.
- A broker negotiates the contract for selling your business.
- A broker helps you close the deal.
- A broker knows how to navigate all the legal documents and requirements for the sale and the closing.

Similar to screening a potential employee, you should consider how much experience each broker has, the broker’s reputation in the community, and the broker’s presence in the marketplace. You should ask questions that address the broker’s knowledge of the ups and downs of the market — both locally and nationally. Additionally, you should receive a detailed plan on how the broker will sell your business, even though the agreement you make in an exclusive listing contract will not mandate exactly how they will promote your business.

Once hired, your broker will become an advocate for your business. The contract will describe all the terms you agree to, including that the broker will exclusively represent you throughout the duration of selling your business and the amount of the commission as compensation.

**Open listing (non-exclusive listing agreement)**

In an open listing, you can retain more than one business broker to sell your business. In an exclusive listing, even if you are the one who finds a buyer for your business, you will still have to pay the broker a commission. On the other hand, with an open listing, you do not have to pay a commission if you are the one who finds a buyer who is ready, willing and able to buy your business. If you choose to hire more than one broker, you only pay commission to the broker who sells the business.

Many sellers think this type of listing is the ideal situation for a seller, as it appears to create a wider market and can save you money if you find a buyer yourself. However, most brokers will not agree to this contract because they want to ensure a commission for the time they will be investing in selling your business. A broker will understandably put much more effort into a listing on which he knows he will not lose his commission. In other words, only inexperienced brokers will agree to an open listing contract.

Also, because many people are involved in selling your business, keeping the sale of your business confidential can become a nightmare. An open listing rarely attracts experienced and knowledgeable brokers. An open listing attracts a dizzying array of inexperienced brokers, all whom may jeopardize the confidentiality of your sale.

**Exclusive agency listing**

In an exclusive agency listing, you can sell your business without paying a commission if you find your own buyer. However, like the exclusive listing, you can only engage one broker at a time to help sell your business. The broker can cooperate with other brokers to help sell the business, but you are obligated to use only the
one broker you contracted with. The broker will receive the commission if they bring a buyer, regardless of the method used.

*Why exclusive listing agreements are the norm*

As mentioned above, brokers are interested in exclusive listing agreements so they can ensure they receive a commission for the time and work they invest in selling your business. Preparing your business for sale, promoting your business and securing a buyer all require a lot of time, work, effort and resources. In fact, it takes so much time that most brokers require a 6- to 12-month contract to sell your business.

Committing your business to one broker for so long may feel counterintuitive, as multiple brokers trying to sell your business may seem to yield a buyer more quickly. However, an exclusive listing benefits you in many ways. If you are committed to only one broker, that broker will be more willing to commit the time and effort it takes to sell your business. With multiple brokers competing to sell your business, none of them will feel confident in contributing their full time and resources to sell your business only to end up with no commission.

Preparation is paramount to selling a business, and brokers working on an open listing will not invest time to help you prepare and properly position your company for sale. Additionally, because brokers use the same marketing methods to sell a business, retaining multiple brokers will result in duplication of efforts that may be unnecessary. You will also lose credibility if buyers see your business listed with multiple brokers. If you take the time to interview brokers as we suggested above, you can rest assured you are putting your business in capable hands.

**Part 2: Other Terms and Conditions to Consider**

*Length of listing*

If you are not comfortable with committing your business to one broker for a year, remember that you can negotiate the length of the contract. You can always try to negotiate a six-month contract instead.

*Cancellation of contract*

Remember to discuss cancellation rights with your broker. Some listing contracts will allow you to cancel any time you want, in which case it does not matter if your contract is longer than a year. By providing you with cancellation rights, the broker is giving you a way to opt out of the contract if you are not satisfied with the results.

*Expiration of contract*

A contract expires when the time agreed upon has expired. Both parties can agree to renew the contract if they like. Nonetheless, at the end of the contract, the broker should provide you with a list of the potential buyers generated throughout the duration of the contract. Remember that in an exclusive listing agreement, locating a buyer and closing the sale before the contract expires will result in a commission being owed to the broker.
**Brokers’ compensation**

Brokers receive compensation in three ways: by the hour, through a retainer or through a commission upon a sale. Of the three, the commission is the most common method of compensation. Some brokers also work using a combination of these methods.

With a commission, you pay the broker at the closing. The details regarding the exact time you pay your broker will be based upon the terms of your contract, although it is usually when you close the sale of your business.

How much you pay is negotiated in the listing contract, and it is a percentage of the sale — usually 10% to 12%. However, it can also be a flat fee. If you own a smaller business that will sell from $100,000 to $1 million, you should expect to pay on the higher end of that percentage range. For businesses over $1 million, brokers will usually employ the Lehman or Double Lehman scales, ranging from 2% to 8% of the purchase price. Nonetheless, commission rates are usually negotiable.

The commission provides not only compensation to the broker for their time but also reimbursement for expenses such as listing the business for sale on websites and otherwise marketing and promoting your business.

**The bottom line**

Find a business broker you can trust, and generally, the most experienced brokers will require an exclusive listing contract. Although you may be a bit wary of it at first, remember that most of the terms are negotiable, including the length of the contract and the amount of the commission. While Morgan & Westfield does not require an exclusive contract and also does not charge high commissions, we are far from the norm. The majority of brokers work on full commission and require an exclusive, one-year contract.

**Part 3: Is It Possible to Sell a Business Without a Broker?**

Yes, it is possible to sell a business without a broker, just as it is possible to sue someone without the help of an attorney. Although a broker is not always necessary, there are instances when a broker may be useful and when you can get away without the help of a broker.

**We recommend using a broker in these situations:**

- You have never sold a business before.
- You would like to maximize the purchase price of your business.
- You would like to sell your business as quickly as possible.
- You do not want the sale of the business to distract you from running your business.
- You are working full time in the business and cannot invest a significant amount of time in the sale process.
- You have been approached by a potential buyer, either with or without an offer.

**Here are a few situations in which we believe it is not necessary to hire a broker:**
● You already have a buyer, have negotiated the price and are not concerned about maximizing the price. While you may not need a full-service broker in a case like this, we still recommend hiring an attorney or a broker to assist with the closing.
● You are selling your business to an insider, such as a family member or an employee. Our recommendation is to hire an attorney in this case.
● You are a serial entrepreneur and have sold multiple businesses before.

What are the pros and cons of selling without a broker?

The main advantage of not using a broker is the opportunity to lower professional fees. This does not necessarily mean you will maximize your net proceeds from the sale. Just as you may “save” money by litigating a case yourself, your net result may mean less money in your pocket than if you hired an attorney.

There are five primary drawbacks to not using a broker:

1. **Lack of expertise** – If you hire a broker whose sole expertise is selling companies, their knowledge alone may justify the fee.
2. **Lack of emotional objectivity** – Selling a business is an emotionally charged event, and an intermediary can put you in a stronger negotiating position and help you maintain your cool throughout the process, potentially raising the purchase price and therefore justifying the broker’s fee.
3. **Larger investment of time** – Selling a business requires an enormous amount of time. An experienced broker is 5x to 10x more efficient at the process than you. For example, while you may save money by waxing your car yourself, the process may take you eight hours, whereas a professional can get the job done in two hours. If a detailer charges $50 per hour, then you are not paying yourself $50 per hour, you are paying yourself $12.50 per hour. Do the math.
4. **Lack of focus** – Selling your business on your own carries the enormous risk of losing focus on your business, letting revenues slip, and therefore negatively impacting the value of your business. Again, while you may save on professional fees, the net result may mean less money in your pocket.
5. **Lack of confidentiality** – Selling a business on your own could put the confidentiality of the sale at risk. If, instead of a broker, you are the contact person of the advertisements you place, it will be easy to trace the sale to you. Your employees or other parties that you do not want to know you’re selling may find out about the sale. You may think you can save money by not paying professional fees, but without confidentiality, the risk of losing more money is high.

What specific tasks do you need help with from a broker?

While the services of a broker are helpful in a variety of scenarios, you should intelligently structure the engagement to use only those services that you need. This is the secret that most entrepreneurs miss. Most business owners hire brokers on an exclusive basis, at a 10% to 12% commission, without giving thought to what exactly they need assistance with.

Unfortunately, most brokers today only structure their engagements as a full commission, one-year, take-it-or-leave-it option. We are one of the few that offer our services on an a-la-carte basis.
The primary tasks brokers perform are:

- Preparing an exit strategy for the business
- Assessing the readiness of the owner to sell
- Valuing the business
- Preparing a business summary or selling memorandum
- Preparing a teaser profile, an abstracted version of a selling memorandum
- Normalizing, adjusting or recasting the financial statements
- Marketing the business for sale
- Screening buyers
- Showing the business
- Negotiating the transaction
- Preparing the offer
- Managing the due diligence process
- Closing the transaction

Not all steps are required for the sale of every business. Review the options above and ask yourself if you need help with these steps. If not, the fee should be reduced accordingly. For example, many businesses do not require a formal valuation or the use of a teaser profile. An owner may approach us after a buyer has made an offer.

Some brokers may attempt to charge a full commission on a deal like this. On the other hand, we believe the fee should be reduced accordingly. In fact, that is exactly how we handle an engagement like this.

*The one step that you can do without a broker*

Review the steps above again. Ask yourself if you have the requisite skills, knowledge, experience and tools to perform these tasks. In our opinion, these steps involve either the use of specialized tools or the use of technical knowledge or experience that you are unlikely to have — except one.

Alarmingly, the one step that does not require specialized knowledge or skills also consumes the majority of a broker’s time. Why would you pay the broker to do this when you can do it yourself? To us, it doesn’t make sense, and brokers do it because that is the way it has always been done and that is how everyone is currently doing it. In other words, they are mindlessly performing this function without questioning its utility.

What is this function? It is showing the business. This involves meeting with the buyer, touring the business and answering basic questions about your business. Frankly, we have attended hundreds of these types of meetings in the past, long before we abandoned this practice. After the 499th meeting we attended, we realized we were not providing value at these meetings and decided to cut this step out of the process entirely.

What was the result? Simple — we cut the time we personally invested in the deal by over 70%, and we reduced the fees accordingly.
The real question

The real question is not “should I use a broker?” but rather, “How do I use a broker?” As mentioned above, there are a few situations in which using a broker is not necessary. Once you have established that a broker would be helpful, ask yourself what exactly you need help with. Then negotiate with the broker to only provide those services. Following this route will result in the maximum proceeds and the smoothest sale possible.

How to make the sale process smoother and easier

As a professional service provider, we must learn to work with what is given to us. We do, however, communicate with our clients, are honest, and work hard to align our goals and set realistic expectations. Being the perfect client for us or any other business broker will thus help you, as doing so will make the sale process smoother and easier. After all, doing so is in your own best interests.

Three most important traits when selling your business

Most brokers talk among each other either at inter-office meetings, industry meetings or other events. In many of these events, they usually discuss their experiences with business sellers. In any professional service industry, when service providers have the chance to get together, they usually talk about their clients.

What if we told you what they are saying about you? What if we told you the one common thing that hundreds of business brokers whom we have talked to say they need from their clients to close more deals? Would you listen? If we told you these things, would you promise to us that you would attempt to do it?

Well, here you go:

1. Cooperation – Business brokers’ jobs would be easier if they could get sellers to cooperate. A business broker’s job is difficult because they must manage the actions and expectations of both the business owner and the buyer, who both usually have very strong personalities and tend to be impulsive. All these factors combined with the fact that selling a business is a stressful event make a business broker’s work far from a walk in the park. Why do you think most business brokers charge 10% to 12% commission?

   A business broker needs cooperation from you. This involves thinking about the sale in advance, preparing for the sale, following through on your promises, communicating openly with your broker, and responding to your broker’s requests. It may be hard to believe, but cooperation is the number one thing that all brokers wish they could receive from their clients.

   Sometimes, not having financial documentations ready makes sellers less cooperative with their brokers. This, however, should be properly addressed because not having clean financial records is the No. 1 deal killer in business sales.
Middle-market business owners tend to be more cooperative because they have a larger support staff to assist them with the sale. Because they do more planning, they are less impulsive and more committed to their plans.

2. **Honesty** – A seasoned business broker has seen just about everything. From owners and their spouses filing for divorce, money disappearing from a business because of one spouse’s drug addictions, to extra-marital affairs. There is nothing to be ashamed about when talking with an experienced, professional business broker because we have heard it all before.

A good intermediary is like a therapist. We have seen and heard it all before. This is strictly a business for us. We see partner disputes all the time. Many people contact us because they have a terminal illness. We have even heard about one of our clients getting murdered for trying to sell a business that was not his. This is a profession for us, not a hobby. We have no reason to make moral judgments. There is nothing to be ashamed of.

Trust is critical to the process because it is a long process. Selling a business can take 6 to 18 months. Eventually, the truth will come out on its own. If you are honest with your broker and other professionals, they will trust you, which will then strengthen your professional relationship. If you are selling because you are bored with your industry and burnt out, then tell your broker.

If you are selling your business because you see a large competitor taking over your industry, then tell your broker. By telling your broker, they will be able to prepare for this objection by a buyer, and you can arm them with the knowledge to defend this objection. No business is perfect; every business has its flaws. We have heard it all, so be honest.

Tell your broker everything they need to know about your business — good or bad. Any information will come out eventually, so tell them everything upfront. Why? This builds trust with your broker. If your broker trusts you, then they will work harder for you.

3. **Patience** – Selling a business is a long process that can take 6 to 18 months. This is not something you can expect to do in a couple of months. Exercise patience and persistence. Give your broker the time they need to do their job. Contact your broker on a regular basis to discuss revising your marketing strategy if you are seeing poor results.

*How you can help your broker make the sale process more efficient*

**Do what you say** – Commit to something and do it. Clients, however, do not always heed our advice, and we are fine with that; just tell us if you will not act on our advice.

**Stay focused on your business** – Postpone your trip to Hawaii until after the conclusion of the sale and transition. Doing so before the closing may result in your business’s revenues slipping. Continue managing your business while your broker manages the sale.

**Provide correct and updated information** – Give us accurate, up-to-date financial information on your business.
**Be actively involved in the process** – Even with the help of a broker, you will still have responsibilities during the sale process, such as showing your business to potential buyers and producing necessary documents.

**Summary**

We recommend first deciding if a broker is necessary to sell your business. If so, hire an experienced broker on an exclusive basis and then decide on the strategy and tasks involved needed to sell your business. The fee should be based on the level of work the broker is expected to do. Once you have retained the broker, work hard to build a trusting relationship and arm the broker with the information and knowledge they need to sell your business.

*Morgan & Westfield can help you navigate one of your life’s most difficult, yet significant events — selling your business.*

*Don’t leave money on the table.*

*Call us today for a 30-minute call to see how we can help you.*
Chapter 5 – Attracting Buyers

Part 1: Fishing vs. Hunting

*Which is the right way to sell your company: using a fishing rod or a rifle?*

Selling a business with a fishing rod involves casting a line, dropping the lure and waiting. In the real world, this involves confidentially marketing your business for sale using various media: online media, trade publications, newspapers and others. This is a passive approach, in which you place the advertisement, then sit and wait (visualize your average fisherman patiently waiting).

When fishing, you do not know who or what is going to bite the bait — it could be a 10-pound bass or a 50-pound tuna. You usually have a rough idea based on the body of water (media) you are fishing in, although there are always exceptions.

Selling a business with a rifle, on the other hand, involves knowing exactly who your targets are, hunting them down, confronting them directly, and firing an accurate shot right where you need to. Selling a business with a rifle is an active, involved process (think costlier and more time-consuming) that requires planning, discipline, accuracy and stealth (confidentiality).

While I prefer to avoid generalizations (yes, this is a generalization about generalizations), here is what I've observed:

You sell  **small** businesses with a fishing rod, and you sell  **mid-sized** businesses with a rifle.

In some cases, you can use both. Note that you also tend to **fish** for smaller creatures (e.g., bass, salmon, tuna, crappie, trout), while you **hunt** for larger creatures (e.g., deer, elk, bison, moose). This is the same in the business world.

*‘Fishing’ is for small businesses; ‘hunting’ is for mid-sized businesses*

Let me first define a small business and a mid-sized business:

- **Small business** - Annual revenue: less than $10 million; annual cash flow/profit: less than $1 million
- **Mid-sized business** - Annual revenue: $10 million to $100 million; annual cash flow/profit: $1 million to $10 million

Who buys small businesses?

In determining a marketing strategy for selling your company, you must first define your target market. **Small** businesses are predominantly purchased by individuals (about 95% to 99% of the time) and not commonly acquired by companies (about 1% to 5% of the time).

Next, you must figure out the most efficient way to contact these individuals. Do you have to go door to door or randomly stop people on the street to ask if they want to buy a business (hunting)? Or is it more effective...
to advertise your business for sale in a form of targeted media (this is the body of water, lake or ocean you choose to fish in) that reaches individuals who are actively looking for businesses to buy?

Because the target market for small businesses is primarily individuals, the most efficient and cost-effective method of contacting those buyers is through targeted forms of media, in which those individuals have identified themselves as potential buyers of businesses. In other words, this group of people has already been corralled for you, thus making the process more efficient, and therefore cost-effective.

What about mid-sized companies?

Again, in preparing a marketing strategy to sell any company, you must first determine your target market. Who buys mid-sized or middle market companies? These are typically purchased by three types of buyers:

1. **Private, wealthy individuals** – The most common buyers of businesses priced at $1 million to $5 million.
2. **Other companies** – They might be your direct (lateral or horizontal) or indirect (vertical or another form) competitors.
3. **Private equity groups** - Also called financial buyers. They can sometimes be strategic if one of the companies in their portfolio holds potential synergies with your company.

Wealthy individual buyers can’t be hunted

Mid-sized businesses priced at around the $5-million to $10-million mark are commonly purchased by wealthy individuals, so it may make sense to both fish and hunt for them. However, as the price of the business increases — e.g., over $10 million — finding wealthy individual buyers becomes more difficult.

Wealthy individuals are also private people, and they cannot easily be “hunted.” Contacting them via targeted media is more efficient. If they maintain a presence on targeted media, then they have identified themselves as someone who may be a good fit. These wealthy individuals are also rare and usually do not have over $10 million in liquid funds to invest in a business. If they do, then they most probably already own another company. In such a case, it makes sense to contact them through the company they own.

Smaller or larger companies: Which should you target?

“Other companies” — the second type of buyers, who are typically your competitors — could be categorized as smaller or larger companies. In buying a business, they normally set minimum criteria: primarily profitability or cash flow. As a general rule, companies tend to acquire other companies with at least $1 million annual cash flow.

In choosing other companies to acquire your business, be particularly wary of smaller companies with revenue of less than $10 million per year. Unlike what most people believe, smaller companies do not actively acquire other companies. Why? Well, they are too busy putting out fires and chasing the next big customer to be proactive enough to create a team focused on developing and executing an acquisition strategy.

An important concept you need to remember when selling your company using the “rifle” method is to approach only those targets that are ready, willing and able to take action. You will know this by researching...
the company and determining how many acquisitions it has made in the past one to five years. The more acquisitions or companies it has purchased recently, the more likely that it will buy another company.

An overwhelming majority of smaller companies are not ready, willing and able to spend hundreds of thousands or millions of dollars to purchase a competitor. Of course, there are exceptions, but in general, only mid-sized and larger companies grow through acquisitions.

Smaller companies typically grow organically — by slowly increasing their marketing and advertising budgets. Most of them are in a state of disorganized chaos, are busy chasing the next big deal or new big customer, and do not have large cash reserves to pursue acquisitions as a growth strategy. Attempting to sell your business to smaller companies is therefore an ineffective strategy that can waste an enormous amount of time.

