



Sale or Dissolution of Your Business

Member Education

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Sale or Dissolution of Your Business

It has been said that all businesses have a lifecycle: birth, dramatic growth, full maturity. Businesses can end in any number of ways - some happy, some not. Among the ways business wind down are resale, takeover by a family member, merger with another company, bankruptcy, or simply closing the doors. Let's hope that when you are ready to retire or wind down your business, the terms on which you do so are happy and profitable. This article covers some of the basics of winding down your business, regardless of which path you choose:

Sale of Your Business

This year, 700,000 American businesses will be sold. Most will be small and mid-sized ventures. Over 80% of business owners who sell their companies report being dissatisfied with the outcome. This is primarily due to a lack of planning, or unqualified advisors. Only 30 percent of all businesses that are put on the market sell within the first year. If you are thinking of selling your business, there are things you should know, to help avoid legal pitfalls and make the process go smoothly.

The waiting game

It always takes time and effort to sell your business, especially in a tough economy. Anyone who makes an offer is going to demand a tremendous amount of information from you. You are going to have to determine how much you want to divulge prior to the sale. And you are going to have to spend an extensive amount of time with prospective buyers explaining the ins and outs of your business, not to mention the time you will spend with your lawyer, accountant, and advisors.

Keep your eye on the ball

Even though selling a business is work, don't let it become your full time job. Continue to devote energy, time, and resources to maintaining your business in good working order. Any slippage in profits or dedication will affect your ability to sell. And remember selling a business is not unlike selling a house. Take time to spruce up your facilities, invest in some new signage, or a fresh coat of paint.

Get your files in order

Have all records ready before you go to market. In particular make sure you have three years of federal tax returns, three years of financials (profit & loss statement, balance sheet), and three years of monthly bank statements. (Your accountant or attorney may even recommend four years). Have a copy of your current lease, a list of all equipment being sold with the business, and any other documentation you think buyers might want to see. Also make sure you know the correct adjusted net income for the last three years. That will be one of the first questions from serious business buyers.

Have a professional business valuation performed, even if your business is small

Yes it can cost a little money. But getting a third party professional business valuation is important for the process. One of the main reasons businesses don't sell is the asking price is too high. Getting an appraisal is well worth the expense and will be utilized by many parties during the selling process: potential buyers, lenders, attorneys, accountants, companies working for the buyer, and others. But remember, no matter how many things are taken into account in the evaluation, sale prices for businesses typically boil down to profits. As one industry analyst put it, "usually, you can figure on the value of your business being driven by its bottom line. The sale price is almost always a multiple of the business' profit." For smaller businesses, most prospective buyers are going to be people looking to earn a living from purchase of the business. So profits are king.

Write a comprehensive business summary

You probably had a business plan when you first started out. It's a good idea to have a written plan when you are selling. You may think it's all in your head, ready to be discussed in detail with potential buyers. But buyers are going to need details about the business, and they want to see it in writing. Your summary need not be lengthy – a few pages will do. Include things like history of the business, date established, interesting milestones, success stories, number of employees, information about the surrounding area, the competition, post-sale training you will provide, and recommendations for future growth.

Confidentiality agreements are a must

The CompTIA Legal Resource Center has some useful materials on non-disclosure agreements. Have all potential business buyers sign a Non-Disclosure Agreement before giving out any information. Make sure potential buyers understand how important it is to keep the sale of the business confidential. If the sale falls through you wouldn't want the buyer sharing details of your negotiations with other potential buyers.

Buyers will want due diligence – but it shouldn't last forever

Due diligence for sale of a small business should be only take a few weeks. And you can speed the process along if you are organized and ready with all important information and documents. It's important that the buyer move quickly because you do not want the business off the market for a prolonged period. So be firm with deadlines. Make it part of the purchase agreement, and if you notice any slippage in the schedule, raise it immediately with the buyers.

Make sure your taxes are in order

Clean up any outstanding issues you may have with the IRS. Do you have an extension with the IRS for filing your taxes? Pay them now. You don't want to do anything that is going to give the buyer cause for concern.

