

7 STEPS TO A SUCCESSFUL BUSINESS SALE OR TRANSITION

By

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Planning for the sale or transition of a business, including a professional practice, often presents very complex financial and emotional decisions for the owner. This article will discuss a few options to help make this process more successful and rewarding for everyone involved.

1. Set a Time Frame

The first hurdle that needs to be crossed is the decision of whether or not the business owner(s) are truly ready to sell or otherwise transition the business management and operation to a new owner. Many business owners struggle with the ultimate decision of whether they are ready to actually step away from the business which they have created and that has shaped both their lives and the lives of the employees who have served them. Many business owners simply have trouble psychologically adapting to the concept that they will no longer be in charge, or the person ultimately responsible for either the success or failure of their business. Accordingly, it is important for a business owner who is considering either a sale or other form of transition of a business (e.g., transfer to a younger generation), to establish a timeframe for both starting and completing the transfer process. Generally, a business owner can never choose the perfect time for sale; however, those who have sold while their business is doing well have generally been rewarded for their efforts.

2. Evaluate Personal Financial Position

A critical component in the decision of whether or not to sell a business relates to whether a sale will allow the business owner to continue the lifestyle that he or she expects once the transaction is completed. Surprisingly, some business owners are well down the road in negotiations before they realize that the after-tax proceeds which they will receive may not allow them to continue the lifestyle which the business had afforded them in prior years. Business owners who are either planning the sale of their business or the transfer of their business to a younger generation should

work closely with their attorneys, certified public accountants ("CPA"), and financial advisors, to determine what cash flow is needed from the business sale, personal investments, and other assets to provide them with the lifestyle that they wish to continue following the date of the anticipated transaction. If this analysis is performed early on, it will allow the owner of the business to both structure and time the transaction in a manner which has a greater chance of accomplishing his or her goals.

3. Develop a Specific Transaction Plan

After the emotional and financial considerations involved with the sale or transfer of the business have been carefully considered, a transaction game plan should be developed. Effort should be made to realistically calculate the value of the business. Often, our clients have obtained the assistance of investment bankers, business brokers, or their CPA to assist them in both evaluating the marketability of their business, as well as determining a realistic enterprise value for the business. If the sale or transfer involves a transaction with unrelated parties, then most sellers are simply hoping to maximize the after-tax proceeds that they will receive from the transaction. However, if the transfer involves a transition to a younger family generation, the focus may shift to assuring that the selling/older generation has the opportunity to realize an ongoing cash flow stream that will support the lifestyle that they have chosen. In either case, it is critical that the business not be overburdened by whatever debt structure is incurred to finance the transfer of the business.

4. Set a Realistic Value

Utilizing the expert assistance of an investment banker or business appraiser is critical to eliminating the uncertainty surrounding the determination of the value of any business. The seller must not only determine how much he or she needs, but also how much a prospective buyer can reasonably be expected to pay. In reaching

a reasonable answer to these questions, it is very important to have current, good financial information to understand and demonstrate the success of the business during the prior 5 year period and to generate pro forma statements that will help a potential buyer or business successor appreciate the value inherent in the business. Although it is important for a business owner to have a realistic sense of value for their business, most businesses are presented for sale without a stated sales price. Instead, potential buyers are often invited to make their best offer, realizing that other potential buyers are also making offers.

5. Run through the Tape

As a business owner approaches the decision of whether or not to sell or transfer his or her business, it is important that the business owner keep the engines running. You don't want the business to be sold while it is coasting or reflecting the results of less active and less energized management. Most successful businesses will be valued based on some multiple of earnings, typically referred to as EBIT (Earnings Before Interest and Taxes) or EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization). The earnings level is critical to a potential buyer or business successor in helping them understand the rate of return that they can expect on their investment, as well as the amount of debt service that can be funded from future operations. Each dollar of profit brought to the bottom line of the business during the last 3 to 5 years of operation prior to the sale or transfer will directly affect the value of the business. Let's assume a valuation multiple of five for each dollar of profit earned. An increase (or drop) in earnings during this period of time will result in either an increase (or drop) in the business value by \$5 for each dollar earned or lost. Accordingly,

it is critically important that the business seller maintains strict control and even improve many of the business practices that have made them profitable in the past. This may include improving business sales practices, better cost control techniques, and reducing some of the “deductible” expenditures that may have simply made the owners life more enjoyable in prior years. Keep in mind that, in preparing to sell a business, the seller is not trying to minimize earnings for tax purposes. Rather, he or she is trying to improve earnings to increase the value of the business to a buyer.

6. Develop a Strong Management Team

Along with increasing the bottom line, one of the most important recommendations for any business owner anticipating a sale or transition of his or her business relates to developing a strong management team that will continue with the business after the sale closes. Accordingly, in the years leading up to a potential sale, it is vitally important for the business owner to seek out and promote those employees who are most capable of helping the business succeed once the business owner is no longer in the picture. Does your business have an infrastructure of well trained and capable managers and department heads that the new owners can rely on to continue the success of the newly acquired business? Although it is easy for many successful business owners to feel pride in the successful operations they have created, it is generally a mistake in a business sale for a business owner to create the impression that the success of his or her enterprise is primarily related to his or her personal expertise or management skills.

7. Plan to Succeed

Assuming that a business owner has committed to a sale or transfer, has a reasonable and informed opinion with regard to the value of his or her business, and has taken steps to maximize both current profitability and expected sales proceeds, the focus then turns to selecting a proper structure. Good planning by the business owner, and his or her attorney and CPA, will significantly improve the after-tax proceeds flowing from the sale or transfer. Although most buyers want to acquire assets in an effort to improve their tax deductions and minimize risk, there are certain situations where a stock sale or transfer (which is generally advisable for a seller), will be acceptable to a buyer. An example is a corporate owned business with various regulatory licenses and/or approvals that may be easily transferred in a stock transaction. If an asset sale is dictated by the tax considerations for the buyer, then the transaction should be structured to include a sale of personal goodwill, a personal covenant not to compete, or a salary continuation agreement that will result in deductible payments for the buyer and only one level of tax (and part at favorable rates) to the seller. While there are significant tax consequences that should be considered, keeping a transaction as simple as possible will often assure a higher degree of success and better understanding by all parties.

In conclusion, pre-planning for a business sale or transfer will always improve a business owner's chances for success. If you have questions regarding any topics covered in this article, or business sales in general, please contact any of the members of our corporate group.

To understand more about planning the sale or transition of a business, please contact:

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West Coast Trust thanks James Griggs for providing this timely information for our use.

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