How to sell the family business (without losing your sanity)

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Proper asset allocation and estate planning is often the best gift to children who have neither an interest in, nor propensity for, running the family business. Sale of the family business is usually a once-in-a-lifetime chance to achieve meaningful liquidity, and well-qualified advisors can add much more in transaction value and stress relief than they take away in fees

After years maybe even decades of nurturing the family business through various market cycles, youve concluded that i t s time to diversify your net worth through a sale. With ranks of business brokers, investment bankers and transitions consultants lined up to help you navigate through the process, where do you begin?

Take solace in the fact that y o u r e not alone. It is estimated that more than $10 trillion in private business value will unlock over the next decade. A fair amount of that value is attributable to tremendous bootstrapping efforts by entrepreneurial baby boomers. Many feel guilty that they are not passing down a legacy to their children. They shouldn't. Studies suggest that less than one-third of closely-held businesses survive through the second generation.

THE FIRST STEP IN SELLING YOUR BUSINESS IS TO SEEK A GOOD ADVISER

Although it is tempting to run the process internally to save on fees, resist the urge to be a do-it-yourselfer. The typical entrepreneur asks, Why do I need an investment banker, when I built this business myself? The answeris simple the do-it-yourself option is the equivalent of planting a f o r s a l e by ownersign in the front lawn of a mansion. How likely is it that the perfect buyer for a painstakingly-restored period home will happen by and pay the asking price, much less a premium?

There are some websites that allow business owners to solicit potential buyers. In some instances, these sites can offer a low-cost way of generating some foot traffic for a sale. But the more complex, specialised, or people/relationship driven the business, the less fruitful aclassified adapproach may be.

At a minimum, an intermediary can help filter prospective buyers, while keeping the process confidential. Whether youve been approached by a buyer (reactive sale) or you are edging towards a proactive approach of contacting targets, well-qualified advisers can add much more in transaction value and stress relief than they take away in fees. The sale of the family business is usually a once-ina-lifetime chance to achieve meaningful liquidity. Leveraging an experts experience and relationships and linking fees to success is a low-risk way of optimising the certainty of closure.

With or without an adviser, the best plan is to take a systematic approach to the sale and do your homework. As you contemplate the sale process, get your books in order and continue to operate the business as usual full steam ahead until it is sold. Dont skimp on the expenses or ordinary capital expenditures because thoughtful buyer due diligence will uncover any deficiencies.

PRE-MARKET PREPARATION TYPICALLY TAKES 6–8 WEEKS

The lifecycle of a deal (Figure 1) begins with good planning. Determine the deal team both internal (a family designate, key employees) and external (investment banker, accountant, counsel).

Have an official kick-off meeting with all hands to educate the team about the business, its history, financials, processes and customers. Understanding the current business conditions and the companys com-

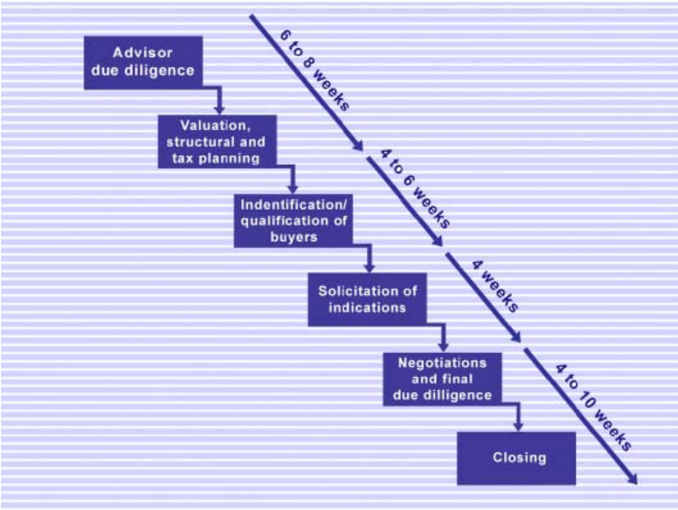

Figure 1. Lifecycle of a deal

petitive advantages and disadvantages is critical. This interaction helps to define the universe of suitable targets as well as identify many potential issues that may arise in the context of a transaction.

