

PREPARING TO SELL YOUR BUSINESS
AN INTRODUCTION

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INTRODUCTION

While the total volume of business sales will likely increase in coming years, the value of those sales is likely to become less predictable. Industry shifts will become more dramatic, and businesses will more rapidly find themselves part of the “old economy.” On the other hand, intellectual property and shareable knowledge will make smaller businesses with those assets more attractive to larger businesses that are continually looking to add value to compete.

This document provides an overview of the ways that business owners can work towards significantly increasing the value of their business prior to sale. Through this we will answer several common questions we are commonly asked.

HOW CLOSE TO THE ACTUAL SALE PROCESS DO I HAVE TO START PREPARING FOR SALE?

You will most likely want to sell your business at maximum value, grow your profits in the meantime and perhaps also leave a legacy. If so, your preparation will be a multi-year work in progress.

Smart owners prepare for sale several years in advance. You'll need to consider who the most cashed up buyers will be, what those buyers are likely to be looking for and what your business must achieve to get to your desired sale price.

It's important for you to be constantly proactive. Things happen all the time within your business and industry that provide opportunity for you to continually value-add to your business. It is important to adopt a mindset of thinking, “can this action or strategy enhance the value of my business?”

Don't underestimate the time, the challenges and the impact on your business that going through the sale process entails.

The best thing to do is to plan your exit by understanding what your business is worth now (through a pre-transaction review process) and determining an amount that you'd like to exit – net of selling fees and taxes. This “value gap” helps you determine what kind of numbers you need to be turning in to reach your required exit price.

As part of this consider your personal situation including your level of enthusiasm, your health and your life after sale,

Timing can be a challenge. It is best to sell a business when it's on its way up and to avoid hanging onto a business when it's at or past its peak

And as you move toward your “sell by” date, consider the housekeeping aspects of the sale – accounts receivable can be collected, stock sold, paperwork in order, contracts updated, premises in shape. As you are better prepared you are likely to attract more interest and the due diligence process is less likely to become stalled through you being perceived as unresponsive to buyers’ requests for further information.

HOW CAN I MAKE MY BUSINESS MORE VALUABLE?

Although you are focused on exiting the business, you’ll receive the highest sale price if you focus is on making it grow as a continuing entity. You’ll be aiming to pass the ownership baton of a healthy, profitable and high growth business – with your key team in place to a new owner. This new owner will value your business based on the expected future profit streams derived from it.

Too many businesses don’t sell for anywhere near their potential. Part of the reason is that the right kind of buyers – strategic buyers, typically from businesses larger than yours – aren’t attracted to them. Many of these businesses languish in the land of price competition and low margins for their products and services, offering little potential for growth to any buyer.

Given that a sale price is determined by multiplies of profit, a small change in profit can make a much larger change in value. And given that profit is revenue minus cost, small increases in revenue and small decreases in cost will have a significant impact on profit.

To truly make your business more valuable, consider the key assets that drive your business, and therefore its future growth. This whole ecosystem of assets, when combined should make your business increase its profitability and growth without you, the owner, being there.

Get to know the possible buyers – think about ways you can work together. Sometimes they’ll even say to you, ‘If you ever decide to sell, I want to be first in line.’

WHAT ARE THE KEY ASSETS OF MY BUSINESS THAT A BUYER IS MOST FOCUSED ON?

Your assets are analogous to pieces of Lego on the floor. The assets and resources may all be present, they just need a smart leader to assemble them together in the optimal way to drive profit and growth.

The key eight assets are as follows.



Financial

FINANCIAL:

The ability of the accounting and financial systems to track, monitor and alert management of performance.



Product

PRODUCT:

A full product eco-system with healthy margins, recurring revenues and a vision and pipeline for product innovation and development.



Customer

CUSTOMER

The capacity to understand the customer and consistently provide them with the right products and support and service them.



People

PEOPLE:

A trained, motivated and well remunerated workforce empowered to make decisions



Systems

SYSTEMS

Well documented processes that enable optimal utilisation of technology to both expand and protect the business.



Competitive

COMPETITIVE

The foresight and resources to understand the likely evolution of the market and be able to provide flexible solutions.



Brand

BRAND

Positive brand recognition through quality and credibility as well as media exposure and being perceived as a force for good in the community.



IP

IP

Ownership of protectable, sustainable non-duplicable knowledge including product smarts, and methodologies to ensure continued competitiveness.

IS BUYING A BUSINESS A FEASIBLE STRATEGY WHEN YOU ARE PLANNING TO SELL?

Buying when you wish to sell might appear to be counterintuitive, but it's increasingly becoming a tool for potential sellers who want to build their business value prior to exiting. It could be for several reasons: to fill in gaps in a product set, to obtain some intellectual property, to create new products or systems, to round out some weaknesses or to get access to a supplier or distribution channel.