*On larger companies making business deals: ‘Size does not matter’*

Again, the primary criterion larger companies use to determine if an acquisition makes sense is annual profitability, cash flow or EBITDA. These companies are looking for a minimum annual cash flow or profitability, also called EBITDA, of $1 million to $10+ million.

Why? The answer is simple — it takes just as much time to do a $1-million deal as it does to do a $25-million deal. Also, the professional fees involved in the acquisitions are similar (just slightly higher for larger deals), regardless of the size of the deal. The fees, therefore, decrease — as a percentage of the total deal size — as the deal size increases.

For example, a $1-million deal may command fees and expenses of $100,000 or more (10% of the deal size), while a $25-million transaction may command fees of $150,000 to $300,000 (0.6% to 1.2%). This means that the percentage of fees and expenses decreases as the size of the deal increases. Doing larger deals is, therefore, more cost-effective.

A company must invest in 25 businesses — each having a cash flow of at least $1 million per year — to have the same impact as buying a single company with an annual cash flow of $25 million. So buying larger companies is more efficient, both from a cost and time perspective.

*Is your business an exception to the ‘EBITDA’ rule?*

In any deal, there are exceptions. In this case, exceptions exist when a company can be sold above its valuation. The only two exceptions, however, that can influence the acquiring company’s criteria are:

1. Intellectual property – the patents, trademarks or trade secrets that your company has.
2. Any form of synergy that can bring a tremendous amount of value and that cannot be easily replicated by the acquiring company.

Based on my years of experience helping business owners sell their companies, less than 5% of companies for sale have either of these two components, so most acquiring companies resort to the “minimum EBITDA” criteria in buying a business.
Let me illustrate an exception:

- **Norm** – Your company is worth about $5 million to $7 million. You would like to sell it for top dollar, which is $7 million.
- **Exception** – Your company is worth about $5 million to $7 million. You would like to sell it for $15 million to $20 million.

Determining whether your business is an “exception” requires us to use our professional judgment or pattern recognition skills. Any experienced professional, however, will not work on exceptions. Most professionals do what they know will work and what has worked in the past. Working based on exceptions only shows a professional’s lack of experience in the industry. Why? Any good professional who has been practicing their craft for over 10 years has likely gained a lot of work from referrals. Much of this work is probably not based on exceptions.

If your company is an exception (Read: You meet one of the two exception criteria above), then these rules — minimum criteria in buying a business — do not apply. Otherwise, the value of your business will only be as good as your EBIT or EBITDA.

*How do you hunt for private equity groups?*

Just like the first two types of buyers, private equity groups (PEGs) do set minimum requirements. As the PEGs’ portfolios become larger, they are forced to do larger deals. Most PEGs set a minimum requirement for revenues of the companies they are acquiring. Many, however, would like to acquire companies with at least $1 million to $5 million EBITDA per year.

PEGs rarely purchase companies because of a synergy. And note that the exceptions listed above for companies do not apply. PEGs are financial buyers who are after your financial performance and not any synergistic capabilities. The business must usually make sense on a standalone basis for financial buyers. The one minor exception is when a PEG owns a portfolio company that may have some synergy with your company.

Whether the right strategy for selling your business is fishing or hunting, or a combination of both, you must first determine your target market. Is an individual more likely to purchase your business? Or is your target market another business, or perhaps a private equity group? Using the information provided here will help you make this determination. And once you’ve identified the type of buyer that is most likely to acquire your business, you can conduct your marketing strategy accordingly.

*So, will you be fishing or hunting for an acquirer?*

The remainder of this chapter is about how to fish to sell your company.

*Where to Advertise*

*Where can you advertise your business for sale?*

- **Craigslist** – This site will no doubt get your ad widespread exposure; however, there’s no better place
to attract more unqualified buyers. Although you can sometimes get lucky and sell your business using Craigslist, if you value your time, it's not a good option. We recommend using this site only if you have the time and your business is worth less than $200,000; however, do so with extreme caution.

- **The Multiple Listing Service (MLS)** - About 30 years ago, the MLS was an effective place to sell a business; however, probably less than 1% of all business brokers use it now. One reason is that only licensed realtors who specialize in residential real estate or homes have access to it. Another reason is that most residential real estate offices no longer allow their agents to sell businesses due to the high degree of knowledge required, as well as the increased potential for litigation. As a result, the MLS is rarely a viable option to sell a business.

- **Newspapers** - Does anyone still actually read the newspaper? If you look at the Sunday edition of your local paper, in the Business Opportunities or Real Estate sections, you will likely see a few ads, most of which are for new franchise opportunities. The only mainstream (not niche) newspaper that's highly effective in confidentially marketing a business for sale is The Wall Street Journal; however, its advertisements are extremely expensive. Alternatively, you can experiment with local community newspapers, which are often low-cost; however, they don't always receive a high response. If you want to sell a business that's geared toward a specific area or tailored to a particular community, you may want to advertise in the local newspaper published just for that locale. Some examples would include a tourist gift shop on the waterfront or a New York-style deli.

- **Business-for-sale sites** - The most effective place to sell most businesses nowadays is business-for-sale sites or portals. These sites exclusively sell businesses and show up first in popular search engines, such as Google or Yahoo, when someone does an internet search using key phrases like "businesses for sale" or "buy a business."

**Here are some of the top portals:**

- [www.bizjournals.com](http://www.bizjournals.com)
- [www.businessesforsale.com](http://www.businessesforsale.com)
- [www.businessbroker.net](http://www.businessbroker.net)
- [www.businessmart.com](http://www.businessmart.com)
- [www.mergerplace.com](http://www.mergerplace.com)
- [www.bizbuysell.com](http://www.bizbuysell.com)
- [www.bizquest.com](http://www.bizquest.com)
- [www.dealstream.com](http://www.dealstream.com)
- [www.acquireo.com](http://www.acquireo.com)
- [www.globalbx.com](http://www.globalbx.com)

The most cost-effective and efficient way to sell your business is by using a business-for-sale portal. Most people immediately visit the internet when making any major decision, such as buying a car, home or business. Search "businesses for sale" or "buy a business" on any search engine, and you'll see the various options available to sell your business.
Part 2: Ad Copy

Make your business stand out with an effective business-for-sale ad copy

If you've decided to sell your business using a business-for-sale website, then writing attractive, engaging ad copy is critical. An effective ad is short, straight to the point, and sparks the interest of potential buyers. Visit some of the portals above to view some of the top websites to place business ads. Getting a feel for the sites to see what attracts you to different businesses is a good idea.

Consider these factors to maximize responses to your ad copy:

- **Gross sales** - Businesses with higher gross sales receive more responses, so you could, for example, use revenue projections in the ad. However, be prepared to explain to potential buyers how they can achieve the same numbers. We regularly suggest that sellers include a projected number or estimate, if the actual numbers aren't available or if they're unattractive, assuming there is a realistic plan to attain this projection.

- **Cash flow (net)** - Cash flow or net has the biggest impact on the number of responses. Again, you could report a higher number or use a projected number, but you'll need to explain to potential buyers how they can attain these results. We will discuss this in more depth later.

- **Location** - Businesses advertised in larger cities or metropolitan areas receive more attention. Be sure to advertise in the closest large market area. Reconsider advertising in a nearby large city if your city has fewer than 200,000 people.

- **Title** - Catchy titles attract more eyeballs, so use a creative and unique title. Here are some examples of titles that have worked well for us: "The Underwear CEO," "Profitable Virtual Internet Business" and "Coastal Lifestyle Business." The objective of the title is meant to pull qualified buyers in and nothing more. While the title shouldn't be misleading, its primary goal is to get qualified buyers to read your ad.

- **Fast response with complete information** - Ads that let buyers know they'll receive a timely response and access to complete information usually receive a more favorable response. We'll talk about this later.

- **Ad copy** - Longer ads receive fewer responses; however, they tend to attract a more qualified buyer in terms of interest. A buyer who is willing to read a long ad copy is committed to buying a business. However, you should keep your ad copy short, crisp and straight to the point if you want more responses. Write a long, descriptive ad if you are looking for highly qualified and committed buyers instead of quick responses. We, however, strongly prefer a brief, more concise ad. As always, balance is important. The balance between quantity and quality is delicate.

How to write a business-for-sale ad copy that sells

Here is an actual ad copy we used that received an excellent response:

```
TITLE - Lifestyle Sports Business 99k Down on California Coast
```
AD COPY - Stable revenue, stable cash flow. Fun, extremely rewarding business; ideal for the sports-oriented buyer. Shorter operating hours. Work indoors and outdoors. Highly motivated, realistic seller offering seller financing. Business is growing and stable. There’s no more enjoyable business if you love sports. The seller is serious and prepared; we have full documentation on this business and the business has a stable, long-term lease, and seller financing is readily available.

Have a 401(k) or IRA? Buy this business with your IRA/401(k) with NO tax penalties.

Email now to immediately receive the full package on this business. We have an electronic NDA you can sign in just 30 seconds, and then we will send you a complete 15-page, full-color summary plus an audio interview with the seller.

Why did it receive such a great response?

- **Title** – The ad had a catchy title that appealed to nearly every buyer. Lifestyle, low down payment, $99,000 and on the California Coast — who could ask for more?
- **Numbers** - The numbers were solid, and we posted them.
- **Ad copy** - The ad copy mentions exciting highlights or benefits of the business rather than boring characteristics or features such as square footage or length of the lease.
- **Call to action** - The ad asks for immediate action and offers a prompt response, along with a complete package. This is a hot button for buyers.
- **Low down payment** - Seller financing offered to buyers with a 50% down payment — another hot button for buyers.

What can you do?

So, what if you have a business that isn’t on the coast of California, is not making a lot of money, and is relatively boring? What can you do to write a better ad? Take some time to make it sound as interesting and as engaging as possible. Writing an effective ad may take some effort, but it will be time well spent.

- **Write a strong, catchy title** - Think about the unique aspects of the business and then put them in the ad. This may take some consideration, but every business has something unique or special worth mentioning.

- **Numbers** - If your business is not highly profitable, consider using projected numbers for the gross sales and cash flow, and then offer an explanation on how buyers can achieve the same results.

- **Ad copy** - Keep the ad copy crisp and concise. Point out the interesting highlights of your business, such as location (on the coast or in a busy mall), seller financing, verifiable numbers and a long-term lease. Avoid adding boring traits, such as a five-year lease offer or the fact that it includes 30 tables and chairs. Put yourself in the buyer’s place when writing an ad — what would catch your attention? What do you like the most about your business?
• **Call to action** – Include a clear call to action in your ads. Keep it short and simple and request that the buyer take the next step.

• **Financing** - Offer seller financing. We’ve consistently found that ads for businesses for sale that offer seller financing receive a significantly higher response.

**Part 3: Should I Disclose the Cash Flow of My Business in Ads?**

Many of our clients ask the question, “Should we include our gross revenue and net profit (SDE) in our ads when trying to sell our business?”

Some business owners believe that they have a “great story” to tell and that including the gross revenue and net profits seems to preclude them from telling their stories if it is dismissed at first glance.

Here’s what I recommend: If you own a small business, include the gross revenue and cash flow (SDE) in your business-for-sale advertisements. Yes, including this information will preclude you from telling your story if buyers dismiss your ads because the numbers are not high enough. However, online business-for-sale portals only include a limited number of details, including asking price and cash flow, on the preview page of their websites.

Disclosing your gross revenue and SDE in the ad copy may scare some buyers away, but we must accept the inherent limitations of the tools we use, e.g. online web portals, which are the number one source of leads for sellers of businesses. In general, buyers will never learn about your story unless they click the ad to view the details. Knowing these limitations and how to work around them are critical to the success of an ad copy.

_A preview of one of our business-for-sale ads that include the asking price and the cash flow, which indicates the multiple._

Unfortunately, gross revenue and SDE can have a significant impact on a buyer’s decision on whether to purchase a business. Most buyers are searching for a business with the lowest multiple possible. Wouldn’t you if you were a buyer?

In other words, wouldn’t you try to buy a business that would put the most money in your pocket for the lowest cost? Wouldn’t you be seeking the highest return on your investment? Which business below would you be more interested in — Business A or B?
<table>
<thead>
<tr>
<th><strong>Ad title</strong></th>
<th>Amazing Service Business with an Amazing Story</th>
<th>20-year-old B2B Service Business</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Asking price</strong></td>
<td>$400,000</td>
<td>$400,000</td>
</tr>
<tr>
<td><strong>Gross revenue</strong></td>
<td>$250,000</td>
<td>$1 million</td>
</tr>
<tr>
<td><strong>SDE</strong></td>
<td>N/A</td>
<td>$200,000</td>
</tr>
</tbody>
</table>

**Ad copy** (only the first two to three lines appear on the summary page)

**Business A**

This is an incredible opportunity to own a business with an amazing story. Our business has been operating for 35 years and it has been successful.

**Business B**

A highly profitable, B2B company with excellent online reviews and a six-year net profit growth rate in excess of 12% a year. The business is a leader in a niche market and has been serving one of the most resilient industries in the world for 35 years. Seller is offering a shared-risk, earnout/buyout package with seller financing and payments spread out over time.

You can also include in your ad copy an image that will appear on the search results page.

Sample search results:

- **Established Businesses For Sale**
  - Lawn & Garden – 35% Annual Growth Rate
    - Los Angeles, CA
    - Cash Flow: $999,752
    - With almost 10 years of experience in the lawn and garden industry, this company is a nationally recognized leader that provides an environmentally friendly solution for...
  - Green Service Business that Saves Homeowners Money
    - Austin, TX
    - Cash Flow: $23,614
    - Own a successful green business in the #1 rated city in America (according to Forbes 2016). This business saves homeowners money and the results are beautiful...
  - Online Product Wholesale & Retailer with IP
    - San Diego, CA
    - Cash Flow: $289,000
    - This company manufactures and sells a product line that sells to large, national retail customers, such as Barnes & Noble and Target. This is a successful business with a...
  - National Innovative Product Line with 4 Patents
    - San Juan, CA
    - Cash Flow: $205,000
    - This company manufactures and sells a successful business with a proven-track record. Customers include large national Class A Retailers. The product...
  - National Toy Company Selling to Major Retailers
    - Seattle, WA
    - Cash Flow: $299,999
    - This company manufactures and sells some of the most award-winning toys in the fastest growing segment of the toy industry. This is a successful business with a...
  - Niche B2B Retail Franchise
    - Houston, TX
    - Cash Flow: $95,000
    - This business is a niche, B2B retail franchise with an excellent, high traffic location and significant walk-in business and repeat customers. The company has been business...
  - Give Your Customers a Professional & Reliable Cleaning Service Experience
    - Baltimore, MD
    - Cash Flow: $127,000
    - This business is devoted to providing consumers with a professional and reliable cleaning service experience. The business seeks to build customer trust with...
  - Technology Retail & Repair with Repeat Customer Base
    - Toledo, OH
    - Cash Flow: $304,124
    - This business was established in 1986 and is a staple in the community, servicing Northwest Ohio and Southern Michigan. The business specializes in communications...
  - Highly Awarded Wedding Coordination & Styling Company
    - Pasadena, CA
    - Cash Flow: $78,000
    - One of the top wedding coordination companies in the Los Angeles area can now be yours! With over a decade of industry experience, this company is approved and...
  - Innovative Green Service Company – No-Weekends
    - Highland Park, IL
    - Cash Flow: $325,000
    - This company is a high-tech green franchise with a strong repeat customer base. Highly sophisticated business model with the capability to build a...
Including an image can influence results, although details on cash flow and ad title have the biggest impact on the results. You must attract the buyer's interest with all of the following, ranked in order of priority:

1. **Cash flow (SDE)** – Cash flow is critical to buyers. This, above all other factors combined, determines how many responses you will receive. Buyers calculate the cash flow relative to the asking price of the business (cash flow/asking price = multiple).

   For example, if the asking price is $1 million and cash flow is $250,000, then the multiple is 4.0. We've observed that ads of businesses with lower multiples can receive as much as 10 times more responses than those with higher multiples.

   So, if you are selling a business at a 2.0 multiple, expect it to generate more interest than a business sold at a 5.0 multiple.

2. **Asking price** – Asking prices can significantly impact the number of responses due to the supply-and-demand principle. There are more businesses available at lower price ranges on the market. A higher number of smaller businesses exist on the market than larger businesses. Additionally, there are more buyers with $100,000 cash than those with $10 million cash.

**Lawn & Garden – 35% Annual Growth Rate**
Los Angeles, CA (Los Angeles County) (Relocatable)

![Image of a well-maintained lawn and garden]

**Asking Price**: $3,500,000

**Cash Flow**: $939,752

**Components of an advertisement that has a significant impact on the results:** 1. Cash Flow; 2. Asking Price; 3. Ad Title; 4. Ad Copy; 5. Photo; 6. Gross Revenue
3. Similarly, there are fewer buyers of businesses at higher price ranges because there are more buyers with $50,000 cash than with $5 million cash.

Buyers of businesses with an asking price of less than $100,000 tend to be unqualified, so sellers of such businesses can receive many inquiries from unqualified buyers. For example, if you are selling a business priced at less than $100,000, then you may receive a lot of inquiries from buyers with less than $20,000 to invest. Businesses priced from $100,000 to $300,000 tend to receive a fair number of financially qualified buyers. For businesses priced above $500,000, the pattern is: the higher the price, the more financially qualified and sophisticated the buyers tend to be.

Sophisticated buyers tend to do more research prior to deciding which business to buy. So for every deal closed, sophisticated buyers may have looked at 100 or more other businesses.

For example, a buyer of a $300,000 business may look at 20 other businesses for sale, whereas a buyer of a $10-million company may research and contact over 100 companies for sale.

4. **Ad title** – The ad title is critical. Experiment with ad titles and change them every 30 to 60 days. An updated ad title can double or triple the number of responses. Using a new or different ad title also makes the business appear as a new listing. A buyer who has viewed your business before with the old ad title might not have been interested, but may now show interest because of the new ad title.

5. **Ad copy** (limit to about 50 words) – Most web portals display a limited portion of the ad copy — perhaps only two to three lines. If you have a story to tell, then you need to tell it in as few words as possible.

6. **Photo** – Avoid disclosing the identity of your business in the photo. Remember that the photo can be viewed by the public, so exercise discretion regarding what you show. The photo, however, should give the buyer an idea of what the company does in a visual format.

7. **Gross revenue** – Buyers do not apply as much weight to the gross revenue as they do to the cash flow, as margins vary widely from industry to industry. In fact, some business-for-sale portals no longer display the gross revenue on the search results. Gross revenue, however, still appears on the advertisement details, which is visible only after a potential buyer clicks on the ad to view the details.
Does advertising a business for sale without the gross sales or cash flow yield results?

We try this all the time and, unfortunately, this rarely works. Without listing gross sales and cash flow, most buyers assume the business has zero revenue; hence, they never bother looking at it and assume the business is a startup or a franchise.

Imperfect marketplace

Online business-for-sale web portals are a double-edged sword. While they make the process of selling a business easier and more convenient for sellers, they have also done so for buyers. Because buyers have more options and access to more information, they are now more selective and educated as a result. Selling a profitable business with a reasonable asking price is still a straightforward and simple process; however, selling an unprofitable business that has a story is more difficult now as compared with selling one 10 to 20 years ago.

The impact of the recession of 2007–2008

Since the recession, there has been an excess, or more supply than demand, of unprofitable businesses on the market. You can still sell an unprofitable business; however, it takes patience, persistence and time. This is
the reason that many businesses priced at less than $100,000 to $150,000 are more difficult to sell now. This
abundance of smaller, unprofitable businesses may, however, have finally cleared up in the previous few years.

Selling your business — the sales funnel

If you look at the sale of your business as a sales funnel, you will learn that the first step in the sale of your
business is generating an interested buyer. This is the most critical step in the funnel and is usually the
bottleneck for most business sellers. An important principle in any sales funnel is that the higher the step is
in the funnel, the greater the impact it will have on the end results. As the first step in the funnel, generating
interested buyers has the greatest impact on the chances of selling your business.