The banker (or primary adviser) coordinates the kick-off process to ensure that responsibilities are allocated across the team and completed on a timelybasis. Your adviser will also help the family articulate and prioritise their objectives for a sale, such as:

- the desired future role of the family;
- the importance of maintaining certain (perhaps all) employees;
- the form of a transaction that best meets the familys financial, estate and tax planning needs .

A descriptive memorandum (DM) is prepared. The DM highlights the selling points of the business and provides enough detail to elicit genuine interest from prospective buyers. It should present the business fairly, but in the most favorable light.Typically, the DM provides historical financials and the current years expected results, normalised for any one-time revenues/expenses or personal expenditures run through the business (e.g. club memberships, planes, cars).

The DM usually includes forward-looking projections for 1 3 years. Avoid the classichockey stickprojections, to the extent past performance has not shown solid growth. A material change or event that suggests dramatic growth will likely occur must be explained carefully. A sophisticated buyer may give some credit for accelerated future growth. But more likely than not, achieving maximum pricing for a fast growing business will be the result of some type of financial contingency, or earnout.

“The DM provides a fair and favourable overview of the business, highlights its selling points, and typically includes forward-looking projections”

Based on the financial prospects, the banker will advise on the expected valuation and assess the implications of any adjustments to the business that might be considered to enhance the deal proceeds.

A list of prospective targets is developed. The initial target list is designed to assist the family in assessing the specific alternatives that exist and to better define the characteristics of the preferred partner. The target list should be further refined and prioritised to concentrate on a limited number of attractive (and suitable) targets.

APPROACHING THE MARKET NORMALLY TAKES 4–8 WEEKS

To preserve the confidentiality of the process, the adviser typically contacts targets on a no-names basis to further qualifybuyer interest. To the extent that the prospective buyer is interested, the party executes a non-disclosure agreement (NDA), and the DM is released.

The adviser will meet with the targets to answer initial questions and report the discussions to the family, keeping them informed of buyersresponses.

If interest is strong, preliminary indications highlighting the financial and strategic considerations may be required to narrow the field to the best candidates.

If the target universe is narrow, preliminary meetings should be arranged with serious, but qualified, parties.

The process of soliciting market interest, fielding questions and introducing top candidates to the company normally takes 4 8 weeks.

INDICATIONS OF INTEREST ARE ANALYSED

The most compatible targets are invited to provide a non-binding proposal, highlighting several key factors. These often include:

- a defined value payable at closing and any financial contingencies;
- strategy for developing the business and any anticipated changes after closing;
- the roles to be played by key employees and associated incentives;
- principal structural requirements;
- additional information required to reach a binding agreement; and
- expected timing for completion of documentation and final due diligence.

"A proposal commonly includes the value payable at closing, financial contingencies, strategy for development, roles for key employees and expected timing for completion"

The adviser coordinates submission of final proposals and analyses each to compare the indications. Such analysis should provide the pros and cons of each proposal and assist the family in determining which prospective partner best meets their overall objectives. It takes approximately 4 weeks to send out a request for indications of interest, receive and analyse the proposals.

EACH ADVISER PLAYS A ROLE IN STRUCTURING AND NEGOTIATING THE DEAL

Once the preferred target is selected, the familys advisers play key roles in structuring and negotiation the deal.

The banker assists in negotiating the business terms (e.g. purchase price,form of consideration, timing of payments, operating aspects) of a transaction and works in conjunction with counsel and the familys accountant to anticipate the legal and tax implications that may arise during the negotiation of definitive documents.

After the parties agree on business terms, the banker coordinates final due diligence in a timely and minimally disruptive fashion. A smooth handoff should be made between banker and lawyer, and legal counsel works to complete the documentation of the transaction and any employment agreements that may be required.

The final stage of the sale process takes anywhere between 4 weeks and a few months, depending upon the complexity of the negotiation.

SELLING A BUSINESS IS LIKE CHESS

As in chess, most of us are familiar with the game, but few do it extremely well. Also as with chess, the variables are extensive. Moreover, it is rare that a trans-action is finalised with the same structure that was originally contemplated.

In most cases, the structure of the deal is ultimately more important than pricing so the ability to respond knowledgeably to an offer is crucial.

It has been said that a goal without a plan is just a wish. Selling the family business requires planning, organisation and outside expertise. Just the skills that built it in the first place.