Your accountants should review financial statements before showing them to the buyer

Most small business owners deduct legitimate perks—vehicle use, higher-than-average salaries, and so forth. You'll need to "add back" these discretionary expenses so the buyer can tell the true cost of running the business. Many small businesses show little profit. That's good for tax purposes, but bad when it comes time to determining the value of what you've built. You want to show buyers the business in the most positive and accurate light possible. There are many perfectly legitimate ways your accountants can recast profit-and-loss statements to reflect adjustments for what the business owner takes out of the business in terms of salary, health care, etc. In recasting your tax numbers, you're not deceiving either the IRS or prospective buyers. You're simply pointing out that the buyer may prefer not to spend money on some of these items in the future, even though you've taken perfectly proper tax deductions for them.

Examine your customer list

If you're relying heavily on one or two large accounts, that may be a problem in the sale process. Start diversifying if you can. Depending on a few large customers is a liability from a buyer's perspective. If you rely on only a few customers be prepared to prove the relationships are rock solid. Letters from customers praising your services can be enormously useful, as can long term contracts demonstrating the customers are locked in for specific periods of time.

Create or update operating manuals

Document how you do things so that a stranger can follow the instructions. Manuals and written materials demonstrate a certain amount of professional sophistication.

Don't insist on an all-cash deal

In a perfect world, all sellers would walk away from closing with hefty cashier's checks. But in a tough economy it might not happen that way. And if you do insist on all cash, many buyers expect a 20-percent discount. Business analysts say more than half of all small-business owners finance the sale of their businesses. You could find yourself lending as much as 70% of the purchase price to the new owner. Terms on these financing deals vary, but many owners and buyers agree on payoff periods of four to five years. Part of the process will involve getting information on the buyer's financial records and background, just as the buyer will need information on yours. If you sell the business this way, you'll definitely want to retain a security interest in the business until the sale price is fully paid. You may even find it prudent to take a lien on the buyer's home or other property. A personal guarantee from the buyer is a must. And one more thing - get the business you are selling pre-qualified for financing. This may sound strange, and you may ask "isn't that is the buyer's responsibility?" But your pre-qualification will help in the event the buyer can't get financing, and you do a non-cash deal.

Ssshh! Keep it quiet

Letting people know your business is for sale can be a big mistake. What if your suppliers hear the business is up for sale, and they pull lines of credit and start insisting on cash up front. Or what if employees hear the news, and start leaving for other opportunities. Good experienced employees are part of the assets that are transferred in a business sale. Of course in selling a business, you need to spread the word to prospective buyers. But use discretion on who you tell, and a good broker can be enormously useful here.

Use a broker

A good business broker can help you determine a realistic price for your business. He or she also can rely on an extensive network of business contacts to identify appropriate buyers. A broker can help write a solid sale summary, negotiate terms of a sale, and maintain your confidentiality so the entire world doesn't find out your business is on the block. And of course your accountants will need to be involved, as well as an attorney familiar with the sale of businesses.

Third party approvals

Don't forget this, and don't let your attorney forget either. Chances are many of your contracts, leases, and loan documents require third-party approval before the buyer step into your shoes.

Pre-closing details

Your lawyer may be well on the way to finishing the purchase agreement. The due diligence is over, and you passed with flying colors. You may even have a date set for the closing. Now what? For starters continue running your business as usual, working as hard as ever. But also use this time to count and inspect inventory, if it's being sold. Have your lawyer make sure all leases, contracts, and loans are assigned to the buyer. Your lawyer should draft a bill of sale for assets, fixtures, and equipment included in the sale. And don't forget all the miscellaneous checklist items. Will you keep some of the assets (a car perhaps) that are currently being used in the business? After the closing, will you work for the buyer, as an employee or an independent contractor? If so, are you locked in for a specified period of time? Will the buyer require you to sign a non-compete agreement that limits your right to work in your current industry? All these things need to be considered pre-closing.

Bankruptcy

We've discussed one of the happy ways people wrap up their business: sale to an enthusiastic buyer for a large profit. Now we need to talk about one of the unhappy ways businesses sometimes end: bankruptcy.