Spending a substantial amount of time crafting your marketing strategy and specific advertising strategies to
sell your business thus makes sense. Selecting the appropriate gross revenue and cash flow figures does not
involve creativity and therefore does not take a lot of time. On the other hand, writing the ad copy,
particularly the ad title, can and should take a lot of time. While this step may seem unimportant, its
importance cannot be underestimated. Correct ad titles can substantially improve the chances of selling a
business. Yes, just a few words can make the difference between selling your business and not selling your
business.

Why do buyers look so closely at the cash flow (SDE) when looking for a business to buy?

Buyers want to buy a business because they want to earn a living. They want the business to put money in
their pockets and pay their bills for their family. Yes, buyers are seeking freedom and independence; however,
a buyer can obtain these from just about any business.

Cash flow (SDE), however, significantly differs between businesses. All things being equal, would you rather
buy a business with an annual profit of $100,000 or one with $200,000? Would you rather put $100,000 or
$200,000 per year in your pocket?

Yes, buyers do care about your story; however, your story takes time to tell, understand and buy into. Cash
flow, however, can be quickly discerned in less than a second in an online ad, whereas most sellers struggle
to succinctly and persuasively tell the story of their business in even a one-hour conversation.

Why won’t buyers listen to my story?

First of all, all sellers of businesses have a story. Any buyer will quickly learn that every seller they meet has a
story to tell. Each seller believes their story is unique; on the other hand, buyers tend to hear the same stories
over and over again.

Try playing devil’s advocate with yourself. Ask yourself the following questions:

✓ If your business is so great, why are you selling it?

✓ If your story is so compelling and is going to result in a surge of revenue growth, then why don’t you
  hang onto it longer so you can realize the increase in value?
If you do have a story to tell, then you should practice telling your story in as few words as possible. You should be able to tell your story in a 30-second sound bite, also called your elevator pitch. If you are using online web portals to sell your business, then you are limited to about five to 10 words in the ad title and another 50 to 100 or so words in the preview of your ad copy. This does not give you a lot of space to tell your story.

If you cannot tell your story in as few words as possible, then neither will the buyer, who often consults with others when deciding to buy a business. Often, they must persuade their spouse, other family members and professional advisors that they are choosing the right business to purchase.

Remember, if you cannot hook the buyer in the first few seconds of them reading your pitch, then you have a slim chance of telling your story. So being able to tell your story in a few seconds is critical. If you cannot do so, then you will never have a chance to take the deal to the next step.

**Part 4: How Long Do Buyers Stay in the Market?**

How long do buyers continue looking for a business before they buy a business or give up on their search? In this section, we will address the two general types of buyers: individuals and companies.

Understanding the different types of buyers, their behavior and their perspectives will greatly aid your ability to sell your business. Possessing this knowledge will help you assess whether a buyer is serious and likely to pull the trigger on your business or the buyer is a tire kicker. It will also help you in dealing with buyers in all stages of marketing and selling your business. Developing an understanding of your “opponent” is key to all successful negotiations.

**Companies**

Let’s first address companies.

**Companies:** Once a company decides to grow through acquisitions, as opposed to organically, it generally stays in the market on and off indefinitely, or at least until it changes its strategy and decides it would no longer like to grow through acquisitions.

**Financial buyers:** Private equity groups and other financial buyers also continually buy companies, depending on the current stage of their funds. Most private equity groups have multiple funds operating at the same time, so they are constantly in search of their next acquisition.

**Individuals**

Business sellers are often unaware of just how long individuals stay in the market for a business. Some buyers stay in the market for years. The time span that individual buyers stay in the market varies based on the following factors:
Motivation: Buyers’ motivations vary. Some are highly motivated, set a goal and buy a business as quickly as possible. Other buyers may impulsively decide they want to buy a business after a bad day at work. These buyers may enter and exit the market more frequently.

What this means for the seller: Just as buyers will perform due diligence on you and your business, performing due diligence on buyers is also paramount. Part of your initial due diligence is to assess the buyers’ motivations. How motivated do the buyers appear to be? Do they quickly return your calls and emails? Are they eager to move forward, or do they appear to be overly critical? Buyers who are overly critical usually do not have serious intentions on buying a business.

Have you ever gone to look at something for sale knowing that you had no intention of buying it? Have you ever test drove a car, went to an open house or looked at any other expensive item that was for sale? If you did, you likely came across as either disengaged or overly critical to the salesperson. You might have critiqued the quality of the ride during the test drive or commented on how the spare bedroom was not big enough.

What is the most accurate way to assess the motivation level of buyers? In our humble opinion, motivated buyers will be eager to jump through hoops. They quickly return phone calls and emails. Despite potential roadblocks, they appear eager to move forward.

In 1964, Justice Potter Stewart’s response when he was asked to define hardcore pornography was: “I shall not today attempt further to define the kinds of material I understand to be embraced ... but I know it when I see it.”

Our response is the same when attempting to identify a motivated buyer. We know one when we see one.

First-time buyers vs. previous business owners: Buyers who have owned a business before are accustomed to making decisions based on incomplete information. They are more likely to make an offer on a business. Previous business owners are also aware that there is no perfect business. Employees, on the other hand, often do not understand what it means to be a business owner and are not accustomed to making decisions based on a gut feel or lack of complete information. Additionally, by definition and because they are current employees, they are more risk averse than those who have owned a business before.

What this means for the seller: First-time buyers are great buyers if and when they decide to pull the trigger. Assessing their tolerance for risk, however, is difficult. A buyer’s strong motivations tend to overcome their fears. Weak motivation, on the other hand, is often easily overcome by fears. And buying any business is accompanied by some degree of risk and therefore fear.

The American dream: Ask yourself what “the American dream” is. Everyone wants to own a business. Go on the street and poll your average American, and most will say their dream is to become an entrepreneur. This is slowly changing with Millennials as most place a high value on work-life balance; however, we have sold a few businesses to people from this generation. American culture looks up to entrepreneurs, often praising them in newspapers, magazine articles, movies, social media and online. Elon Musk, Bill Gates, Mark Zuckerberg, Richard Branson, Larry Page, Henry Ford, Thomas Edison, Andrew Carnegie, Jeff Bezos, Sam Walton. Almost every American can name the companies that these people created.
Douglas McMillon, Rex Tillerson, Mary Barra, John Hammergren, Stephen Hemsley, Larry Merlo. Do you recognize any names on this list? They are all CEOs of Fortune 500 companies. They are not “entrepreneurs” as most define them. Most Americans look up to bootstrapping entrepreneurs yet would have a difficult time naming CEOs of some of the largest American companies.

Few dream of landing a job. As a result, an enormous number of people are looking to buy a business. Unfortunately, the majority will never pull the trigger. We estimate that less than 5%-10% of the buyers visiting the most popular business-for-sale portals will ever buy a business.

What this means for the seller: Nearly everyone wants to buy a business and become a business owner. As a result, you must question every potential buyer’s motivations — unless they have owned a business before. Previous business owners have more realistic expectations than those who have not owned a business before.

Finances: Many buyers are unrealistic regarding how much money is required to buy a business. Most are undercapitalized. As a result, many stay in the market for a long time because they do not have enough liquid cash to buy a business. Also, many of these undercapitalized buyers make offers on businesses that are contingent on bank financing, and most of these deals are turned down by banks, often months later.

What this means for the seller: Assessing a buyer's financial capabilities is simple: Ask them. This process should be done in phases. We initially ask a buyer two questions: How much liquid cash do you have, and what is your net worth? We later thoroughly screen prospective buyers to find out their level of interest in the business.

Deals gone wrong: Additionally, many buyers make an offer on a business, and the seller accepts. The buyer then invests several months negotiating the deal and performing due diligence only for the deal to later fall apart. Many of these buyers later re-enter the market.

What this means for the seller: Motivated buyers are ready to buy. They are great buyers to deal with if you are selling your business; however, be fully prepared to sell your business and be totally honest with this group.

Stay away from buyers who have been in the market for too long

Beware of buyers who stay in the market for too long for these reasons:

1. **The search for the perfect business** – Just as there are lots of bachelors and bachelorettes looking for a spouse without flaws, and still single of course, there are many buyers who are searching for a business without flaws. Obviously, no such business exists. If it did, it likely would not be advertised for sale. It would be quickly purchased by a competitor or close friend.

2. **Aversity to risk** – Second, many buyers are scared to take the final leap of faith that is required to buy a business. Buying a business requires buyers to confront their fears. At some point, a buyer must pull the trigger. Unfortunately, first-time buyers are often terrified to dive in, cut a check for several hundred thousand or millions of dollars, and buy a business.
Many buyers create a New Year’s resolution to buy a business. We met one individual whose goal was to buy a business by the end of the year. At the beginning of the year, he created an email address that contained “buy a business” and the year he wanted to buy a business in. Unfortunately, he had to change his email address three times because it took him three years to buy a business.

Buyers should be able to identify a business and make an offer within six to 12 months. They should be able to close on a business within 12 months of starting the process. If the buyer has been in the market for over a year, then you may have problems. Occasionally, we see buyers who have been in the market for one to two years; however, we almost always dismiss buyers if they have been looking for over two years. One to two years is a coin toss. A buyer who has been in the market for over two years is a red flag.

**Part 5: The Importance of Persistence When Selling a Business**

Selling a business is ranked as one of the most stressful events in an entrepreneur’s life. Why? Because selling a business takes an enormous amount of preparation and requires a lot of dedication and follow-through, and the process often brings with it setbacks, frustrations and major disappointments. Imagine working on the largest transaction of your lifetime only to have it crater at the last minute.

For this reason, preparation is critical to lowering the stress level and therefore improving the chances of selling your business.

The first phase or step of selling your company is preparing it for sale, which requires organizational skills and a lot of hard work. Once your business is active on the market, then it mainly involves patience or persistence. If your business is actively being sold through a broker or intermediary, then this is the step where you will be the least involved.

**Here is a summary of the process:**

**Preparation** – This is when you, a business intermediary and other professional advisors (primarily your accountant) begin preparing your business for sale. This involves organizing all documentation on your business, including your financial statements, preparing a valuation on your company and doing other cleanup and organizational work before you put your company on the market. You should be fully prepared before you put your business on the market.

**Marketing** – Note that the preparation and marketing are performed consecutively and not at the same time. Only when you have fully prepared your business for sale will your business broker be able to actively market your business. Business brokers will be doing most of the work in this step, assuming that business owners have properly prepared their business for sale. This is the case because brokers have the knowledge they need to market your business and hold preliminary conversations with buyers. Your broker will be actively marketing your business for sale using the marketing strategy developed during the preparatory stage. Your primary role as a seller is to continue running your business and maintain or increase the revenues of your business.
Offer, Due Diligence & Closing – Once the broker has found an interested buyer, you will become involved in the transaction again. You will spend a lot of time with the buyer, answering more detailed questions about your business, particularly those that were not addressed in your offering memorandum. You will likely meet with the buyer several times before accepting an offer. Once you accept the offer, you will spend 30-60 days performing due diligence with the buyer. This will be a very involved step for you.

Again, you will be actively involved in preparing your business and negotiating the offer. The marketing process tends to be more hands-off for you until your broker has identified an interested buyer in your business.

We have had many clients who felt despondent after several months of having their business for sale on the market and who did not have an offer in hand. These clients were then overjoyed and completely relieved when they had received an offer and later closed the sale of their business. Selling a business is not like football, baseball or any other sport where you make slow, measurable progress toward the goal line. Because so many entrepreneurs tend to be goal-driven and have Type A personalities, they can become easily discouraged by this “all or nothing” game.

It tends to feel “all or nothing” because you either win or lose. There is no middle ground. Either you have an offer on your business or you don’t. If you don’t have an offer, it is easy to get discouraged. This is where patience plays a major role for sellers. Being patient and letting your broker do their job is important. Stay focused on your business. Whatever you do, do not take your hands off the steering wheel and let the revenues of your business decline. This will kill the prospect of a sale faster than anything else.

Small businesses are primarily sold online through business-for-sale web portals. This is a passive approach wherein your broker confidentially advertises your business online, screens the buyers and then presents these buyers information on your business. Again, business owners are action-oriented people, and they feel best when taking action toward a goal. Because this is a passive process, it involves patience and waiting.

Selling a middle market business with cash flow or profits of at least $1 million annually involves actively contacting potential buyers (other competitors or private equity groups) of your business by phone, email, fax or mail. Ironically, selling a profitable middle market business is easier than selling a small business, and yes, the professional fees are also much higher.

Selling a small business with cash flow of less than $1 million per year requires a lot of patience because it involves a sit-and-wait approach.

If you are in a tremendous hurry to sell your business, then we suggest becoming actively involved in the process.

Why can’t my broker contact people to buy my small business? There are two reasons:

1. Who can they contact? The fact is that no one out there will likely buy your business other than an individual. No competitor or other company is likely to buy your small business. Please note that there are a few minor exceptions to this. If you actively hear about companies your size being
purchased in your industry, then your industry may be an exception. Most small businesses are
struggling to hang on and do not have the financial resources to buy out a competitor. The one
exception is if your business has intellectual property that is highly valuable to another large
company. Most small companies grow organically, and companies typically do not begin growing
through acquiring competitors until they reach tens of millions of dollars in revenue.

2. It is not cost-effective. Selling a $250,000 business using the middle market method or auction
process by contacting competitors by phone, email, fax or letters/mail takes just as much work as
selling a $25-million company. Selling a small business by advertising it for sale on online business-
for-sale portals is both highly efficient and cost-effective. Selling a small business by contacting
competitors, on the other hand, is not cost-effective because the probabilities that they would buy
your business are very low.

Any serious potential buyer of a small business will start their search online. Try this for yourself: Go online
now to Google and look for information on buying a small business. You will end up on dozens of portals that
specifically address this market. This is a self-selected pool of people who are actively looking to buy a
business. This is the most efficient and cost-effective way to sell a small business.

If you were selling your car, which do you think is more effective?

1. Advertising your car online on websites such as www.autotrader.com, www.cars.com,

2. Going door to door and asking, calling and emailing people if they want to buy your car.

If you decide to call your competitors and ask them if they are interested in buying your business, most will
be very interested. There is a big difference, however, between interest and action or follow-through. Think
about it this way: If one of your competitors called you today (stop and visualize this now), told you they are
selling their business and wanted to talk to you to see if you are interested, would you listen? Wouldn’t you
be curious enough to talk to them a bit? Wouldn’t you “act” interested so you can see the financial
performance of one of your competitors?

And this happens a lot. But even if a fraction of small businesses is sold this way, doing this is not practical
or cost-effective.

What can you do to improve the chances of selling your business?

There is one very important thing you can do to sell your business. If your business is actively being marketed
for sale and you are receiving poor results, then you should have a meeting with your business broker to
revise your marketing strategy.

We have had several clients in the past who tried to sell their businesses through at least two other brokers
who put the businesses for sale on the market for a full year, yet they had never revised their marketing
strategy.
Here is what our previous clients told us:

“| Page
---|---

“| Page
---|---

“I found a business broker who wanted to list it with like a $15,000 minimum commission ... I signed up with them and I got very few responses ... I signed up with another broker who wanted $1,500 down to advertise and we got very few responses. Two years, two brokers, not much response. The second broker by the end of the first year didn't even want to re-list with me. He didn't think my business was really sellable ... At that point, I contacted Morgan & Westfield, which put my business on over 10 different websites nationally. And that was the first time I was getting responses left and right. Eight months later, I had two buyers at the same time that wanted the business.” — Matt Wakelin

“We found a broker and listed the company, did all the paperwork, paid the money upfront for the advertisement and everything. A year later, we had no buyer, whatsoever ... With Morgan & Westfield, it was a pleasant experience. Within a week, we had buyers. As for the other broker, I don't think they went through the type of advertising campaign that Morgan & Westfield does. It's the only thing I can think of because they brought us absolutely nobody.” — Dan Ness

Think about this, if you are attempting to hire a new employee and you were running a “help wanted” ad for 30 days without any results, would you continue blindly running that ad for another six to 10 months? Or would you revise your strategy?

This advice is critical to selling your business. Again, if your business is currently being marketed for sale by a business broker and your strategy is not working, then revise your strategy — plain and simple.

We also had an experience in which the client’s revision of their own ad copy generated more results than the ad copy we had written. The business was on the market for over six months, and we were receiving poor results. We had buyers, but we did not feel we were generating the kind of results we needed to close a deal in the next three to six months.

At about the three-month mark, we spoke with the seller and did a little strategic planning. We discussed the results of our marketing efforts up to that point. Then the seller talked about the buyers whom he had met. We then revised our strategy and talked again in 60 days. Again, the results were poor. And what did we do? Did we give up? No. We revised our strategy again. But this time, we had the seller write the ad copy. Amazingly, the seller’s ad copy outperformed ours. We generated so many prospective buyers and landed an offer within a few weeks. We then closed the sale two months later.

The key here is that selling your business is an iterative process. This is a principle based on the “lean development” method that technology companies use to develop software. The lean development method is an iterative process that involves short bouts of action followed by reviewing what was learned and then more intelligent action based on what was learned. Each action results in more learning opportunities, which prompts you to take more action and to learn from previous results. It is a fast cycle of act, learn, act, learn, and so on. So, you market your business for sale, review the results on a regular basis, and then adjust your strategy regularly based on what you have learned. In other words, marketing your business requires tweaking your strategies until the desired result is attained.

Our successful (those that sell their business) clients were all persistent and patient. After receiving poor results from our initial marketing strategy, they did not give up. They pressed on; we revised our strategy and
continued marching on. The most patient sellers did this several times before successfully closing a deal. This was difficult for most entrepreneurs because they were used to either doing nothing or taking dramatic action.

If you want to sell your business, then be patient and persistent. Keep your focus on the process.

**Summary**

First, decide if fishing or hunting is the correct strategy to sell your business. Generally speaking, larger companies are sold using a rifle and smaller companies are sold using a fishing rod. When selling a larger company, an auction process should be used. When selling a small business, the business should be confidentially marketed on third-party portals. Knowing how to use these portals is key. Write a persuasive title and ad copy and screen the buyers using our approach discussed in the next chapter.

**Part 6: Keeping the Sale Confidential from Employees**

We may focus on keeping the sale a secret from employees, which could be a real challenge to sellers.

*Should I tell my employees about the sale?*

The first question you must ask yourself is, “Should I tell my employees about the sale?” Frankly, there are no hard and fast rules here. If the culture in your company is positive, and your employees trust you and you trust them, then you may consider telling some of your employees about the sale (we will cover who and when below).

Second, if you have a larger-sized business and have an in-house controller or CFO, then you will greatly benefit from informing your controller/CFO because he or she will play a pivotal role in the process. Keeping the sale a secret from your in-house accountant when preparing your business for sale and during due diligence is too difficult. Both processes involve numerous financial requests, and your controller will become suspicious unless this is the norm in your company.

*When should I tell them?*

When to tell your employees about the sale is the simplest question to ask among other questions. Quite simply, the sooner, the better. The longer the employees know, the more opportunity you will have to build trust and prepare them for the process. If you were an employee, when would you want to know? Exactly, you would want to know as soon as possible.

If your business is already on the market, then this may be a risky move. If you share an enormous amount of trust with your employees, then we recommend sharing your plans with them. If, on the other hand, your culture is not ideal, then we recommend keeping your plans close to your vest. Remember that loose lips sink ships, so once you make the decision, commit to the plan and do not waver.
Be prepared for the question

You must be prepared in the event that word does slip that you are considering a sale. If this happens, you have two options:

1. **Play it off** – “Yes, ha-ha, of course. Everything is for sale for the right price, did you bring your checkbook?” In other words, you need a pre-planned story. If you choose this route, we recommend asking your spouse to catch you off-guard and ask you the question on whether your business is for sale several times randomly throughout the day, so you can practice and hone your response.

