WHY THE SALE OF A BUSINESS FAILS

ARTHUR KLEIN | Discovering no one wants to buy your business can be a soul-crushing experience and a financial catastrophe

Many owners, being resolutely proud of the businesses they have built, and influenced by other, similar company sales, place a value on their businesses that exceeds its true value

For many business owners, the context of selling their business has many expectations – not the least of which is to sell for the right price and with the best terms. Often these would-be retirees discover that they have not fully prepared themselves for effective transition – often harbouring unrealistic expectations. In the world of business brokerage and transactions the outcome can be a soul-crushing failure to sell.

Recent business transaction surveys by the International Business Brokers Association, in partnership with Pepperdine University, report that the No. 1 reason sellers went to market (for $500,000 to $50 million businesses) wasn't retirement. More than 80 per cent of business owners cited having cash at closing as a primary goal, followed by taking care of employees and getting out of the business quickly, at 70 per cent and 58 per cent, respectively.

The surveys also indicate that the major barriers to a business sale were declining profits, falling revenues, poor financial and operational reporting and owner dependency.

Business owners often contemplate selling for months, if not years. They simply have not taken the clear and progressive measures to plan for an optimal sale.

So let's look at the value-to-price dynamic.

While there is no such thing as a perfect business free from defects, there are a number of problems that can hinder a sale that could be remedied, if given enough time. And if there is one parameter that is the core of this paradox, it is that of a defensible and realistic opinion of business value.

Many business owners, being resolutely proud of the businesses they have built, and influenced by other, similar company sales, place a value on their businesses that exceeds its true value.

This leads to one of two scenarios:

- an adviser may recommend simply not taking the business to market because the owner's expectation of business value is unwarranted; or
- the business will go to market, offers will be below the owner's valuation expectations and the sale will fail.

The core value drivers that affect business value are historical profits (cash flow), income risk, business growth and terms of sale. Owners should strive to enhance operating margins, reduce client concentration, and balance financeable earnings and assets while maintaining growth.

At the end of the day, it all relates to managing against risk.

DEAL KILLERS ■ Deal structure and tax management must be addressed proactively and early in the process. One critical but not consistently understood element is that of the lifetime capital gains exemption (LCGE). If eligible, the business owner can take advantage of the $835,000 (2017 threshold) exemption when selling shares, which has three critical measures per Canada Revenue Agency rules of Canadian-controlled private corporations:

- the qualifying corporation shares have a minimum holding period of 24 months;
- throughout the holding period, 50 per cent of the fair value of its assets were used in an active business; and
- at time of disposition, 90 per cent of the fair value of its assets were used in an active business.

Aside from these rules (and at press time the anticipated federal government changes for 2018 were not fully known) many business owners have wrapped their personal holdings (non-business investment accounts, real property) or even hold excess cash in the corporation. That, or they do not hold the shares of the operating corporation directly. In many cases that would put them offside to realizing one of the primary benefits of a business sale: not qualifying for LCGE.

Often the buyer and seller place all of the focus on the sale price, at the expense of the "net after-tax results and deal terms" of a business transaction.

From a practicality point, the key comes down to understanding the latent drivers of business value and how a buyer will seek to mitigate risk.

Of most current transactions, approximately 75 to 80 per cent of deal value will be cash at closing (which includes debt financing), with vendor financing contributing 15 to 20 per cent.

When it comes to terms, one must leave the ego at the door and be receptive to seeking competent transaction advisers to facilitate terms that are normal and customary to protect your interests, while still remaining reasonable to the other side.

It is not uncommon for business sellers to become so emotionally attached to the company that they look past glaring problems that a business intermediary, a lender or a prospective buyer will immediately recognize. But this critical juncture it is not the time to stop learning or planning in such a way to prepare for a successful business sale.

Merger and acquisition advisers and other professionals need to be honest and direct in educating a business seller on the challenges faced in such a potential sale, the range for a realistic transaction price, as well as creative terms and structuring options that might be utilized.

Arthur Klein is an M&A adviser with Vancouver-based Pacific M&A and Business Brokers Ltd. He can be reached at 778-329-9558, or through www.pmabb.com.