The decision to file bankruptcy is one of the most difficult choices a business owner ever has to make. Sometimes there is truly no choice. The profits, sales, and income just aren't there. But in other cases, an owner may feel that with a little time he can get back on his feet and return to

profitability. It's an agonizing choice. And you'll also have to decide which of the various kinds of bankruptcy works for you. Here are some basics that can help you through this arduous process.

What kind of bankruptcy?

The Federal Bankruptcy Code provides a number of options for bankruptcy. For small businesses the two main types are Chapter 11 and Chapter 7. Chapter 11 allows you to reorganize your business, obtain relief from creditors, and hopefully emerge on the other side with a revised workable business. Chapter 7 on the other hand, is liquidation. It is used when the owner believes there is no option but to permanently close the business, and hopefully minimize the personal damage. Obviously neither choice is ideal.

Chapter 7

This is the primary way the Bankruptcy Code provides for liquidation of a company's non-exempt assets, and determining how much creditors will be paid. Following the work of the court, the attorneys, and the creditors, there will be a final discharge. This frees the debtor from further obligations to creditors. The decision to file Chapter 7 is a complex one, and no debtor escapes unscathed. See some of the links at the end of this discussion for articles on the many negative implications of declaring bankruptcy.

Chapter 11

This part of the Bankruptcy Code is entitled, "Reorganization", and that is precisely what it allows your business to do. While Chapter 11 reorganization will not magically cure financial problems, it does allow for a formal procedure for operating and possibly reorganizing a company, and for dealing with creditors in an organized fashion. Once a Chapter 11 petition is filed, most creditors are held at bay for a period of time to give the debtor, "breathing room" to formulate a reorganization plan. That period usually lasts from 12 to 18 months. It is by no means easy. But Chapter 11 has provided many companies with a final opportunity to reorganize and stay alive, and there are many success stories.

Temporary relief from debt collectors

One of the immediate benefits you get from either form of bankruptcy is that any pending litigation against your company is temporality stopped (or "stayed"). Demand letters from angry creditors or collection agencies should cease. If there are creditors who have the right to draw directly from your bank accounts, that will also stop. Under Chapter 11 you may have the right to reject certain types of binding contracts and leases. Of course, all these matters should be discussed with your attorney, and you should hire an attorney who specializes exclusively in bankruptcy.

Should your business be reorganized or liquidated?

To answer this question, you have to know what caused the problem in the first place and

whether you think you can fix it. Reorganization can't create a market, increase revenue, or improve skill sets. But reorganization can free up cash from paying old debts to finance current operations. It can make it easier to reject contracts that are hurting your bottom line. It can stem the loss of vital operating cash to collection actions. Chapter 11 can also allow you time to consider whether you want to convert at a later date to Chapter 7 at a later date.

Chapter 11 requires work

Any business owner faced with bankruptcy needs to ask if the management team has the personal resources and desire to engage in the reorganization process. Reorganization in Chapter 11 requires a significant time commitment by owners and managers. In exchange for stopping collection of debts and other bankruptcy protections, debtors must provide full disclosure of the company's financial condition to creditors and the court, both at the beginning of the case and on a monthly basis thereafter. While the bankruptcy is ongoing, the debtor owes creditors full and open reporting, keeping them completely informed. There are penalties for lack of candor. Reorganization can drain an already stressed business, because management personnel must take time to participate in bankruptcy proceedings, and the legal expenses are significant. And the sad truth is most reorganizations fail, usually for lack of a real plan to solve the underlying business problems.

Additional resources:

There is a wealth of information available for any business thinking of declaring bankruptcy. Check out this article from the Better Business Bureau, describing the enormous toll that bankruptcy can take on business owners, personally and professionally.

<http://www.bbb.org/us/article/tips-for-consumers-considering-bankruptcy-6102>

This law firm website does a good job covering bankruptcy basics, especially for small business owners.

<http://www.moranlaw.net/>

The American Bankruptcy Institute, a non-profit organization, is a great resource on bankruptcy with a searchable database for bankruptcy articles, seminars, and other materials,

<http://www.abiworld.org//AM/Template.cfm?Section=Home>