2. **Confess** – Your second option is to confess. Again, there are no hard and fast rules. If you are unsure, use the first option and play it off, and you can always come back and confess later on.

Whom should I tell about the sale?

Whom should you tell about the sale? Let’s cover some key stakeholders:

- **Professional advisors** – Telling your professional advisors is almost always a safe bet, assuming they are professionals. They are used to their clients selling their businesses and are unlikely to be surprised. Additionally, professional advisors, such as accountants and attorneys, do not like surprises, and getting them involved early in the process may prove to be of great benefit.

- **Landlord** – Landlords are also accustomed to businesses being bought and sold, and the news will not shock them. Your landlord may also potentially have a buyer. Informing your landlord early on normally carries the benefit of being able to pre-negotiate terms of the transfer.

- **Franchisor** – Franchisors are also very accustomed to the transfer of franchises within their system. Again, the sooner you tell them, the better, and there is little risk here. In fact, franchisors may become distrustful if you do not inform them early in the process. Many franchisors also provide assistance to the process and may also help in generating exposure for your business.

- **Family** – We recommend informing those closest to you, especially if you live in the same house. Keeping the sale a secret from your nearest family members will be nearly impossible. If your family members work in the business, then this should be handled with caution.

- **Friends** – We recommend telling only your closest friends about your plans, as most will have a difficult time keeping their lips sealed. If you trust and share a close bond with a friend or two, then this friend can be a safe person to talk to during the process. They may also provide some emotional stability for you during the transition.

- **Employees** – We recommend knocking over the easy dominoes first. In other words, pick out one or two key employees whom you believe will be comfortable with your plans. Then tell the remainder of your employees one by one. We do not recommend informing your employees in a group setting, as group dynamics can take over and can be impossible to predict. In our experience, about 20% to 30% of business owners inform their key employees.
• **Suppliers** – We do not recommend informing your suppliers unless you believe they would be a valuable source of potential buyers. Telling your suppliers is highly risky because they also likely do business with your competition.

**Marketing, Screening Buyers and Releasing Information**

Once you have decided whom and when to inform about the sale, you should next develop a strategy for confidentially marketing the business and screening buyers.

Confidentially marketing the business for sale is best done using a third party and a nondescript copy. A nondescript ad copy will not identify the name of your business. It will describe your business in generic terms. It will be descriptive enough to generate interest, but it will lack the specifics for any person to identify the business. Doing so is an art form and is best done using a third party.

Screening buyers involves requesting that all prospective buyers sign non-disclosure agreements before you release information to them. Once a buyer signs the non-disclosure agreement, release information to the buyer in phases. Knowing what information to release and when is largely based on experience, and this is an area where a broker can provide a tremendous amount of value.

**Retention bonus and other methods for pacifying your staff**

If you do decide to tell your employees, we highly recommend offering your key employees a bonus for staying through the transition. The bonus should be substantial enough to motivate them to stay for a significant period of time following the transition, especially if you are financing a portion of the sale. You can also consider releasing the bonus in phases.

When informing your employees, positioning your plans as a positive move for employees may also be helpful. For example, a new buyer may purchase your business, invest heavily in your business, increase salaries, and so on. If you position the transition correctly, employees will view this as an opportunity rather than a threat.

Remember that your employees’ primary fears are loss of their jobs or major changes to their roles. If you can assure them that neither will happen but rather that they may benefit from the transition, then your employees will be comforted and will be able to assist more readily with the transition. Informing your employees also makes buyers feel enormously comfortable with your business.

**How to handle buyers who want to talk to employees**

Will this timing not conflict with the demand of the buyer who might want to talk to an employee during due diligence? Does this happen? Unfortunately, yes this does happen. We recommend standing your ground. This involves a resolute poker face and resolution. Most buyers will give in, move on to other issues, and forget about it. Some buyers, however, absolutely insist. If the buyer insists on talking to a few select employees about the sale, then only do so after all other due diligence matters and all contingencies have
been resolved (financing, transfer of lease, etc.). In other words, the sale should be ready to close, and this should be the only remaining step.

*Morgan & Westfield* can help you navigate one of your life’s most difficult, yet significant events — selling your business.

*Don’t leave money on the table.*

*Call us today* for a 30-minute call to see how we can help you.
Chapter 6 – Screening Buyers

Part 1: Our Research on the Process of Buying a Business

Here's an interesting and important question you should ask yourself: What is it like to look for a business from a buyer's perspective?

A few years ago, someone asked me this question and, unfortunately, although I had a vague idea, I didn't know what the entire experience of buying a business was like for a buyer. So I put my buyer's hat on and went looking for a business to buy. I responded to multiple business-for-sale ads and here is what happened.

What happened next was shocking:

- **Non-response** - Between 60% and 70% of the sellers or brokers did NOT respond at all.
- **Delayed response** - Of those who did respond, only 25% of sellers and brokers did so in a timely manner.
- **Cold, canned responses** - Most inquiries received a template email in response, without additional information on the business.
- **Complicated process** - Most sellers and brokers sent forms to complete, including a non-disclosure agreement (NDA). Most forms had to be printed, signed and then faxed back. If you're trying to sell something, why make the process difficult?
- **Lack of preparation** - Most brokers and sellers were not ready to sell and had incomplete information. In addition, they were unable to answer basic questions, such as whether they offered a non-compete agreement and for how long, or provide specifics regarding the seller financing terms.

The bottom line: The responses were disappointing because only a few were adequately prepared. And those who responded didn't do so in a timely way and couldn't provide any useful information. Yes, there were a few solid responses; however, they were rare.

What you should do as a seller

- **Respect the buyer's time** - Looking for a business is a frustrating, time-consuming process. Respond to buyer inquiries promptly and professionally with more information and clear action steps.
- **Be specific** - Avoid responding to a buyer inquiry with "What do you want to know?" This type of response makes you look unprepared and is insulting to a serious buyer. Anticipate buyers' questions and offer accurate, complete information that will help them decide if they want to take the next step to buy your business.
- **Commit to selling** - Be sure you want to sell. Don't waffle with the buyer. Don't say you are motivated to sell if you are not — this wastes the buyer's time.

These are all attitudinal tips. In the next section, we'll explain specifically how to respond to buyer inquiries.
How Buyers Respond

Following is a description of how buyers initially respond when they see your business advertised for sale:

- **Contact forms** - Buyers respond to ads posted on most business-for-sale sites using a contact form. Typically, they submit their names, email addresses, phone numbers and other contact information, which the site then forwards to you, the seller, or the broker who is selling your business. Most sites won’t publicly display contact information and email addresses to reduce spam or potential fraud.

- **Email** - Most buyer inquiries arrive via email because the sale of a business is confidential, and sites for business sales are set up with that in mind, allowing brokers and sellers to advertise without disclosing their business name or contact information. Buyers must then inquire through a web form. This also reduces telemarketing calls and 99% of spammers. In addition, live human beings monitor these business-selling sites, so they can quickly block spammers.

- **Response rates** - What response rate do most sellers receive after emailing a buyer? Our feedback shows response rates fall between 20% and 30%. By following our advice, you should receive a response rate of 60% or more, which is nearly three times higher than the average response rate.

Responding to Buyer Inquiries

Here’s how we respond to buyer inquiries:

- **Provide timely responses** - Our responses are immediate because we have set up our email program to reply automatically with important information, as well as a specific call to action.

- **Reply with unscripted emails** - Our responses don’t read like a template because we write them in simple, natural, conversational language.

- **Provide a summary** – The email contains one to two paragraphs on the business, including what was in the original ad, because most buyers often respond to multiple ads and may forget the specifics of yours. This is also a good opportunity to resell the business and persuade buyers to take the next step.

- **Make it easy** - We don’t include forms that the buyer must print, sign and then fax back to us. We’ve made the process easier because our process is electronic.

- **Show gratitude** - When we respond, we thank the buyers for their time and acknowledge that we understand how the process of buying a business is often frustrating.

- **Build trust** - We always include our full name and contact information to help build trust and credibility.

**Sample response** - We send a reply immediately, usually within minutes of an initial buyer inquiry, to ensure high response and follow-through rates. Following is an example of a reply we send:

*Thanks for considering one of our businesses for sale. This is a company that makes hot and cold packs for the head, hands, back and knees. The company has sold them in major sporting goods stores, on*
television via QVC, and negotiations are in place to sell them in Walgreens stores. The asking price includes a large amount of inventory, as well as exclusive rights to the design and sale of the products. The owner is in his mid-70s and is highly motivated and ready to retire. This business can be operated from anywhere in the world, as the company currently outsources the manufacturing, and the products are drop-shipped direct from the manufacturer.

We have a complete package available on this company that we can email you. However, for us to do so, please take a moment to sign our electronic NDA.

The NDA takes less than a minute to complete. Once we receive it, we will immediately email you complete information on the company.

We understand that the process of buying a business can be frustrating, and we respect your time; therefore, we continually strive to make the process as quick and easy as possible.

Feel free to call us anytime if you have questions.

Thanks,

The Morgan & Westfield Team

Part 2: Non-disclosure Agreements (NDAs)

What is an NDA or confidentiality agreement?

A confidentiality agreement (CA), also called a non-disclosure agreement or NDA, is often signed by potential buyers prior to the release of confidential information on the seller’s business.

How do I use a confidentiality agreement or NDA?

It’s customary for business brokers to respond to a buyer inquiry with a request for the buyer to sign an NDA before the broker releases additional information on the business. However, bear in mind that when you sell your business, placing obstacles between you and the buyer will minimize the chances of a sale. Asking them to fill out more than one document or making them print, sign and fax your NDA is a potential obstacle.

If you are serious about selling your business, you should respond to the buyer inquiry with more information on your business beyond what’s in the ad, and then include your NDA and a method to contact you if a buyer has any questions.

Can I use a template for the NDA?

In our opinion, most small businesses priced under $5 million can safely use a properly crafted template for the CA or NDA. Most attorneys, business brokers or M&A advisors will provide you with a template to use, often at no cost. In practice, we estimate that less than 1% of buyers of small businesses request a change to the terms of our NDA. Beware, however, that many templates you find online are not specific to the sale of a business and are designed to be used for some purpose other than selling a business.
Additionally, NDAs are rarely litigated. The primary goal of a properly drafted NDA is to prevent litigation in the first place. It appears that they are doing their job.

Note that we also use the NDA as an opportunity to initially screen the buyer financially by asking them two questions:

1. How much liquid cash do you have?
2. What is your net worth?

Most business owners do not make the error of using incorrect language. Rather, they make the error of not asking the buyer to sign an NDA in the first place.

For mid-sized companies with an asking price of $5 million to $50 million, most M&A advisors prepare the initial draft and then the seller's attorney makes changes to the draft to reflect specific concerns the seller or their counsel may have. Once the business is on the market, most buyers then request changes to the NDA. In other words, the NDA for each buyer of a mid-sized company is negotiated and modified.

In reality, why would a business owner use a template? Let's examine the common scenarios:

- A business owner has engaged a broker or intermediary to sell his or her business. In this case, the broker will have a standard template that is being used.
- A business owner has been approached by a potential buyer. In this case, the owner's attorney should be able to draft an NDA in less than an hour's time, including adapting the NDA to the owner's specific needs.

If you do not have specific needs, then you can safely use a template. If you have specific needs that need to be addressed, then we recommend asking your attorney to draft a specific NDA that meets those needs.

In our practice, we see a lot of sellers use a template, and the majority of these appear to be fine.

**ROI:** Realistically speaking, if you are actively selling your business and you are showing confidential information to dozens of buyers for your business, does it make sense to spend a few hundred dollars on an attorney to draft an NDA to properly protect yourself? We think so.

**Part 3: The Secret to Screening Buyers Quickly**

Read this over 10 times. This one point alone will save you dozens of hours with unqualified buyers. We have discovered one little secret that will save you countless hours prescreening buyers.

**Here's the process:**

**Step 1** - You receive a buyer inquiry.

**Step 2** - You promptly respond to the buyer inquiry via email.

**Step 3** - You send the buyer a summary of your business containing one to three concise paragraphs, along with an NDA for them to sign.
What you need to know about the NDA

Keep the NDA simple and no longer than two pages. Include the following three important questions:

1. How much liquid cash do you have to invest in the business?

2. What is your approximate net worth?

3. What is your approximate credit score?

This process works like magic. Buyers who believe they’re not qualified will typically answer with an “N/A” — meaning not applicable — or simply leave these questions blank. Some buyers may even enter that they only have $50,000 liquid cash to invest in a business with an asking price of $1 million. Unfortunately, many buyers think they’re qualified to obtain a bank loan to purchase the business.

Here are more tips for screening buyers:

- **Limit questions** - There’s no point in asking the buyer dozens of prescreening questions. Focus on the most important ones. You should only prescreen them financially at this point in the sale process. Avoid screening the buyer based on subjective factors.

- **Be specific** - If your landlord or franchisor requires a buyer with a specific credit score and net worth, you may also want to include questions that your landlord or franchisor may ask, such as those relating to operational experience.

- **Weed out buyers** - Another magical thing this method does is weed out buyers who haven’t looked at other businesses for sale. Buyers rarely buy the first business they look at, so it is prudent to weed out these buyers. Nearly all experienced buyers know they must sign an NDA before they receive additional information on a business for sale. Experienced buyers will respond to your email by quickly signing and returning your NDA. These are the buyers you want to deal with because they are cooperative and willing to respect the confidentiality of your sale.

- **Choose savvy buyers** - We don’t explain what an NDA is and why it’s required because the buyers we prefer to deal with already know an NDA is required. Inexperienced buyers will often ask why it’s required and then try to avoid signing it. In such cases, we simply move on to the next buyer as few buyers purchase the first business they look at.

What Should I Send After I Receive the Signed NDA From a Buyer?

If you want to save time and increase the chances of selling your business, prepare a summary of your business that answers the basic questions nearly every buyer will ask.

You can quickly lose buyers after the second or third round of phone or email tag. Simplify and streamline this process by sending buyers a summary about your business. We call this a Business Summary, which contains an overview of your company and provides the essential information every buyer wants to know about your business after replying to your ad or signing your NDA.
Can you answer the following questions? A Business Summary addresses them quickly and efficiently, saving countless hours with buyers. Note that not all of these questions will apply to your business:

**The company**
- What’s the history of the business?
- When was the business started and by whom?
- How long have you owned the business?
- What are your days and hours of operation?
- Is the business seasonal?
- What products or services do you offer?
- How do you handle pricing?
- What licenses are needed to operate the business?
- Who are your competitors?
- Do you have a website?

**Financials**
- How profitable is the business?
- How much working capital is required?
- What are your major operating expenses for the business?
- What were the annual gross sales for the past three years?
- What percentage of your sales are cash sales?
- What are your average accounts receivable and accounts payable balances?
- Who does your bookkeeping and how often?
- What could you do to improve your business?
Operations

- Can you describe the premises and lease terms, such as square feet, the length of the lease, terms, NET/CAM charges, options to renew, annual increases, and security deposit?
- Who is the landlord, and are they a large national landlord or a small, local landlord?
- How much inventory and equipment do you have, and are they included in the price?
- What is the total value of the equipment, furniture and hard assets?
- Is any equipment on lease or on loan from suppliers?

Employees

- Are there any key employees or family members who are working in the business?
- How much do you pay your employees?
- Are benefits offered to employees?
- Have your employees signed employment agreements?
- Have your employees signed non-compete agreements?
- Are any employees contract workers?
- How many employees do you have, both full- and part-time?
- Are the employees willing to stay after the sale?

Terms of the Sale

- Is bank financing available, or can you finance a portion of the sale? If so, what are the terms?
- Are you willing to sign a non-compete?
- How long are you willing to train a buyer?

The Secret to Selling Your Business Efficiently

Here is the method we use to sell businesses with the minimum possible effort:

- **Step 1** - Advertise the business using business-for-sale portals.
- **Step 2** - Receive buyer inquiries.
- **Step 3** - Immediately send the buyer a short email about the business, along with an NDA for them to sign if they want to review the Business Summary.
- **Step 4** - Receive the buyer’s NDA and confirm the buyer is financially qualified.
- **Step 5** - Email the buyer the Business Summary.
- **Step 6** - Interested buyers then call or email us to set up an appointment to see the business.

Once this process is complete, it takes less than one hour per month to prescreen buyers and set up appointments. We automate this process; however, you should spend less than one hour per month on it. You’re left with prescreened and interested buyers who want to see your business and already know the answers to dozens of questions about it. Little is left to do other than answering a few more questions, showing the buyer the business, and then discussing an offer to purchase.
Part 4: Inquiries

How many inquiries should I receive from my ads?

Over the past year, most ads have averaged three to five qualified responses per month for us. Remember, it only takes one buyer to sell your business. A slow ad will receive one or two responses per month. An efficient, active ad will receive more than 10 responses per month.

Below are the number of responses we receive monthly on our ads:

- Lifestyle business - 20
- Auto repair in rural area - 1
- Orange County restaurant with zero money down - More than 40
- Fitness studio with asking price of $65k - 10
- Manufacturing company with asking price of $10 million - More than 20
- Auto glass company - 5
- Frozen yogurt shop - 5
- Large city restaurant - 5

Unqualified Buyers & Investors

I have a buyer who is interested in my business but does not have enough cash. What should I do?

You have a buyer for your business. You have been approached by someone who is interested in your business; however, the deal looks skinny. The buyer doesn’t appear to have enough liquidity to purchase your business. What are your options? Let’s discuss the three general options you have:

1. **SBA financing** – We recommend getting your business preapproved for an SBA loan. Yes, that means your business is preapproved for a loan, not the buyer. The most popular loan for purchasing a business is the 7(a) loan. This loan requires a 20% down payment; however, if you structure the sale properly, you can reduce this requirement to only 10%.
   a. This requires that you take action. Once your business has been preapproved, then you may also have the buyer preapproved as well. Don’t reverse these steps.

2. **Other sources of funds** – Alternatively, the buyer may be able to access the equity in their other assets, such as equity in their home or their retirement account.
   a. We recommend going back to the buyer and asking if any assets can be liquidated to provide a larger down payment.

3. **Investors** – A last resort for the buyer is to seek money from investors. Note that this is commonly used by foreign investors, and rarely used by non-minorities in the U.S.
   a. If the buyer claims to have potential investors, communicate with them directly. The investors will not make an investment without seeing information on your business as well, so they should also sign your non-disclosure agreement.

There is also a fourth option: offer more seller financing. We assume, however, that you would explore the three options above first before offering additional seller financing.
How to handle investors

How to respond to the buyer that says: "My father-in-law is the investor and has the cash. I can sign the NDA as long as you are aware this is between me and my investor."

For small businesses, we rarely see “investor deals” happen. For this reason, heavily screen these deals so you don’t waste your time. We recommend communicating directly with the investor as if they were one of the purchasers; after all, they are. Do you really think the investor is going to hand over hundreds of thousands or millions of dollars without reviewing at least some information on your business?

The investor should sign your non-disclosure agreement. After all, the investor will receive confidential information on your business, so they should sign the NDA as well.

If the buyer who initially contacted you does not have the liquid cash or net worth to buy your business, are you going to take their word that the investor has the funds to buy your business?

How you handle this conversation with the buyer is important and will set the expectations with the buyer regarding how they will treat you during the rest of the deal. If you are passive and naïve enough to accept the buyer’s word that “the buyer has an investor, and the investor wishes to remain private,” then you can bet that the buyer will treat you as a naïve, unsophisticated business owner.

Selling a business is a complicated matter, and the balance of power is critical throughout the deal. It is important to portray yourself as an intelligent, experienced business owner throughout the process. Be sure to handle the “investor issue” tactfully and diplomatically.

