Selling Your Business Today: The Business Succession Advantage

By Alison Anderson, CEO, SuccessionMatching

One of the biggest misconceptions among business owners is that the most challenging barrier to selling a business is finding a buyer. In reality, the true challenge is being fully prepared to engage with potential buyers.

Many business owners struggle to successfully transition because they haven't done the groundwork to make their business attractive and ready for sale. This resource will address this critical misunderstanding and guide you through the essential steps to ensure your business is well prepared for a successful sale or transfer.

STEP-BY-STEP GUIDE TO A BUSINESS TRANSITION

In technical terms, a business transition is when the business is passed from one owner to another. This can be a family member, employee share ownership program. or third-party sale at market value. Every plan can be unique because of the human factors involved, but all three types of business transitions have similar elements.

There are five phases to business transitions:

- Getting the Business Ready to Sell,
- Actively Looking for a Buyer or Engaging the Family or Staff Member
- Due Diligence
- Financing
- Transitio.

The entire process can take anywhere from two to seven years depending on the needs of the sellers and buyers, market conditions, and the type of industry.

Phase 1: Pre-Sale Preparation (12-24 Months)

- Financial Due Diligence: Ensure meticulous financial records to accurately determine the transferable value and identify areas for improvement. Disorganized books delay sales.
- Valuation & Optimization: Engage bookkeepers, accountants, or Certified Business Valuators (CBVs) to establish a comprehensive valuation, identifying opportunities to maximize the sale price and reduce key-person dependency.
- Strategic Planning: Develop a "go-forward" plan based on valuation insights, implementing changes to enhance business attractiveness and mitigate risks.

Phase 2: Buyer Identification (6-12 Months)

- Internal Succession Assessment: Initiate confidential discussions with qualified family members or employees to gauge their interest in succession.
- External Buyer Search: If internal succession is not viable, explore external buyer options, comparing services based on price, confidentiality, and reach.
- Buyer Compatibility: Prioritize finding a buyer with compatible soft skills to facilitate knowledge transfer, build trust during due diligence, and ensure long-term sustainability.

Phase 3: Due Diligence (1-12 Months)

- Professional Team Assembly: Engage accountants, lawyers, and business services professionals early to ensure a thorough and efficient due diligence process.
- Trust & Confidentiality: Utilize confidentiality agreements and down payments to establish trust and protect sensitive information.
- Documentation & Negotiation: Maintain comprehensive documentation of all timelines and expectations. Establish BATNAs (Best Alternative to a Negotiated Agreement) to streamline negotiations and finalize a sell price.

Phase 4: Financing (1-6 Months)

- Financing Options Exploration: Investigate various financing options, including charter banks, alternative lenders, vendor financing, and venture capital, considering tax implications and long-term agreements.
- Buyer Financial Readiness: Ensure the buyer has a robust business plan, a prerequisite for most lenders.
- Flexible Terms: Be prepared to offer flexible buyout or payment terms to accommodate buyer needs and market conditions, potentially including employee share ownership programs.

Phase 5: Transition & Post-Sale (0-60 Months)

- Knowledge Transfer & Mentorship: Offer a key employee contract for 6-12 months to facilitate a smooth transition and transfer corporate knowledge.
- Operational Clarity & HR Management: Define clear expectations for the seller's continued involvement and address potential operational and HR changes, including hiring and disciplinary procedures.
- Personal Transition & Purpose: Recognize the emotional impact of the sale and plan for post-sale activities, ensuring a fulfilling transition to the next phase of life.

HOW DO YOU DETERMINE THE VALUE OF YOUR BUSINESS?

One of the key aspects of a formal succession plan is determining the value of the business. There are a number of different methods to determine the value of your business, which is determined by the industry and the type of sale you are using to transition from one owner to the next. Here are a list of the most common types:

1. Discounted Cash Flow (DCF) Method
   The DCF Method is based on a projection of the future cash flows of the business, taking into consideration inflation.
   Used for: Selling an operating business to a new owner.

2. Book Value Method
   The Book Value Method is based on taking the value of the shareholders' equity of a business from the balance sheet statement, total assets minus total liabilities.
   Used for: A business that has stopped operations or is assessing an asset sale option.

3. Earning Multiplier Method
   The Earning Multiplier Method helps medium to large businesses, including franchises, estimate future revenue by comparing companies with consistent profits.
   Used for: Selling to professional buyers like private equity groups.

4. Times Revenue Method
   The Times Revenue Method is a basic calculation that can be used in niche markets like tech that professional buyers believe they can grow the revenue quickly through market advantage. The equation is a total revenue times multiplier for that industry and economic environment.
   Used for: Selling to niche markets whose value is derived from a market advantage

5. Market Capitalization Method
   The Market Capitalization Method is based on taking the company's share price multiplied by the total number of outstanding shares.
   Used for: Publicly traded companies.

Buyer Perspective

A business owner could ask whatever they like for a business, but that does not mean someone is going to buy it. There are multiple factors that come into play when a buyer is looking at a business, primarily:

1. What is of real value in the business that will ultimately receive a return on the investment in the future?

2. Will the opportunity cost of capital be returned in five years or less?
   Too often we hear business owners say: "If someone came in with more money, energy, and a little bit of marketing then this business would be a huge success." Although that may be correct, that potential buyer could invest their money and time into a number of different activities and realize a return. If the business will not pay for itself in five years or less, then a buyer is unlikely to purchase it.

3. Is it bankable? The biggest barrier to purchasing a business is finding financing. Many institutions will not lend on goodwill because it's risky. As a business owner, you have years of experience managing the ups and downs, plus have those personal relationships with all of the customers. The potential buyer may really love the business and can see the opportunities, but if they are using leveraged financing, then a business owner has to understand that lenders may require some safeguards like vendor financing or holdbacks.

Talking to an expert about your valuation
Just as you wouldn't ask a general doctor to perform brain surgery, you wouldn't expect a general accountant to handle complex tax issues or business valuations. Tax Accountants and Chartered Business Valuators (CBVs) in Canada have specialized training for these roles.

Many business owners get fixated on the price of a business, but there are many factors which contribute to the value of the business. Engaging a CBV after completing your formal succession plan can help you negotiate a better position in the value of your business. It is important to keep in mind that a business valuation is a range that the business could be worth, and different components of the business could help you drive up the total return on investment that you receive from the business.

Valuations can be expensive and aren't useful if the timelines don't align with your goals to sell. Navigating this process can be frustrating but our team has vetted professionals and works with hundreds of professionals in accounting, banking or legal across North America to help ensure that the services we recommend line up with our members' needs.

ABOUT THE AUTHOR

Alison Anderson is the Founder and CEO of SuccessionMatching.com, a marketplace for buying and selling businesses. Recognized internationally as a leading expert in business transition planning by industry associations, private businesses and various levels of government, Alison has deep roots in rural Saskatchewan, where she grew up and began her career in banking and economic development.

As a business owner herself, she understands the ever-changing and unpredictable nature of the business environment and how difficult it can be to find time for future planning. Currently implementing her own succession plan, she is here today to share valuable tips that can help you save time and money.