Articles

Selling your business: pitfalls to avoid

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For most business owners, selling a business happens once in their lifetime. Such an exit event is normally the end game for most entrepreneurs, however it is human nature that lots of other emotive factors can often distract from the main goal of completing a smooth transaction and maximising value.

Having emerged from a sharp downturn in buyer appetite over the first six months of the Covid-19 pandemic, buyer appetite has rebounded strongly to such an extent that 2021 is on track to break all records in terms of the value of aggregated deals completed. This is being driven by the availability of cash on buyers' balance sheets and the continued increased availability of both debt and equity funding. Despite merger and acquisition (M&A) deal values being dominated by multi-million-pound transactions, we are also seeing increased deal volumes in the SME market.

With the M&A landscape set to continue to boom for the foreseeable future, an increased number of business owners are receiving unsolicited approaches to acquire their company. It is important to be able to be ready and react to such approaches, as it could be the ideal opportunity to exit, albeit earlier than anticipated.

In selling a business, getting it right the first time is absolutely key, there will be no second chances. The sale process is long and potentially complex; we have set out below a few pitfalls to avoid before and during the process.

What's it worth?

Valuation is arguably the most important factor for most vendors in a sale process. While maximising value is always the key focus, vendors can often have unrealistic expectations as to what price a business can achieve. Sometimes valuation is driven by market sentiment and other factors outside your control, and therefore timing becomes an important factor. Ultimately, the business is only worth what someone is prepared to pay and independent views should be taken on board. In a situation where you have been approached by a purchaser, consideration should be given to undertaking a wider search for potential buyers as competitive tension can often result in a higher sale price.

Numerous factors are taken into account in valuing a business by potential acquirers and growth prospects will be high on the agenda. 'Earn-outs' are a good way of bridging a pricing gap (where the seller receives a contractual provision for compensation, subject to the business' future performance), but care should be taken on two fronts – that the mechanism is not subject to manipulation and that vendors' personal tax position is not compromised.

Don't ignore management

A key strategy in preparing any business for sale is to have strong management in place, such that the business can operate successfully after the vendor departs. Employee incentive schemes are a great way to incentivise and tie in key management and are especially important in people-based businesses. Not only is it beneficial to have such schemes in place, but timing is equally as important and if not done early enough, this could lead to the management team potentially being left in a tax position that is less than ideal.

Management could also potentially be an option as an exit route for your business by way of a management buy-out, and this should be considered. The challenge can be assessing whether management can obtain funding and whether such funding can meet your own price expectation.

Fail to plan, plan to fail

It is never too early to start planning for the sale of your business as you never know when you might be approached outside of a sale process. Good planning should also extend into how the sale process is run and managed. Certain buyers will quickly sense if there is a lack of direction from the vendors and use this to their advantage, creating opportunities to chip away at the price. Being clear about the process and the transaction structure all the way through to completion helps to set certain parameters for all to work within and these should be fully reflected in the heads of terms at the outset, before granting exclusivity.

Once a buyer is in a period of exclusivity and commences due diligence, any opportunity to chip away at the price could potentially be taken. It can be particularly tempting for sellers to succumb to these tactics and accept these price chips, especially right at the end of the process after many hours of work and being within touching distance of the finishing line.

Plan B

With the best will in the world, sometimes deals will fall over part-way through a process, perhaps because of something that comes up in due diligence or maybe as a result of the buyer being unable to obtain the required funding. The seller and their management team will likely devote considerable time and resources to the sale process and may well inadvertently take their eye off the day-to-day running of the business. The impact of this may not become apparent until a few months down the line when you are marketing the business again and talking to other potential buyers. There are ways in which these risks can be managed and mitigated.

A numbers game

As alluded to above, there is much more to selling your business than the numbers, yet ultimately this is where a significant focus for any buyer will be. Good steady growth in revenues and profits over the last few years will appeal to potential buyers, particularly if these are in the public domain and where they have been subject to independent review.

If you are considering selling your business, or have any questions based on the issues raised here, please contact your usual Saffery Champness partner.

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