Summary

The process of screening buyers resembles any other planned sales funnel. The funnel contains a list of discrete steps performed in a certain order. First, respond to inquiries with more information on the business and a request that the buyer sign your non-disclosure agreement. Once you receive the executed NDA, then email buyers a summary of your business. Interested buyers will then contact you with questions after reviewing your summary. Set up a face-to-face meeting with these buyers and then proceed to the next step, the showing.

*Morgan & Westfield* can help you navigate one of your life’s most difficult, yet significant events — selling your business.

Don’t leave money on the table.

*Call us today* for a 30-minute call to see how we can help you.
Chapter 7 – Meeting with Buyers

Part 1: Wait for Buyers to Contact You

You’ve advertised your business for sale. You’ve prescreened buyers and sent qualified buyers your Business Summary. What do you do now?

What should I do after I send buyers my Business Summary?

The next step is simple — wait for buyers to contact you. It’s normal for buyers to call or email you if they have questions or if they’re interested in buying your business. However, calling the buyer to introduce yourself when you send your Business Summary may be a good idea. If you don’t hear back, you can follow up with buyers. We recommend doing so three to five days after you receive their initial inquiry.

Part 2: Set Up a Meeting

What should I do with interested buyers?

Set up a meeting. We can’t stress this step enough because it dramatically increases the chances of selling your business.

Interested buyers will call you to ask specific questions. Do or say anything you can to set up a physical meeting because the chances of a successful deal improve once you get face to face with a buyer. Ask the buyer to invest their time, and then meet the buyer to establish trust. Show them the business. Although it’s OK to answer a few questions before the meeting, it’s a good practice to gently persuade the buyer to meet with you to view the business before you answer lots of questions.

We only include two or three pictures in the Business Summary. Why do we do this? This is so we can leave some curiosity in the buyer’s mind, and give them a reason to come see the business and meet you.

Tell the buyer you have additional information on the business that you would like to share, such as your financial statements, a detailed seller's disclosure statement or any other documents the buyer may want to see. Tell the buyer you can make these documents available if they meet you. Avoid emailing documents, especially your financial statements, at this stage of the transaction. Always convince the buyer to come and meet with you in person.

The purpose of this phone call is to set up a meeting. You cannot sell your business over the phone, so don’t try. Set up a face-to-face meeting and then use this time to establish a trusting relationship.
Part 3: The Showing

What should I do when the buyer comes to see my business?

Immediately show your business to the buyer after a short get-to-know-each-other introduction. At this point, the buyer usually hasn't seen the business and is anxious to go on a tour, so don’t sit down and engage in small talk. The only thing on the buyer's mind is seeing the business, so don’t waste their time or yours. Show the business, and have a discussion afterward. Let the buyer ask as many questions as they want and then answer them as best and as straightforward as possible. You can get to know each other during the showing, when you can ask questions about the buyer and share information about yourself, too.

Show the business and explain as much as you can. Show pride in your business by adding interesting tidbits about its history. You can also add tips on how to grow the business, as well as what you like and dislike about your business.

Be honest - Mention some of your dislikes about the business in general. This will help you look more credible to the buyer. Pointing out things the buyer could change should they decide to purchase your business, such as using updated marketing methods to promote it better, may also be a smart move.

Avoid doing the following:

- Showing your tax returns and bank statements
- Discussing financial aspects of the deal during the showing
- Disclosing proprietary or trade secrets
- Negotiating the purchase price
- Discussing other terms of the transaction

The importance of consistency

Thoroughly read your Business Summary to memorize the information it contains. It’s important that you present the information about your business consistently to interested buyers because any inconsistencies will be noticed. If a buyer doubts what you say because your claims are inconsistent, you'll lose the sale. For example, if you claim your markup is 35% in your Business Summary but later claim it is 40% when you meet with the buyer, then the buyer will learn that they need to validate all your claims and will take little you say at face value.

Part 4: Disclosing the Right Amount of Information

What’s the next step?

Don’t fill the buyer's head with too much information at first. Keep the meeting the right length. It helps to keep some things a mystery. Tell the buyer that if they are interested and willing to come back for a second meeting, you'll show them more interesting things about your business. And if the buyer is intrigued, they will come back for another meeting. Some buyers make an offer after the first meeting, and some don’t. There’s no magic formula, but the right number of meetings is usually between one and four. The purpose of the first meeting is to set up the second meeting. Don’t try to sell your business on the first meeting. Instead,
try to set up the second meeting. The purpose of the second meeting is to set up the third meeting, and so on.

**Part 5: When Is It Time to Move On?**

Is the buyer requesting a sixth or seventh meeting? In such cases, don't waste your time, move on to the next interested buyer.

Remember that when selling a business, you’re making certain representations regarding your income and other factors. These representations aren't verified before the buyer makes an offer, so five or six meetings should not be necessary. Save the in-depth investigation of your business for after you’ve accepted an offer from the buyer. This time period is called due diligence. A few meetings should be enough for the buyer to decide if they want to make an offer and move forward. If the buyer can’t make up their mind after the fourth or fifth meeting, then another meeting is unlikely to persuade them to move forward. At some point, the buyer must tackle their fears head-on and make the leap of faith. Additional information rarely appeases the buyer’s fears.

*Why is my buyer requesting so much information and multiple meetings?*

Fear is the biggest deal-killer for the sale of small businesses, specifically the universal fear of the unknown. Perhaps the buyer has never owned a business and is scared to take the leap. Your job is to make them feel comfortable. If you're financing a portion of the sale, you can mention that you wouldn't finance the sale if you didn't have faith in your business. Also, explain to the buyer that if an offer is made, they will have plenty of time to perform their due diligence.

**Part 6: The Purpose of Due Diligence**

Is the buyer requesting too much information? Have you met with the buyer multiple times? It's time to explain that a thorough investigation can be conducted only after an offer is accepted. Due diligence typically takes 30 days; however, it can be any length of time as long as you both agree to it. The buyer can usually back out during due diligence for any reason, but the explanation for canceling the offer should be reasonable during this period.

*Documents to disclose before the offer*

You are talking with several interested buyers, and a few of them have asked to see your tax returns and bank statements or other sensitive information. What should you do? How should you handle this situation? Should you show these documents without having an offer in hand? What guidelines should I follow when dealing with buyers and deciding what to show them?

Before receiving an offer, you should be cautious regarding the information you show to a buyer. Be helpful and engage with the buyer, but don’t show them everything they ask to see. At some point, you should politely and tactfully ask the buyer to present you with an offer.

**Here's what to share before the offer:**
● Business Summary
● Profit and loss statements (P&Ls)
● Balance sheets
● Summary or abstract of the lease, but not the entire document
● Equipment list
● Sales literature and brochures

Here’s what to share after the offer:

● Customer lists
● Federal income tax returns
● Bank statements
● Invoices and receipts
● Full copy of the lease

_The buyer would like to see the tax returns and bank statements before moving forward with the process._

**What should I do?**

Tactfully point out that if an offer is made, the buyer will have plenty of time to do their due diligence and verify the accuracy of your financial records. Offer 30 days for due diligence, and let the buyer know they can extend it if needed. Explain the security risks of providing sensitive information without being accusatory, and state that an offer to purchase gives them the go signal to obtain the necessary information to learn more about the business and then complete the sale.

_The buyer is going to walk, what should I do?_  

If the buyer still insists on seeing tax returns and bank statements before they make an offer, the best thing to do in such cases is to say no and see if they walk.

If your records are complete, set up a meeting with the buyer at your place of business. Arrange the requested documents on a table and let the buyer spot-check some of them for a short period of time. This way, you can give the buyer the confidence that you have the backup material to satisfy their due diligence requirements, but under no circumstance should you give them copies to take home. After the buyer has gone through your records, put them away and then press them for an offer.

This type of buyer could be seeking the reassurance of making a good decision. Buyers typically do this by trying to acquire more information. However, more information doesn’t always make their fears go away. You may need to challenge the buyer by asking them to make an offer.

_Is there a better way to explain this process to the buyer?_

Yes. Explain to the buyer that you are making representations and that these representations are verified during due diligence. Assure the buyer of the quality of your backup information and explain to them that their earnest money deposit will be held by a licensed escrow agent or third party.

**Part 7: How and When Should I Provide Year-To-Date (YTD) Financials to a Buyer?**
Here’s a question that our clients commonly ask:

“I have met several times with a prospective buyer. We spent three hours with him last night, and he seems very interested. The buyer called me this morning and asked for year-to-date financials. How should we proceed with this request?”

This is a reasonable request from any buyer. You should provide interested buyers with updated, year-to-date financials; however, keep in mind a few important points:

**Normalize your financials:** Don’t send your raw, unadjusted financials. Be sure that you adjust or normalize your financials before sending them to the buyer.

**Compare YTD with the previous year’s:** Don’t just send the buyer your YTD financials. Send the buyer a comparison of this year’s and last year’s results. If it is October and the buyer is requesting to see the January - September profit and loss statement (P&L), then send them the January - September P&L for the current year and the January - September P&L for the previous year. This allows the buyer to account for seasonality in the business and allows them to see how the business is performing relative to the same period last year.

**Warning:** If the buyer sends you a detailed request for additional documents, such as tax returns, then they are likely attempting to shop your business for financing. This is a warning sign — the buyer should first receive permission from you, the seller, before sharing your confidential information with third parties. If the buyer is shopping the business for financing early in the process, then this may mean the buyer does not have the down payment, or the buyer has lied to you and failed to tell you that the down payment indicated would be coming from a bank. This is rare, but it does happen. Stop immediately and talk with the buyer. You don’t want them shopping your business without your knowledge or consent.

**Revenue recognition:** Beware of timing differences in recognizing revenue and expenses. You may have just landed a big six-figure contract for your business, and this may skew the results significantly. Alternatively, you may have just paid a large expense that may inflate your expenses and therefore lower your profit. Most small- and mid-sized businesses are not performing proper accrual accounting and are using either a cash-based system or a hybrid accounting system, which is a blend of cash- and accrual-based methods. Additionally, because you are analyzing interim financial statements, your accountant has not made the final entries into your system for items such as depreciation. For these reasons, telling the buyer the story behind the numbers is important.

**Monthly revenue chart:** We also recommend maintaining a chart of the monthly revenue for your business. Look at the two charts below. While there are major spikes in revenue, the overall trend is positive. You can also see that major spikes and valleys are the norms for this business. Focusing on these short-term trends can skew one’s perspective. Maintaining a chart of the monthly revenue prevents this inaccurate analysis of the overall trends in the business.
**Tool to gauge interest and further qualify the buyer:** We recommend intentionally withholding your YTD financials in your offering memorandum. Doing so forces the buyer to request them directly from you, which gives you the opportunity to:

1. **Further screen/qualify the buyer** – If the buyer is requesting additional documents or clarifications from you, then this also gives you an opportunity to further qualify the buyer. Perhaps you can ask the buyer for bank statements or other source documents to back up claims they may have made on their personal financial statement (PFS).

2. **Gauge the buyer’s interest level** – If the buyer goes out of their way to ask you for updated financial statements, then you can reasonably assume that they have some interest in your business.

**Summary**

The goal of your first encounter with a buyer is to set up a face-to-face meeting. After sending the business summary, wait for the buyer to respond by asking questions regarding the business. When they do, press them for a face-to-face meeting at your business. Take the buyer for a tour of your business and disclose the correct amount of information during this meeting.

The goal of the initial meetings with the buyer is to receive an offer or letter of intent (LOI). Resist giving the buyer information that should be released only during the due diligence process. If the buyer requests information to allay their fears, then reassure the buyer that they will have plenty of time to investigate your business during the due diligence period. Once the buyer is prepared to make an offer, then you are ready to move to the next step, “making an offer.”

*Morgan & Westfield can help you navigate one of your life’s most difficult, yet significant events — selling your business.*

*Don’t leave money on the table.*

*Call us today* for a 30-minute call to see how we can help you.
Chapter 8 – Negotiating and Accepting an Offer

Part 1: Qualifying the Buyer Further

At this stage, you should qualify the buyer further before negotiating and accepting an offer.

Tactfully ask the buyer to provide the following:

- Personal financial statement
- Buyer disclosure statement
- Buyer profile

You can ask the buyer for this information before you begin preparing the offer, or you can stipulate in the offer or purchase agreement that the buyer will provide this information within three to five business days of acceptance of the offer. This effectively makes the due diligence period mutual, which allows you to cancel the offer if you don’t approve the buyer. This is an important strategy that can save you from spending time negotiating with buyers who are not qualified.

What about further pre-qualifying the buyer?

There’s no set, specific time frame for when you should introduce pre-qualifying documents to a buyer. At the very least, buyers should complete these when making an offer or within a certain period after making the offer, which is typically within three days of the seller’s acceptance of their offer to purchase.

We recommend asking the buyer to complete these documents on their second or third visit. We also suggest introducing these whenever the buyer requests additional in-depth information, or if the buyer wants to take home information on your business.

Talk Terms

Have an interested buyer? Don't panic — talk with the buyer. You’ll want to agree on the following basic terms of the deal:

- Selling price
- Earnest money deposit
- Down payment
- Amortization period
- Interest rate
- Due diligence length
- Training length
- Non-compete agreement
- Closing agent or attorney
- Any contingencies
Don't waste your time preparing a lengthy purchase agreement if you can't agree on the basic terms listed above. Continue to talk with the buyer to see if you can come to an agreement. If you agree on the terms, we suggest putting them in a short offer to purchase form, letter of intent (LOI) or a Term Sheet. This helps move the deal forward without worrying about the purchase agreement.

Visit the resources section on our website at [www.morganandwestfield.com](http://www.morganandwestfield.com) to see a sample offer to purchase form.

**Part 2: Types of Offers**

**Term Sheet**

Use the Term Sheet for discussion purposes only. It allows you to focus on structuring the key elements of the deal without concerning yourself regarding the language required to document those terms. If you can agree on the Term Sheet, then you can move straight to an offer to purchase or a definitive purchase agreement.

We have combined our Term Sheet and offer to purchase into one simple form. Both parties sign this simple document, which enables you to concentrate on the deal free of concerns regarding the language.

**Note:** We see many sellers make the mistake of calling an attorney before they have a real deal. Don't involve your attorney until you agree on the essential elements of the deal.

**Offer to purchase**

Offers to purchase vary in length. Our one-page form comprising the Term Sheet and offer to purchase is short and doesn't contain the necessary language for a closing; however, it allows both parties to commit to the essential terms so they can move the deal forward. Replacing the shorter offer to purchase form, LOI or Term Sheet with a more comprehensive offer to purchase is important. Here's how the language we usually use looks:

"Seller and buyer agree to replace this offer to purchase/letter of intent with a definitive purchase agreement within five business days of acceptance."

**Letter of intent**

Letters of intent (LOIs) are similar to Term Sheets and are an effective tool if used properly. They also work for discussion purposes as well; however, you should replace it with a binding offer if you are committed to the buyer. Many sellers accept an open-ended LOI — meaning there's no expiration date or termination rights on their part — without accepting an earnest money deposit or qualifying the buyer. This is a serious mistake that can cost you dearly if you commit to the wrong buyer as this entails an open-ended commitment with no deposit from the buyer.
Definitive purchase agreement

This document is a comprehensive agreement signed at closing by both the buyer and the seller. Starting the process with this document may not make sense, as it may intimidate some buyers, and it may also be a waste of time if the buyer is not qualified or if the terms the buyer proposes to you are not acceptable. As we mentioned above, beginning the negotiations with a Term Sheet, LOI or simple one-page offer form makes sense as a starting point.

Part 3: Keep Your Focus

The number one mistake sellers make when they accept an offer is to get too excited and lose their focus on the business, without realizing that over half of deals don’t make it to the closing table, even after an offer is accepted. If you want to close the deal, focus on running your business while obtaining additional backup offers.

Many sellers also take their business off the market — this is a critical mistake. Take a minute to consider how this affects the buyer. If you want to maintain your negotiating position, keep your business on the market, continue to show it and accept backup offers. This keeps the buyer on their toes and may prevent them from playing games later on in the process.

Making an offer

Keep this phase simple by discussing the basic terms of the deal with the buyer. Assure the buyer that they will have plenty of time to conduct due diligence after an offer is accepted. Remind the buyer that they are not committed 100% until the due diligence period is finished.

Part 4: Negotiating the Transaction

We are going to tell you a little secret. Negotiating the transaction is highly overrated. The actual negotiating process requires little skill if you have the correct positioning. To put it more bluntly, negotiation is overrated, and positioning is underrated or forgotten altogether.

The key to negotiating is positioning. When purchasing a new car, is it easier to negotiate the purchase when you desperately need a car or when you couldn’t care less if you walk off the lot with a car?

The key to positioning is wanting to sell but not having to sell. Avoid desperation at all costs. The only exception is when the price is so competitive that you are negotiating with multiple buyers.

How do you maintain this positioning throughout the process? Firstly, deal with buyers in an interested, professional but somewhat dispassionate tone. You should communicate to the buyer that you are prepared and motivated; however, you are not dependent on the outcome. Convey that you love what you do, yet it is best for you to move on now.

Secondly, keep the business on the market until you sign the documents at the closing table and the money clears. Note that this is not possible in mid-market deals where nearly all sophisticated buyers (companies, private equity groups, etc.) require a standstill once you accept a letter of intent (LOI). For smaller businesses,
however, keep the business on the market until the day after the closing. Doing so helps you maintain your negotiating position. Additionally, continue negotiating with other buyers throughout the process.

An additional method to keeping your position is to maintain emotional objectivity. How is this done?

- Use a third party, such as an intermediary or broker, as a buffer between you and the buyer.
- Do not be dependent on the outcome, do not spend the money before you receive it, or make elaborate plans until you complete the closing.
- Be aware that 50% of accepted offers do not close.
- Assume the deal will not go through.
- Keep your interest in the business.
- Maintain or increase your revenues. Doing so will increase the value of your business and put you in a strong negotiating position.

Many negotiators recommend ploys or other tricks when negotiating. Frankly, these may work; however, there are risks. The best situation is always an actual position, as opposed to a manufactured one.

Avoiding what we call ‘deal fatigue’ is also important. Sophisticated buyers are aware of the natural tendency of business owners to experience fatigue as the process wears on. They may take advantage of this by drawing out the process and nibbling at the last minute. The best way to avoid this again is through positioning. You should sell, and you should always have other options available.

What soft skills are involved in the process?

- **Honesty** – Any buyer who senses you are being dishonest will either run or triple their level of scrutiny during due diligence. They may also request holdbacks or other forms of protection to protect themselves.
- **Humility** – Humility goes a long way in a transaction. Price is inversely related to risk. The lower the risk, the higher the price. Who do you trust more: a pompous, arrogant person or a humble individual?
- **Emotional stability** – Buyers will become extremely nervous if you lose your cool. Try your best to stay calm and collected throughout the process. If a discussion becomes heated (and it will), wind the discussion down and ask to continue at a later date.
- **Communication** – Many roadblocks in negotiations can be avoided through basic communication skills, such as listening and clear communication. We recommend reading ‘Getting to Yes: Negotiating Agreement Without Giving In’ by Roger Fisher and Willing Ury.

An often underrated negotiating tool is preparation. If you prepare your business for sale years in advance, your business will be positioned in the best possible light. Doing so will attract the best possible buyers, and you will be in the driver’s seat throughout the process.

Preparation for negotiations begins years before the actual negotiations themselves. If you can prepare for the sale years in advance, then the sale will inevitably go smoother, and your leverage and confidence in negotiations will greatly improve.
Part 5: Earnest Money

What about an earnest money deposit?

We always recommend obtaining an earnest money deposit. This demonstrates good faith on behalf of the buyer and lets you know the buyer is serious. This also psychologically commits the buyer to a greater degree. You share a lot of private and financial information with the buyer, so obtaining an earnest money deposit is a reasonable request to make.

A typical earnest money deposit is 5% of the purchase price of the business. The amount of the earnest money deposit, however, is negotiable. An offer with a higher earnest money deposit carries more weight. Many buyers know this and are willing to put down a larger deposit. The earnest money deposit is usually held by a third party, such as an escrow company or attorney.

Part 6: Using Templates

Should I use legal templates when buying or selling a business?

As with most legal questions, the answer to this question is: “It depends.”

Attorneys normally begin with a template when beginning to draft a document; however, they have the expertise and experience to modify the templates.

Let’s explore each of these five stages in the transaction process and when you can safely use a template.

Process

To understand how documents fit into the process, let’s discuss the transaction process itself.

1. **Buyer makes an offer or issues letter of intent; due diligence begins**: The buyer issues a letter of intent to the seller. If the seller accepts it, the buyer will make an initial deposit, which will be placed into escrow with an escrow company. When the seller countersigns the letter of intent or offer, the due diligence process begins. The buyer and seller will try to resolve the contingencies before the end of the due diligence period. If the period is set to expire and the parties need more time, the parties may agree to extend the timeframe.

   These shorter documents do not contain the necessary language to affect a proper closing; however, they allow the parties to agree on the essential terms and move the deal forward. A more comprehensive offer to purchase, or definitive agreement, should replace the shorter offer to purchase form, letter of intent or Term Sheet.

   Purchasers of small businesses tend to use an offer to purchase, while buyers of mid-sized businesses tend to use a letter of intent. LOIs are commonly used for mid-market transactions with an asking price of $5 million to $50 million. Most LOIs are drafted by the buyer and reviewed by the seller’s attorney. In other words, these are all almost always custom drafted. For this reason, we do not need to address this.
2. **Due diligence ends; buyer and seller decide on the next move:** At any point during due diligence, or upon its expiration, the buyer may decide they are satisfied with their investigation of the business and will proceed with the transaction. When this happens, the buyer and seller will sign an agreement stating that due diligence has concluded, which documents the contingencies that have been resolved and those that survive due diligence. Upon signing, the buyer will place an additional deposit with the escrow company. If the transaction is canceled because of the buyer’s fault before a definite agreement is signed, the buyer will forfeit both the initial and additional deposits. Otherwise, these deposits will be applied to the final purchase price.

3. **Definitive purchase agreement and closing:** This is the formal document signed at closing. The agreement will set a date for the completion of the transaction, a process known as the “closing.” Prior to the closing date, the parties should resolve any remaining contingencies. The buyer should transfer the balance of the purchase price to the escrow company three days prior to the closing. On the closing date, the parties may physically meet around a table, where the buyer may deliver the final payment, and the seller may sign and deliver the closing documents. Alternatively, the parties may simply send the foregoing documents to each other electronically or via FedEx. Most of our closings are virtual closings where documents are sent electronically or via next-day air.

4. **Transition and training:** The seller trains the buyer and assists with the transition period.

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**Offer to purchase**

In our firm, we see many sellers use a template for this stage. Most offer to purchase templates are either missing a critical component or enough components that a re-draft of the agreement from scratch by a professional would be more time-saving and cost-effective than for that professional to fix the seller’s template.

Here is a list of errors or missing components we commonly see:

- ✓ What is the amount of the earnest money?
- ✓ Who holds the earnest money?
- ✓ How are closing costs split?
- ✓ What costs and expenses are prorated (e.g., property taxes, transfer fees, etc.)?
- ✓ Has the allocation of purchase price been agreed to? This can kill deals if you don’t agree to it early in the process.
- ✓ Is the transaction being structured as an asset or stock sale?
- ✓ Does the buyer have exclusivity?
- ✓ Can you accept a backup offer if a better one comes along?
- ✓ What is included in the sale? For example, are accounts receivable, inventory, cash and liabilities included or to be assumed?
- ✓ Is there an additional deposit required once due diligence is completed?
- ✓ Are the contingencies clearly defined?
The buyer is seeking an exclusive period; however, they are not offering earnest money.

Due diligence period is not clearly defined.

Disposition of the earnest money deposit is not clear.

The buyer has prepared an LOI when an offer to purchase would be more suitable.

The errors we see in the offer to purchase do not relate to errors in the contract language but often relate to the major terms of the deal. Errors in the contract can overwhelm professionals and prevent them from focusing on the essential terms of the deal.

Most sellers, unfortunately, request that we point out the errors in the offer to purchase so they can quickly fix them, for free, with a quick Google search of course. Unfortunately, as any attorney knows, this cannot be done easily. Doing so usually creates something similar to what computer programmers call “spaghetti code.”

Any experienced professional who sells businesses for a living can easily and quickly spot these types of errors, as most of them have seen hundreds of LOIs and offers to purchase over their careers. They then quickly review the remaining portions of the contract. The professional will, often correctly, assume that because three to four errors have been spotted in the first two minutes of reviewing the contract that it also likely contains additional errors. As they say, “When you see an ant or a cockroach, you know there are always more of them.” The business owner usually presses the attorney or professional to quickly rattle off the errors over the phone so the business owner can quickly do a Google search and fix them. Unfortunately, if being an attorney and practicing law was this easy, then Google would have made attorneys obsolete a long time ago.

Performing a careful analysis of the contract and requesting changes and revising the language takes time. The attorney usually spends more time, especially if the template is of poor quality, fixing these errors than preparing an effective contract in the first place. To properly review a contract, one must use a checklist and then check the contract to ensure that it addresses the essential components of the agreement. During the review, most professionals use their professional judgment, which is based on years of experience. While they can quickly spot a few errors, thoroughly reviewing the entire contract would take significantly more time than it would to properly draft the contract in the first place.

To make sense and develop proper flow, legal documents require a consistent set of language and tone. Business owners or buyers who download and make modifications to a template often change the style and tone of the agreement and sometimes use different definitions and terms. Cleaning up the document and making the language and tone consistent often takes longer than paying an expert to prepare the agreement correctly at the outset.

**Summary/action points**

As a seller, you have the most negotiating leverage early in the transaction. By using a template and not taking advice from experts, you are throwing this leverage out the window. This is the time when you can negotiate key deal terms that will make a tremendous difference in how the deal progresses. Take advantage of this leverage while it exists. The most intelligent way to do so is to have experts advise you along the way.

**FAQs**
Who should write the offer — the buyer or seller?

The individual who writes the offer exerts the most control over the timing and structure of the deal. We suggest that the seller prepare the offer. Many buyers are first-time buyers and are not comfortable with preparing an offer on a business. Make it easy for the buyer and prepare it for them.

What is the difference between an LOI and a purchase agreement?

Letters of intent are not normally structured to be binding and should not, therefore, be taken as seriously as a written offer or purchase agreement. Letters of intent are common for large transactions, as the buyers are larger corporations or private equity groups that have credibility and have successfully completed dozens of transactions. For smaller transactions, we recommend accepting an offer to purchase or purchase agreement, along with an earnest money deposit. For a buyer, walking away is too easy with a non-binding LOI and no earnest money deposit. Buyers of larger companies invest a significant amount of money and time, and this displaces earnest money deposits in cash.

What is a Term Sheet?

A Term Sheet is used to start the negotiations by agreeing to the key terms of the deal while setting aside the specific legal language until the terms are agreed upon. We have seen many parties spend dozens of hours and thousands of dollars in attorney fees when they have not yet agreed to the essential terms and structure of the deal. A Term Sheet can be as simple as a sheet of paper with your agreement regarding the basic terms.

What is the difference between an offer to purchase and a purchase agreement?

An offer to purchase is the document used when a buyer makes an offer before the due diligence period. The definitive purchase agreement is the document signed at the closing and after due diligence. Sometimes, the offer to purchase is used as the definitive purchase agreement, and other times, a separate document is prepared to be signed at the closing, which incorporates any additional agreements made after the initial offer had been accepted.

To see other examples of forms used for the sale of a business, visit the resource section on our website by visiting www.morganandwestfield.com, or email us at info@morganandwestfield.com.
Summary

Qualify the buyer before accepting an offer. You want to ensure the buyer is financially and operationally qualified before you invest a significant amount of time in negotiations with that buyer. Once you confirm the buyer is qualified, focus on negotiating the key terms of the deal before you wrap language around the deal. The key terms should be worked through using a checklist or Term Sheet. Once agreed upon, engage a professional to prepare an offer to purchase if you own a small business, or a letter of intent if you own a mid-sized business that is being purchased by a company.

Be sure the offer is accompanied by an earnest money deposit, which is typically 5% of the purchase price. Keep your focus on running the business after you accept the offer. Continue to maintain the revenue and profitability of the business throughout the closing period. Once the offer is accepted, then you will move to the next step, due diligence.

*Morgan & Westfield* can help you navigate one of your life’s most difficult, yet significant events — selling your business.

*Don’t leave money on the table.*

*Call us today* for a 30-minute call to see how we can help you.
Chapter 9 – Preparing for Due Diligence

Part 1: Due Diligence

What is due diligence?

After a buyer makes an offer on your business, you'll set up a period of time for them to research your business further. This period of time, referred to as due diligence, normally lasts 30 days.

Typical document requests and items that buyers inspect during due diligence include:

- Financial statements
- Tax returns
- Bank statements
- Leases, such as premise and equipment leases
- Third-party contracts, such as supplier or vendor contracts
- Sales and Use Tax reports
- Staffing and payroll-related documents, including job descriptions and employment contracts
- Insurance-related documents like workers’ compensation as well as health and liability insurance
- Equipment inspection reports
- Licenses and permits
- Marketing, advertising and promotional documents
- Environmental documents and inspections
- Franchise-related documents

Note: The list above isn’t typical for every business. Each business will have its own unique due diligence structure. Most due diligence requests are more extensive than the list above.

How long is due diligence?

Due diligence can take any period of time, as long as both you and the buyer agree to it. The typical due diligence period for small to mid-sized businesses is 30 to 60 days.

Base the length of due diligence on the following:

- Availability of information - If you respond promptly to the buyer’s document requests, the due diligence period will be shorter.
- Turnaround time - This depends on how fast the buyer reviews the information. If you provide information that’s concise, organized and clear, you’ll speed up the due diligence period.
- Communication - Making yourself more available to the buyer will also shorten the due diligence period.
What is the purpose of due diligence?

Businesses are complicated, with hundreds of factors buyers must take into consideration. When evaluating a home for sale, buyers can look and quickly form an opinion on the value and suitability of a home. Homes and other tangible purchases often require little to no due diligence. However, buying a business involves assessing many intangible variables, which are not readily apparent and are more difficult to assess and evaluate. With a business, the buyer must first make an offer, and then the seller’s representations are verified only after an agreement is mutually agreed upon regarding the basic terms of the deal. If all buyers conducted their due diligence before making an offer, then sellers would spend a tremendous amount of time with many buyers whom they may never reach an agreement with in the end.

How should I prepare my business for due diligence?

Preparing your business for sale greatly increases your chances of success. Getting your business ready for due diligence is simple. It involves assembling and organizing the documents that most buyers request and review during the due diligence period.

Why should I prepare for due diligence? Can’t I just get the documents ready when the buyer requests them?

Laying the groundwork for due diligence helps convince the buyer to agree to a shorter due diligence period, perhaps as short as one or two weeks. By organizing all the documents so they are ready for review, you’ll ensure the process is quick and simple. Immediately after you accept an offer, the buyer can start reviewing the documents.

You also demonstrate to the buyer that you’re serious when you take the time and effort to prepare your business for sale. Buyers prefer dealing with sincere sellers. Believe it or not, many sellers put their business up for sale only to find out what buyers think of it, as well as to determine what the business may be worth in the marketplace.

A buyer who has encountered an unmotivated seller will become interested in your business if they see that you are 100% motivated and organized. Buyers are more likely to spend time with a seller whom they know has prepared for the sale.

You can greatly increase the chances of receiving an offer when you show the buyer you’ve prepared and organized all the documents needed for due diligence. Buyers are often reluctant to make an offer on a business because they think sellers don’t have enough information for them to perform their due diligence.

What other tips can you give me?

If you’ve prepared your business for sale and organized all the documents, be sure to mention that fact in early conversations with buyers. You could say something like this:

"I’m a motivated, serious seller who has prepared my business for sale with the help of a Certified Public Accountant (CPA). I have all the necessary documents ready for due diligence, including tax returns, leases, equipment lists, financial statements and more."
Part 2: Observation Periods for Cash Businesses

You have a “cash business” and don’t have accurate financial statements. How do you demonstrate to the buyer that the business is profitable without relying on your financials?

You can do this by taking advantage of an observation period, in which a buyer observes your business or works with you in the business by keeping track of the sales and estimating the income. Observation periods are used for businesses that maintain poor financial records.

What types of businesses are observation periods suitable for?

Observation periods are useful for businesses that have stable cash flow from month to month, such as liquor stores, restaurants and most other retail-type businesses. Observation periods are not suitable for service-type businesses where sales can easily be ramped up for short periods of time with additional marketing and advertising.

What precautions should I take before allowing a buyer an observation period?

Be sure to ask for the buyer’s contact information or identification, such as a copy of their driver’s license, if you can do this in your state. We have heard of scenarios wherein the buyer stole money from the cash register and disappeared, leaving the seller with nothing more than a first name.

You should also have an accepted offer to purchase at a specific price as well as an earnest money deposit. Do not let the buyer observe the business without first agreeing to an offer. An alternative might be to let the buyer sit in the parking lot and watch the traffic flow for a short period of time. Many buyers do this before making an offer. The downside to this, of course, is that you could happen to have a slow day, and the buyer may base their decision on this.

Any other words of advice for us?

Yes. If you cannot substantiate what you are telling the buyer with backup documentation, then do not put it in writing. We commonly see sellers emailing documents with line items called “unreported income.” This is just asking for trouble. Uncle Sam may quickly come knocking on your door.

Now, this comes with a huge legal disclaimer and explanation: It is a known fact that small business owners do not always accurately report their earnings. We are not here to make moral judgments. We are only accepting the situation as it is and telling business owners that they should only put in writing what can actually be documented. That’s it; nothing more, nothing less.

The point is clear: Put in writing only the information that you can document. For everything else, use an observation period.
Summary

Invest time in preparing your business for due diligence. Most sellers of businesses skip this step altogether. By preparing for this process, you will greatly improve the chances of a successful sale. Additionally, demonstrating to the buyer that you have prepared for due diligence increases the buyer's confidence in your business and reduces their fears. As we have mentioned before, fear is the number one deal-killer in the sale of a small business.

*Morgan & Westfield* can help you navigate one of your life’s most difficult, yet significant events — selling your business.

*Don’t leave money on the table.*

*Call us today* for a 30-minute call to see how we can help you.
Chapter 10 – Closing the Sale

Part 1: Get Help

Are you ready to close on the sale of your business? Get help. Period.

Don’t handle the closing on your own. One small mistake can cost you tens or hundreds of thousands of dollars. You can have your attorney handle the sale, or you can contact us for help at 888-693-7834 x-3.

We often get approached by business owners who want us to assist them in handling the closing. They think they can save thousands of dollars by doing a quick Google search and downloading a template online. Whatever you do, do not use a template for the closing, especially if you are financing a portion of the sale. There are far too many things that can go wrong.

Doing a quick Google search and providing your attorney with a template downloaded online will not save your attorney time or save you money.

Like any attorney or law firm, we use our own customized templates for closing a transaction. We — or any attorney handling the closing — will start with a template, then we customize for a particular transaction.

Because the sale of a business involves dozens of documents, attachments and addenda, the language throughout these documents must be consistent. Terms must be consistently used in the documents.

The Adverse Effects of Not Handling the Closing Properly

- In the case of seller financing, the seller has inadequate or zero security over the business assets. When the buyer is unable to pay, the seller has insufficient or no recourse against the business assets and must sue the buyer for payment.
- The buyer could fail to transfer business registrations to their own name or fail to take necessary legal steps to assume the responsibility of the business. Liabilities incurred by the business, such as taxes, injuries to consumers, unpaid wages, unpaid utilities, among others, could continue to pile up in the seller’s name.
- The seller and the buyer could have agreed that the buyer would assume some outstanding liabilities, such as unpaid suppliers, but because this was not properly documented, the buyer could turn around and claim the seller should remain liable.
- Creditors could sue the seller for the buyer’s debts because business transfer or bulk sales laws were not complied with.
- Without proper documentation in this regard, the buyer could claim the seller’s inventory was damaged or improperly stated and sue the seller for the balance.
- If the buyer is an entity, the buyer could later claim the person who dealt with the seller was not properly authorized, and thus the buyer is not bound by any of the documents that the person signed. The seller needs help in verifying proper corporate or equivalent entity consents.
- The buyer is frustrated by the seller’s delays with resolving contingencies, such as providing
financial information, submitting or reviewing proposed agreements, getting approval for license transfers, among others, and walks away.

- While the buyer is waiting for the seller to organize the necessary documents, they see a better deal elsewhere or get early buyer’s remorse or cold feet and walk away. The seller has to organize the closing as fast as possible while the buyer is getting cold feet.
- The franchisor does not approve the transaction; the buyer is left holding a nonviable business and sues the seller as a result.
- The buyer fails to obtain key licenses or business approvals; the buyer can neither legally operate nor generate revenue with which to pay seller financing, or the buyer could blame the seller and sue as a result.
- One or both parties mistakenly fail to pay the proper taxes on the sale, and the IRS decides to pursue the seller as a result.

Part 2: The Closing Process

**The process – small businesses (less than $1 million to $5 million)**

Many small business purchases are handled with only one agreement. The same agreement that is used to make an offer on the business is often the final agreement that is signed at the closing. A buyer makes an offer to purchase the business, along with an earnest money deposit. The buyer and the seller then complete due diligence. The same agreement that was originally submitted to make an offer on the business is then used at the closing to transfer the assets.

The parties involved in a small business transaction are often not as sophisticated as those involved in larger transactions, and using one agreement simplifies the process. Additionally, many business brokerage offices hire untrained business brokers, and they simplify the process by using fill-in-the-blank forms in portable document format (PDF). Doing so may not be best for the buyer and the seller, but using fill-in-the-blank forms simplifies the process for the business brokerage offices. Many franchised business brokerage offices operate this way.

**The process – mid-sized businesses ($5 million to $25 million)**

The process for a mid-sized business is a bit more complicated, requiring the documents outlined below.

**Letter of interest** – Most mid-sized transactions begin with either a letter of interest or a letter of intent. Whether the process opens with a letter of interest varies based on whether the process is an auction, and it also depends on the parties’ preferences.

**Letter of intent (LOI)** – At some point, a letter of intent is offered often without an earnest money deposit. Sophisticated buyers make a substantial investment in professional advisory fees during due diligence, and most view making an earnest money deposit as unnecessary. Additionally, almost all middle-market buyers are either corporations or financial buyers, such as private equity groups, and most are credible and their deal-making history can be researched and validated. Letters of intent are usually non-binding. Sophisticated
buyers invest significant time and money on due diligence and consider this a demonstration of their earnest intent in lieu of a monetary earnest money deposit, so few sellers require a binding agreement.

**Due diligence** – Due diligence then begins, typically lasting 30 to 60 days. For middle market deals, due diligence is mostly performed online through a virtual data room. Most parties invest a significant amount of time and money at this stage. Additional negotiation often occurs after completion of due diligence if the findings differ from the seller’s initial representations.

**Definitive purchase agreement** – Due diligence then concludes, and the parties’ attorneys draft a definitive purchase agreement, which is signed before the closing. This time period involves the execution of many additional agreements to consummate the sale. Occasionally, additional contingencies remain prior to the closing.

**Closing** – The closing is anticlimactic and can either be a round-table closing or a virtual closing. The closing simply involves a virtual or physical meeting of the parties. The list of the typical items and documents that must be addressed for a successful closing is listed on Appendix A.

**Part 3: Definitive Purchase Agreement**

*What is a definitive purchase agreement?*

A definitive purchase agreement is a final document that is signed during the process of buying or selling a business. It outlines the terms and conditions for buying or selling a company, such as the payment structure, the representations, the termination clause and other important considerations. Unlike a letter of intent, which is a non-binding, preliminary document, “definitive” means the agreement is the final one to be signed before the closing.

A definitive purchase agreement transfers the ownership of a business. A business is nothing more than a collection of individual assets owned by an entity, such as a corporation or LLC. The purchase agreement to transfer those assets can take two general forms:

1. **Stock Purchase Agreement** – This transfers the shares of the entity, otherwise known as a corporation or LLC, that owns the assets of the business. By purchasing the shares owned by the entity, the buyer then owns the assets that were previously owned by the entity. Shares in an LLC are technically called “membership interests.” However, for the sake of simplicity, most parties refer to the transaction as a “stock sale.”

2. **Asset Purchase Agreement** – This agreement transfers the individual assets from the seller to the buyer. However, the seller retains ownership of the shares of the entity, and the buyer typically forms a new entity for the assets that they bought.
Final advice

Much of what is contained in the definitive purchase agreement is boilerplate language. That is, the contents are taken from previous templates; however, the agreements may differ substantially among deals. A savvy advisor can quickly spot these differences. A lawyer offering low-cost services may cost more than an “expensive” lawyer because they are learning along the way. When being involved in one of the most important transactions of your life, hiring experienced advisors, including your intermediary, attorney and CPA, is a prudent idea.

A list of supporting documents and the typical clauses in a definitive purchase agreement is found in Appendix B and C.

Legal Style

Legal documents do not have to sound too technical. Instead, legal documents should be simple, direct and straight to the point. For example, at Morgan & Westfield:

▪ We avoid the elaborate conventions of traditional legal documents: “whereas,” “aforesaid,” “heretofore” and so on.
▪ We do not use legalese, jargon or technical legal terms, except when absolutely necessary.
▪ We avoid long-winded enumeration and redundancy.
▪ We focus on the essential provisions. We do not attempt to cover every possible contingency under the sun because that would be impossible and impractical.

Documents that are simple, direct and straight to the point make legal and commercial sense for the following reasons:

▪ Buyers more easily understand exactly what they are buying, and can thus come to a decision quicker. The quicker the transaction, the lower the transaction costs.
▪ The plainer the document, the less chance of misunderstanding or misinterpretation, and the less chance of any conflict or recrimination later on.
▪ In the unfortunate event that a document needs to undergo litigation, a court, a jury or an arbitrator can comprehend the document more quickly. The faster they understand its meaning, the faster the proceeding and the lower the legal costs.

Part 4: What Is Escrow?

Escrow serves several important functions in the sale of a business.

Roles

Let’s first discuss the roles and importance of an escrow agent:

An escrow agent serves as a neutral third party in a transaction. Escrow is an impartial agent who acts only on mutually agreed upon instructions. This is important because escrow agents often hold substantial sums
of money during various phases of a transaction. It is critical that these funds be held by an independent third party.

Escrow agents are licensed and regulated at the state level. Escrow agents must undergo an annual audit by a certified public accountant and must adhere to a strict code of conduct. During this annual audit, the escrow holder must account for every penny that was either received or dispersed. They must also go through a criminal background check. Additionally, most states require escrow agents to be bonded and require minimum asset and liquidity requirements.

Having a trustworthy third party is paramount because large sums of money are being handed over to them.

Included in an escrow holder's code of conduct is an obligation to maintain confidentiality and privacy. In other words, they can escrow not only money but also information. For example, the seller may be in arrears, or behind on their royalty payments to their franchisor. These royalties may need to be paid off completely before the franchisor allows the franchise agreement to be transferred to the buyer. And perhaps the seller does not have enough money to pay off the royalties before the closing. As a result, the escrow holder must hold the purchase price down payment from the buyer and then pay off the franchisor's royalties before releasing the money to the seller. The seller may wish to maintain privacy or confidentiality on being behind with the royalties to the buyer. Whether or not the seller should have disclosed this as a material fact will not be addressed here. The escrow agent would enable this to happen.

Escrow agents have a fiduciary relationship to both the seller and the buyer, whereas professional advisors almost always have a fiduciary relationship to only one party. These professional advisors, such as accountants, attorneys and brokers, are often held to a code of ethics that prevents them from representing more than one party in a transaction — they often define this as a conflict of interest. By definition, then, this would prevent a professional advisor who is involved in the transaction from functioning as the escrow agent because they would not be an impartial, unbiased, neutral third party.

Escrow agents must act only on mutually agreed upon instructions and within the context of those instructions. This enables them to maintain their impartiality. Note that agency and fiduciary relationships are complex and nuanced subjects, and will not be covered in detail in this section.

A fiduciary relationship, however, means that the fiduciary, or escrow agent, holds a relationship of trust along with legal obligations when handling financial assets or information. This relationship requires one to place complete confidence and trust in the fiduciary for a particular transaction. A fiduciary is necessary for the sale of businesses primarily for timing reasons. For example, the fiduciary holds funds or sometimes documents (e.g., a signed lease or franchise agreement) pending completion of events, or may hold the funds until certain events are completed and then later release the funds.

The escrow holder may also act as a third-party clearing house. The sale of a business is complex with dozens of interdependent chains of events. A clearing house is “an agency that collects and distributes something.” In the context of an escrow, this is either money, information or documents. Acting as a clearing house also requires the escrow agent to provide an accounting, which is another duty of the escrow agent, to all parties involved in the transaction.
Services

Now that we understand their roles, let’s discuss some of their specific services:

Clear title: Escrow agents ensure the buyer is transferring a clear title of the business assets to the seller. The sale of a business is primarily the sale of personal property, as opposed to real property, and is covered under the Uniform Commercial Code (UCC). Escrow agents check whether the title of the assets is clear by searching for UCC liens at the state or local level, although the exact process varies based on the state. This can get quite complex, as there are certain situations in which a UCC lien might not have been filed but in which case the seller may not be free to transfer those assets. An experienced escrow agent is essential in this regard.

Settlement services: Escrow agents also act as a third-party clearing house (also discussed above) for payment of liens, debts or other bills prior to or after the sale of a business.

Intermediary: Escrow agents also sometimes act as a third-party intermediary for both private and public parties such as franchisors, landlords, brokers and banks. Public parties include the IRS as well as state and local governments. The sale of a business involves a dizzying array of payments of taxes. We suggest you employ professionals to ensure you are in compliance with all direct and indirect parties to your transaction.

We have personally experienced many closings being stalled for technical reasons. For example, one seller neglected to file his annual report for his corporation with the secretary of state. As a result, his corporation was not properly registered, and its assets were not therefore authorized to be sold. In another situation, one seller neglected to file and pay his personal property taxes for over a decade. The sale was held up by the county treasurer, and the taxes and penalties had to be paid. Note that successor’s liability can also exist in certain situations. This means that the buyer may be held liable for certain liabilities that the seller has incurred, even though the buyer might not have been made aware of these.

Successor’s liability primarily relates to payroll taxes, sales taxes and environmental issues; however, employing professionals to be sure is always wise. Certain licenses must also be transferred (for example, a liquor license in the state of California) through an escrow agent.

Disbursement of funds: Perhaps the most critical service that escrow agents provide is holding and releasing funds pending the completion of an event. This is important for timing issues, as we discussed above. For example, we strongly prefer that earnest money deposits be held by a neutral third party. The escrow agent holds the earnest money deposit pending the completion of due diligence. They may only release the earnest money deposit upon mutual instructions from both the buyer and the seller. The typical duties of an escrow holder in a business asset sale or purchase transaction are listed in Appendix D.
Part 5: What Happens to Debt When Selling a Business?

When it comes time to sell a business, many business owners incorrectly assume that the company’s debt will disappear when the business is sold. This comes from the belief that a new buyer will simply take over the debt. In some cases, the debt is absorbed in the transaction as part of the sale. However, automatically presuming that you, the current business owner, will be free from all debt just because you sold your business is wrong.

Understanding what happens to debt when you sell your business is important, and that largely depends on how the transaction is structured. There are two ways a transaction can be structured: as a stock sale or as an asset sale. Both will be discussed in turn, followed by some important exceptions to the rule.

*Stock sale*

A stock sale occurs when the buyer purchases the stock of the entity and assumes everything that the entity (corporation, LLC, etc.) owns, including its assets and liabilities. Generally, when a transaction is structured as a stock sale, the buyer is purchasing everything the entity owns — including any unknown liabilities. This is the reason most stock sales are done by larger companies. In fact, less than 5% of businesses that sell for under $10 million are structured as stock sales.

A buyer will typically decide to structure the sale as a stock sale if they want to inherit something that the corporation or entity owns that cannot be independently transferred. For example, some contracts are specific to a corporation, LLC or entity, and structuring the transaction as a stock sale would ensure that these are passed along to the new owner, assuming the contract does not state that a change in control requires the consent of assignment of the contract.

When structuring a stock sale, two things should be determined: what assets are being purchased and what liabilities are being assumed. Then, all you must do is sign the stock certificates and all the other assets are transferred automatically unless they are owned by an individual rather than the entity.

*Asset sale*

In an asset sale, there is only a transfer of specific assets and liabilities from the seller to the buyer. You can choose which assets and liabilities are included in that transfer.

The asset sale involves the transfer of titles to certain assets and sometimes certain liabilities. The combination is varied and subject to negotiation. For example, sometimes all of the inventory is included, and sometimes none of the accounts receivable is included. Again, there are manifold combinations. Sometimes, buyers select some assets and leave other assets, and they do not keep the cash or the working capital, but they include the inventory and the hard assets. Again, any combination is possible.

Most of the small businesses that are sold are structured as an asset sale because of potential contingent or unknown liabilities. A contingent liability means the buyer does not know its existence and so the buyer does not know what they are inheriting. If the stock of the company is being purchased, a number of unknown liabilities could exist, and the buyer must trust the seller to properly disclose these.
To affect the sale, the buyer forms a corporation and that corporation purchases the assets of the selling corporation.

The purchase agreement is more complex in an asset sale than in a stock sale because the assets and liabilities are independently chosen. On the other hand, all you have to do in a stock sale is sign over the stock certificates and all the other assets are transferred automatically unless they’re owned by the seller or the individual.

**Exceptions**

There are a couple of exceptions.

**Exception 1 - Leased equipment**

If equipment is leased by an individual, that lease or asset must be transferred over, regardless if it’s an asset sale or a stock sale.

**Exception 2 - Successor liability**

There is some potential for successor liability in the sale of a business, which means that the buyer could potentially be liable for certain things, even though this wasn’t agreed to contractually. Examples could be unpaid utilities, sales tax, property tax, payroll taxes, income and Social Security taxes, and others. Successor liability occurs by operation of law, not by contract.

Additionally, in certain states, the buyer could be subject to claims of creditors in states in which the bulk sales law is still in effect. As a result, extensive due diligence should be performed to avoid the possibility of successor liability regardless of the type of transaction. Additionally, the buyer should use an escrow company, and basic representations and warranties should be included in the purchase agreement to address the potential for successor’s liabilities.

Another creative thing for the buyer to do would be to not pay the seller all cash at the closing, but to pay a portion of it, and to structure a portion of the price as a promissory note. The buyer may then have a right to offset (legally withhold payment) the note for certain claims. For example, if the buyer pays the seller $10 million for their company, perhaps the buyer can pay $5 million at closing and then $1 million per year, plus interest, for five years, for a total price of $10 million. And if a large claim pops up for sales tax or payroll tax, and the state or federal government pursues the buyer, then the buyer could deduct those amounts from the promissory note. This would still likely result in litigation; however, the buyer is in a much more powerful position because they have the money.

**How to handle debt at the closing**

The following are four options for handling debt at the closing:

1. The debt could be paid at the closing.
2. The debt could be assumed by the buyer.
3. You could negotiate with the lender before the closing to see if they can reduce the amount of the
outstanding debt.

4. Deduct the debt from the proceeds of the sale — this is the simplest way to handle debt. If you're selling a company for $10 million and you have $2 million in debt, then escrow deducts $2 million from the proceeds at the closing. And then the remaining $8 million would be paid to you at closing.

**FAQs about the closing**

**Do I need to use an escrow company?**

No, this is not an absolute requirement in any state that we are aware of. Certain states, such as California, require that you comply with certain laws (e.g., bulk sales laws), and typically only escrow agents offer this service. You should, however, strongly consider the use of an escrow agent. Why? It is always a good idea to have an objective third party hold the funds, make sure there are no additional encumbrances against the business, and ensure that both you and the buyer are in agreement on the closing prior to releasing funds.

**Do I need an attorney?**

An attorney might be helpful but is not a requirement. Many transactions conclude successfully without one.

**Is the closing process the same in every state?**

No. In states that have not repealed the bulk sales statute (in other words, you must comply with bulk sales laws), the closing process is more complex and time-consuming than in states that have repealed these laws. Additionally, business sales on the west coast tend to be handled by escrow agents, whereas those on the east coast tend to be handled by attorneys.

**Should my broker handle my escrow?**

No. Technically, your broker is not unbiased and cannot provide a fiduciary relationship to both parties. This represents a compromise of the broker's ethics if they simultaneously function as the escrow agent.

**Do you recommend obtaining earnest money?**

Yes. Earnest money deposits serve two purposes. First, they offer demonstrable proof that the buyer is serious about buying your business. Second, if the buyer defaults on the purchase agreement after due diligence and other contingencies have been removed, the earnest money deposit typically serves as liquidated damages to the seller. Would you, as a business owner, take an offer for your $350,000 business seriously when it was accompanied by a good faith deposit of only $5,000? Would you allow someone to tie up your business for 30, 45, 60 days or more with only $5,000 in escrow?

Always ask for an earnest money deposit. This shows good faith and lets you know the buyer is serious. It also psychologically commits the buyer to a greater degree. You are releasing a lot of information to the buyer regarding your business, and obtaining an earnest money deposit is a reasonable move. A typical earnest money deposit is 5% of the purchase price of the business, sometimes with a $5,000 minimum.
An offer with a higher earnest money deposit carries more weight; many buyers know this and are willing to put down a larger deposit. The earnest money deposit is typically held by a third party, such as an escrow company or attorney.

**How do I secure the note when financing the sale of my business?**

Your note is secured with a UCC-1 lien that is filed in your local county or state. It is also protected by a promissory note and personal guarantee.

**What is the allocation of the purchase price?**

Allocating the purchase price, or total sale price, of a business among the various asset components (asset "classes") of a business is usually necessary for tax purposes when a business is sold, whether it is via a stock sale or a non-stock sale. Consulting both the seller's and the buyer's tax advisors when the allocation is being negotiated is important. Frequently, the allocation of the purchase price can become another area of negotiation after the price, terms and conditions of the sale have been agreed upon by the buyer and seller. Since the typical tax implications are "whatever is good for the seller is bad for the buyer, and vice versa," occasionally the allocation of purchase price negotiations can be as contentious as the purchase price negotiations.

**What is the role of the escrow company?**

The escrow agent ensures regulatory compliance, prepares routine transaction documents and closing statements, and handles administrative details in a cost-effective manner. Business escrows protect the interests of buyers and sellers and are used extensively by transaction attorneys and intermediaries.

**What is my attorney's role in the process?**

Your attorney must review all transaction documents to ensure your legal rights are protected. For example, your attorney would check whether the transfer would be effective under your state's bulk sales laws, if any; whether any creditors should be notified; whether you have strong remedies against the buyer in a seller financing agreement; and whether a security agreement over the assets sufficiently protects you.

**Is the escrow process for a business different from the escrow for a house?**

The primary purpose of escrow for a business transaction is the same as that for buying or selling a house, which is to provide a neutral third party to handle the money and paperwork. However, a business transaction has a different set of laws to follow and generally involves many other parties.

**What is a holding escrow?**

A holding escrow is when an agent limits their services to the holding of funds. For example, the agent may hold the buyer's earnest money deposit and may not perform any other services.

**What is a bulk sale?**

A bulk sale refers to the sale and transfer of nearly all of the business's inventory to a single buyer where the transaction is not part of the ordinary course of business. Bulk sales laws are meant to protect creditors by
giving them a notice of a bulk sale. This would be necessary if the supplier had sold the inventory to the business on terms — the business owner could quickly liquidate the inventory to a single buyer and skip town with the cash. Bulk sales statutes require advance notice, typically through publication in a newspaper, that is often released 14-30 days before the sale. Creditors are given the opportunity to submit claims to the escrow holder. Most states, however, have repealed the bulk sales laws because they have done little to protect creditors. Additionally, the bulk sales laws only apply to certain types and sizes of businesses.

**Are escrow agents called anything else?**

Yes, they are also sometimes called settlement agents, closing agents and escrow officers.

**How are most closings handled?**

More and more closings are of the virtual type. In this situation, the closing documents are often mailed to the parties via courier for signatures and then sent back to the escrow agent for release at the closing date. This is a terribly uneventful closing for most; however, this is becoming more common. Round-table closings are becoming less common with the advent of technology.

*Morgan & Westfield* can help you navigate one of your life’s most difficult, yet significant events — selling your business.

*Don’t leave money on the table.*

*Call us today* for a 30-minute call to see how we can help you.
Find a New Focus for Your Energy: What Happens After You Sell Your Business?

After being business owners for many years, most of our clients are initially relieved to retire. Time and again, our clients who are near retirement share dreams of traveling, spending time with grandchildren, fishing, reading, learning a new hobby, and every other kind of cliché retirement activity you can imagine. And, in theory, this is a great plan. You have worked hard all your life; now it’s time to slow down and relax.

The problem with this plan is many entrepreneurs do not know how to “do nothing” or simply relax. Many clients, the same ones who were excited at the idea of retiring become stressed and overwhelmed once a buyer puts an offer on the table for their business.

As we discuss the details of finalizing the sale, we have several clients ask us, “Now, what?” Then, when the sale is complete and they are officially “retired,” they go off to do all the glorious things they imagined. The hitch is, most are not going to spend the rest of their lives traveling or playing with the grandkids.

A year into retirement and oftentimes even less, the entrepreneur is looking for something else to do with their time. Many of our clients even come back asking to play a role in their old business!

Most entrepreneurs are go-getters. They need something to do with their time, be it a hobby, a new job, a role in a charitable organization or something that will give them a purpose. Once their business is sold, many entrepreneurs find that what they once thought would be their dream or retirement turns out to be the very thing they resent.

Other entrepreneurs become so stressed during the closing — because they realize they will have nothing to do once the business sells — that they often delay the sale or even back out entirely! This is because of the anxiety they get at the thought of doing nothing after a lifetime of work.

Luckily, there are ways to calm your nerves when selling your business. You need to realize that what happens after you sell your business needs to be planned just as much as the sale itself. You would not sell your house without knowing where you would be moving to. The same principle applies here: Why would you sell your business without having a detailed plan about what you will do next? Answering “I will be retired” is not enough. You need to direct your energy toward a new passion.

If you are preparing to sell your business and are not sure what you will do next or you plan to just retire, I challenge you to spend some time answering this question: “What do I want to accomplish over the next 5, 10, 15 years?”

Writing down your short-term goals (e.g., traveling or visiting family), as well as your long-term goals (e.g., learning a new language or starting a not-for-profit undertaking), will help you feel less overwhelmed as you
get closer to selling your business. You can even gather information now about the different things you would like to accomplish once your business is sold. The more detailed your plan after the business sells, the better. You will find that a little preparation now will save you stress and anxiety about your future as you navigate through the complex process of selling your business.

**Summary**

- Most entrepreneurs are go-getters.
- To say, “I will be retired,” is not enough. You need to direct your energy toward a new passion.
- You will find that a little preparation now will save you stress and anxiety about your future as you navigate through the complex process of selling your business.
Recommended Reading

Streamlining Your Business & Entrepreneurship

“The Lean Startup” by Eric Ries and “Running Lean” by Ash Maurya – These books teach you the “lean” system in business strategy as opposed to the outdated waterfall method of business planning, in which each stage of the process has to be completed before moving on to the next stage. Being lean and agile in business can help you quickly accomplish many goals and speed up the process of the steps involved here.

“Work the System” by Sam Carpenter – This is a book that walks you through, step-by-step, how to document your business and prepare an operations manual for your company. This is a great resource if you have never automated, documented and delegated processes in your business.

“The E-Myth” by Michael E. Gerber – This is a classic book that all entrepreneurs should read and many franchisors recommend. The essence of the book is that entrepreneurs spend too much time working in their business and too little time working on their business.

“Scaling Up” by Verne Harnish – This popular book, a sequel to the “Mastering the Rockefeller Habits,” teaches you the four essential processes any small business needs to install before they begin scaling their business. Note that installing these tools is easiest if you have a management team to help you do so. This book is a collection of skills, tools and processes. Implementing all the suggestions contained in this book may take you up to 6 to 12 months.

“Duct Tape Marketing” by John Jantsch – This book will help most small business owners create marketing processes. Yes, you need scalable, repeatable marketing processes in your business. These are practical, easy-to-implement suggestions. Like all suggestions contained here, though, implementing these processes entails a lot of time and help from your core management team.

Personal Productivity

“Focal Point” by Brian Tracy – This book assists you in establishing a laser-like focus on critical goals in your life. Focus is paramount to entrepreneurs. Most entrepreneurs suffer from an over-abundance of ideas rather than a dearth of ideas. In other words, they have a “lack of focus.”

“Getting Things Done” by David Allen – The GTD system is widely known as the most effective time management system in business. David Allen’s book, in our opinion, is the best book available on time management. David teaches you specific techniques that you can implement in your life to improve your time management.

“Your Brain at Work” by David Rock – I always say that energy management is more important than time management. This is the case once you possess rudimentary time management skills, such as daily planning, prioritizing and delegating. I always run out of energy before I run out of time. “Your Brain at Work” recognizes that energy is a limited resource, and it teaches you how to strategically use this scarce resource.
You should treat energy like any other limited resource, such as time or money. Did you know that multitasking can turn a Harvard MBA into the mental equivalent of an 8-year-old? Yet, we all do this all the time. This book offers practical insights on how to earn the highest ROI on your energy investment.

“How to Hire A-Players” by Eric Herrenkohl – Management starts with hiring the right people. Sourcing and interviewing are skills that can be learned. This book teaches you a step-by-step process for hiring superstars. It takes a lot of practice, and hiring is simpler if you have a management team to assist you in establishing the right systems for attracting the talent you need.

“Carrots and Sticks Don’t Work” by Paul L. Marciano – Most small-business owners with fewer than 50 to 100 employees manage their employees using the carrot-and-stick method, which uses rewards and punishment as tools to motivate. Unfortunately, this method produces poor results in any industry in which engagement is important. This book teaches you 5 to 10 management techniques you can use to develop an engaged long-term workforce.
Checklists available for download

Checklist 1 – Preparing for the Sale
Checklist 2 – Valuing Your Business
Checklist 3 – Financing the Sale
Checklist 4 – Finding and Working with a Broker
Checklist 5 – Attracting Buyers
Checklist 6 – Screening Buyers
Checklist 7 – Showing Your Business to Buyers
Checklist 8 – Negotiating and Accepting an Offer
Checklist 9 – Preparing for Due Diligence
Checklist 10 – Handling the Closing
Appendices

A – Typical Items and Documents Needed for a Successful Closing
B – Supporting Documents to the Definitive Purchase Agreement
C – Typical Clauses in a Definitive Purchase Agreement
D – Typical Duties of an Escrow Holder in a Business Asset Sale or Purchase Transaction
Appendix A

Typical items and documents that need to be addressed for a successful closing

- **Allocation of purchase price** – This must be filed with the IRS at the end of the tax year. Failing to do so can expose you to large penalties.

- **Assignment of contracts** – Any contracts included in the sale must be assigned.

- **Assignment of equipment leases** – Any equipment leases that are to be assumed must be properly transferred from seller to buyer, whether individually or to the buyer’s entity.

- **Bill of sale** – This is the actual document that transfers possession of the assets at the closing in the case of an asset sale.

- **Business bank account** – The buyer must have the proper licenses, such as a DBA and business license, and form an entity to open a bank account in the business’s name.

- **Business license** – The business license must be transferred as part of the sale process.

- **Buyer’s disclosure statement** – This further reduces your liability post-closing for any disclosures the buyer may not have made.

- **Closing adjustments and prorations** – Multiple adjustments and prorations must often be made (lease payment(s), utilities, property taxes, accounts receivable, etc.) at the closing to account for timing differences between when bills are paid and when a change of possession occurs.

- **Consulting agreements** – These are often negotiated between buyer and seller.

- **Corporate resolution** – If your business is a corporation, LLC, or other entity, then the proper documentation must be drafted, authorizing you to dispose of the corporate assets.

- **Employer Identification Number (EIN, TIN)** – The EIN and TIN are often required by third-parties, such an escrow agent.

- **Equipment inspection** – We recommend the buyer inspect the equipment well before the closing to eliminate last minute surprises.

- **Equipment list** – This must be attached to the bill of sale.
- **Escrow instructions** – Handling the money yourself is not wise. The funds should be held by an independent third party and placed into a licensed trust or escrow account.

- **Financing documents, if applicable** – If third-party financing is involved, then multiple additional documents must often be completed, such as business plans, projections and others.

- **Forming a new entity** – The buyer needs to form a new entity, such as a corporation or LLC. The promptness of this is critical because deals can be delayed for up to two months when the buyer doesn’t form their entity in a timely manner.

- **Franchisor approval** – The franchisor must approve the sale, if applicable.

- **Holdback agreement for training** – In an all-cash deal, savvy buyers may request to hold a portion of the payment until training is complete.

- **Intellectual property transfer** – If your business owns any intellectual property such as patents, copyrights or trademarks, they must be documented and then transferred to the buyer.

- **Inventory count and transfer documents** – Inventory must be counted and transferred.

- **IRS checklist** – Your accountant should assist you in closing your entity by following the checklist provided by the IRS.

- **Landlord/lease assignment** – If you plan to transfer your lease, the landlord must first approve it in writing. Never transfer the lease until the closing. Timing is crucial here.

- **Licenses and permits** – The seller must create a list of permits and licenses for the buyer to apply for and obtain. Again, timing is important here because the buyer needs to coordinate this with other closing tasks.

- **Non-compete agreement** – This is a separate document and agreement signed by you only, typically notarized, although this is not technically required.

- **Notice to creditors** – A notice to creditors must be filed in 13 states in which this law is mandated. Failure to do so can leave you open to exposure for many years to potential third-party claims.

- **Payroll tax clearance** – Another critical component. You will want to document that your payroll taxes are paid and current before closing.

- **Promissory note** – If seller financing is involved, this should be put into an agreement and signed by the buyer.
• **Property tax calculation and proration** – Property taxes must be prorated concurrent with the time of closing.

• **Sales tax clearance** – If your business collects sales tax, you must obtain a clearance certificate for the buyer prior to the closing. Failure to do so could expose the buyer to unpaid taxes.

• **Security agreement** – If seller financing is involved, then placing a lien on the assets of the business until you are paid in full is wise. Doing so will prevent the buyer from selling the business or further encumbering the business without your permission. If seller financing is involved and you are placing a lien on the assets of the business, then filing a notice, or lien, with the appropriate filing office is recommended.

• **Seller’s entity** – The seller’s entity must be in good standing to sell the assets.

• **Seller’s disclosure statement** – We recommend preparing and signing a disclosure statement and including it as part of the closing package.

• **Tax clearance certificate** – Clearance may often be required from other state agencies for payroll and other taxes.

• **Termination and transfer of DBAs associated with the business** – If the buyer wishes to operate under the same trade name, then you must terminate your DBA/FBNS and transfer it to the buyer.

• **Training agreement** – This document spells out your agreement with the buyer to train him or her. Having the buyer sign off on the training when it’s complete is important so there are no disputes. If you fail to do this, the buyer could refuse to make payments later, offsetting the note by claiming you failed to train them properly.

• **Transfer of any third-party contracts** – These include the yellow pages, advertising, equipment leases, etc.

• **Transfer of merchant accounts** – The buyer must be properly licensed and have bank accounts and other necessary things in place before they can apply for a new merchant account.

• **Transfer of utilities** – A clause should be contained within the purchase agreement to transfer the utilities in a timely manner. Failure to do so could leave you responsible for the utilities until they are transferred.

• **Transfer of websites, domain names, phone numbers and other asset transfers** – In the purchase agreement, other assets of the business should be outlined and a clause should be included whereby you agree to transfer these to the buyer at the closing.

• **Transfer of telephone service** – Telephone services should be arranged to be transferred prior to the
● **Uniform Commercial Code (UCC) financing statement** – File a notice or a lien with the appropriate filing office when you offer seller financing and then put a lien on the assets of the business.

● **UCC search** – A UCC search must be made to ensure the assets being transferred are free of any liens.

**IMPORTANT** – The list above is in no way complete. It simply represents the typical documents and steps required to close. Only a licensed professional should handle all business closings. The list above is provided for illustrative purposes only.
Appendix B
Supporting documents to the Definitive Purchase Agreement

Typical supporting documents attached to the definitive purchase agreement as schedules or exhibits include:

- **Corporate resolution** – A corporate resolution is required in an asset sale if the seller is an entity and is selling a majority of the assets of the company. Technically, the seller in an asset sale is the entity (corporation or LLC), and a corporate resolution is typically required in the Corporate Bylaws for taking major actions, such as selling all assets of the company. This resolution is not required if the seller is selling the entity, such as in a stock sale.

- **Bill of sale (if selling the assets)** – This document transfers the individual assets of the company, similar to when you sell a car and must sign a bill of sale. The bill of sale should list all assets included in the sale, along with a detailed description. Some advisors list intangible assets separately and transfer them using a separate set of exhibits.

- **Deed of sale of entity (if selling the entity or stock)** – This document is required if the seller is selling the shares in the entity.

- **Non-competition agreement** – The non-competition agreement contains a description of what the seller may and may not do and specifies the length of time the agreement stands. Almost all sales include a non-compete agreement. Sometimes, this agreement is included as a clause in the purchase agreement, and sometimes it is listed as an exhibit. The non-compete agreement should be voided if the buyer defaults on payments to the seller.

- **Training log** – Logging the completion of the training period is a good practice to prevent potential future litigation.

- **Promissory note, security agreement (if the seller is financing the asset sale)** – This document is required for asset sales or if seller financing is involved. The promissory note outlines the terms of repayment, and the security agreement is a document allowing the seller to place a lien on the assets of the business until the buyer pays in full. A UCC-1 also needs to be filed to perfect the lien.

- **Share pledge agreement (if the seller is financing the stock sale)** – For stock sales, shares of the entity can be held in trust or escrow until the seller is paid in full, which is similar to placing a lien on assets of the company. However, it is a good practice to have a third-party physically hold onto the shares until the loan is paid in full.

- **Allocation of the purchase price (for an asset sale)** – This document breaks down the purchase price into separate asset classes for IRS purposes. It is only used for asset sales. The tax implications for asset and stock sales can be substantially different.
● **Assignment of shares (for a stock sale)** – This document transfers shares of the entity; this is used for stock sales only.

● **Independent contractor agreement** – The independent contractor agreement is necessary if the seller is to continue working for the buyer in some capacity, although it can also take the form of an employment agreement.

● **Assignment of contracts** – This document transfers third-party contracts from the seller to the buyer upon the closing. This document may not be necessary for stock sales, as some agreements are transferable despite a major change in the ownership of the entity.

● **Assignment of equipment lease** – The assignment of equipment lease transfers the lease for the premises. The seller usually remains as a guarantor for the lease until the lease expires. This document must be signed by the landlord; however, it is not necessary if a new lease is created. A different agreement is necessary if space will be subleased from the seller to the buyer.

● **Assignment of intellectual property** – This exhibit transfers any intellectual property from the seller to the buyer, such as patents, trademarks or other registered intellectual property. It can also transfer non-registered intellectual property, such as phone numbers, websites and content.

● **List of assets** – This is a detailed list of all tangible assets that are transferred. It is not necessary for stock sales, although it does not hurt to be clear on which assets are owned by the corporation or LLC. Doing so can help prevent litigation regarding which assets were included in the sale.

● **List of intangible assets and intellectual property** – This exhibit includes a list of intangible assets, such as phone numbers. Providing clarity in this area can prevent future litigation and disputes.

● **List of titled properties** – It includes a list of titled properties, such as real estate or vehicles. These assets require a separate set of transfer procedures.

● **Seller’s disclosure statement** – This is a statement made by the seller regarding any adverse conditions of the business that the buyer should be aware of. Notifying the buyer in writing of any material, adverse conditions of the business is critical. Doing so prevents potential litigation.

● **The release of holdback** – Savvy buyers will request that a percentage of the purchase price is held in escrow until the training period is complete. In some middle market transactions, this amount can be held in escrow for up to 12 to 24 months to cover any additional unknown variables, such as customer warranty claims, gift certificates, among others. This varies from 5% to 20%, or more, of the purchase price.

**Appendix C**
Typical Clauses in a Definitive Purchase Agreement

- **Definitions** – Any well-written purchase agreement contains definitions of the keywords used throughout the document. This section clarifies confusion; e.g., how is the term “closing” different from “change of possession”? Is the “closing” date the same as the “change of possession” date?

- **Purchase price and financing** – This defines the amount of the purchase price, typically broken down by the earnest money deposit, the down payment, the additional funds needed upon conclusion of due diligence, the amount of seller financing, third-party financing, and the holdback amount. It outlines if financing is a contingency; if so, it defines how long the buyer will have to obtain third-party financing. It also details whether an earnout is involved.

- **Solicitation** – This area details whether the parties are negotiating exclusively with one another. “No shop” or “go shop” clauses may be included in this section.

- **Inventory** – This section contains a description of the inventory included in the sale as well as who will count the inventory: the buyer, the seller or an inventory valuation service. It also provides adjustments to the purchase price based on the difference in inventory between signing and closing as well as a representation regarding the condition and salability of the inventory.

- **Contingencies** – The purchase agreement sometimes contains contingencies if a substantial period of time has passed from signing to closing. Buyer contingencies can relate to obtaining financing, obtaining a license, transferring a lease or obtaining franchisor approval. The agreement may also be contingent on the seller approving the buyer’s credit and financial position if the seller is offering financing.

- **Earnest money deposit** – The agreement outlines who holds the earnest money deposit, whether it is refundable or non-refundable, and the conditions for refunding the deposit.

- **Closing costs and prorations** – This area of the agreement explains who will pay which closing costs. Many closing costs are split equally between the buyer and the seller, with each party paying their own advisors.

- **Training and transition period** – This section outlines in detail the length and form of the training agreement. Being highly specific regarding the length of the training agreement, including how many hours and on what terms, is a good practice. Not doing so can lead to post-sale disagreements, and buyers sometimes sue sellers for failure to properly train them.

- **Representations and warranties** – The seller’s representations are often more thorough than the buyer’s representations. Examples of the seller’s representations include: 1) All assets are in good repair; 2) All taxes will be paid at the closing; 3) Seller has the legal capacity to sign the agreement; and 4) Seller has complied with all laws. Representations and warranties (called reps and warranties for short) are heavily negotiated in larger transactions and used by many buyers to flush out potential problems. Unfortunately, some sellers will sign anything, take the money and run.
• **Confidentiality** – This clause is sometimes included even though a separate confidentiality agreement may already exist.

• **Default and remedies** – This area includes conditions for canceling the agreement and penalties for defaulting, including a break-up fee.

• **Miscellaneous legal provisions common to all legal agreements** – This section can include attorney fees, mediation, indemnification, entire agreement, severability, governing law, risk of loss and other provisions that generally apply to all legal agreements.
Appendix D

Typical duties of the escrow holder in a business asset sale or purchase transaction

- Collecting and disbursing closing funds according to escrow instructions.
- Disbursing funds as authorized by instructions, including commissions and payoff liens.
- Distributing final transaction documents to all parties.
- Drafting escrow instructions according to the terms and conditions of the purchase agreement.
- Filing and recording all necessary documents with the appropriate authorities.
- Filing UCC-1 Financing Statement with the Secretary of state when seller financing is involved.
- Holding earnest money in a safe, secure escrow account pending the closing.
- Ensuring that secured creditors are satisfied. Coordinating any necessary payoffs and handles.
- Notifying and obtaining clearances from county, state and federal agencies as required.
- Notifying the county tax collector.
- Obtaining a copy of all real estate leases. Coordinating and confirming the lease assignments with the landlord.
- Obtaining from the secretary of state a corporate status report of all entities involved in the transaction and confirming that the entities exist and are in good standing.
- Obtaining written evidence of proper authority for an entity to sign the purchase agreement and related documents and to consummate the transaction.
- Overseeing UCC-3 terminations, amendments and releases of liens.
- Performing a UCC-1 lien and business personal property tax search on the business to make sure a clear title can be conveyed.
- Performing routine consultation regarding problems that arise.
- Preparing estimated closing statements prior to the closing of escrow.
- Preparing fictitious business name statements.
- Preparing final closing statements for the parties and accounting for the disposition of all funds deposited in escrow.
- Preparing separate buyer’s and seller’s settlement statements reflecting that all funds are being handled through escrow.
- Prorating and paying the rent, deposits, taxes and other expenses required out of the sales proceeds.
- Prorating taxes, interest, rents, security deposits, among others, as instructed.
- Requesting demands from existing lienholders, and receiving claims.
- Requesting publication, recording and UCC lien searches for state and county.
- Securing releases of all contingencies or other conditions imposed on the particular escrow.
- Securing tax clearances.
About the Author

**Jacob Orosz** is the founder and president of Morgan & Westfield, a professional services firm that specializes in the confidential appraisal and sale of small- to mid-sized, privately owned businesses.

A certified business broker and licensed business/real estate broker, Jacob has nearly two decades of experience in facilitating mergers, acquisitions, sales and other business transfers with values ranging from $30,000 to $75 million.

Jacob has successfully participated in or managed the sale of over 300 privately held companies in both the main-street and middle-market arenas in which he represented both buyers and sellers from North America, Central America, South America, Europe and Asia.

Jacob also writes for various trade journals and magazines about growing and selling a business.

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About Morgan & Westfield

Our one and only specialty is helping entrepreneurs successfully plan and execute the sale of their businesses.

We specialize in selling small and mid-sized businesses with revenues up to $50 million. Our clients include franchised businesses, privately owned businesses, online businesses, and emerging growth companies in various industries throughout the United States and Canada.

Whereas most brokers work exclusively on a commission basis, we eliminate this bias by working similar to other professionals, such as attorneys and accountants. This allows us to provide significant savings and offer unbiased advice to our clients.

Because we have a professional team devoted to helping sell our clients' businesses, we can give them access to an extensive amount of resources that other brokers can’t provide. Our clients get the benefit of the same processes and resources that the best brokers and M&A advisors in the country use, plus access to our dedicated team of expert advisors, but without the high fees and long-term contracts.

You can follow Morgan & Westfield on LinkedIn or Facebook.

Morgan & Westfield can help you navigate one of your life’s most difficult, yet significant events — selling your business.

Don’t leave money on the table.

Call us today for a 30-minute call to see how we can help you.