Ultimately, you need to optimise the potential of your business and if it's faster, cheaper, or less risky to buy another business rather than build, then take this option seriously.

WHAT TYPE OF BUSINESSES ARE LIKELY TO BECOME MORE COMPETITIVE?

There's no doubt that the overall M&A market is going to accelerate worldwide as competition becomes ever more intensive and businesses seek to buy resources rather than trying to build themselves. Even in Covid-ridden 2021, the total value of transactions worldwide exceeded all previous years.

Larger companies used M&A to increase their capabilities, scale and to access new products and markets. With competition, the price of these businesses that have assets of value to acquirers was driven up through contested, competitive transactions.

In a post (or controllable) Covid 2022 and beyond, businesses must solve some of the challenges that were highlighted by the pandemic. These include technological omnipresence in logistics and e-shopping, labour shortages and supply chain management.

Selling your business is about selling futures for the buyer, who is interested in the future revenues and profitability that can be derived from your business. The best sale price comes from a buyer who can exploit the business better than you can.

You'll need to develop an understanding of what a target buyer would be looking to do with your business. A strategic buyer is looking at the future cash flows that will come from your business. If that buyer has other businesses in the same or similar space, you may own assets that can improve performance of their other businesses. This will in turn increase the value they see in your business.

There are eight different motives that strategic buyers have to purchase smaller businesses. They are as follows, and if your business is built on one or more of them, you are likely to command a higher deal price.



Intellectual Capital

INTELLECTUAL CAPITAL

If you own intellectual property, access to technologies, databases or methods that can fast track a buyers growth



Geographic Expansion

GEOGRAPHIC EXPANSION

If acquiring your business can provide the buyer access to your market to sell product or market test new opportunities for a new product or service range.



Consolidation

CONSOLIDATION

Your profitability can be significantly improved upon by the removal of some of your costs, revenue synergies from the buyer and economies of scale across the business.



Market Share

MARKET SHARE

The purchase of your business will enable the acquirer to increase their market share, creating additional strength and negotiating power with suppliers, customers and distributors.



Customers/ Channels

CUSTOMER OR CHANNELS

Your acquirer can utilise the channels that you have built and sell to your customers as well as their own.



Key People

KEY PEOPLE

Your personnel may possess certain expertise that can help your acquirer fulfill their own objectives.



Product Expansion/
Diversification

PRODUCT EXPANSION OR DIVERSIFICATION

Your product can help your acquirer diversify their product offering and include your products and services in a broader product range.



Defensive

DEFENSIVE

Acquirers often seek to remove competitive threats by buying them, thereby strengthening their market position.

IS THERE ANYTHING IT WOULD BE ADVISABLE NOT TO DO?

Owners considering selling should be careful about making large investments including committing to capital equipment, expanded premises or technology that the eventual buyer may not require. If you believe that your business has the potential to be purchased by a larger buyer consider the possibility that the eventual buyer will already own the requisite equipment, resources or channels.

Don't become a perfectionist. Often owners wrongly assume that other owners run more efficient operations while their own business is held together with "chicken wire and gaffer tape." The reality is that all businesses suffer certain deficiencies that makes it fall short of perfection.

It's important for you to maintain an outsiders' perspective on your business and work on the business. To do this, it's important that you maintain your networks, talk to industry insiders, and visit trade shows and conferences simply so you can see your business the way that outsiders do. While this takes time, it's time well spent.

Be careful not to be insular and be prepared to have your assumptions questioned. Owners must have a positive mentality, accentuating the positive, but this should not screen out any negative feedback either within your business or within the market. The world is changing faster than it has ever been.

IS IT GUARANTEED THAT IF MY BUSINESS GROWS IT WILL BE WORTH MORE?

Typically, there is a positive correlation between profitability and sale price, but that may not always be the case if your business becomes riskier. It could become riskier through external market developments or through internal challenges.

Risk can derive from internal challenges – the threat of litigation, the loss of a key employee, or a small number of customers contributing most of your revenue. There are also external

challenges – market shifts new competitors entering the market, lower cost manufacture and a whole host more.

The challenge is in making your business as “future proof” as you can for the incoming owner. This is a tough challenge as the world is constantly changing. Look at the advancements in technology and the way that the world has changed over the past 5 years to know that in another five years the world may have changed even more.

CAN I SELL A LOSS-MAKING BUSINESS?

Yes. There are several ways you can. If any of the following apply to you, then it is possible that a buyer will see your business as an opportunity.

- Your business is growing and significant profitability will occur in the foreseeable future.
- Your business owns some intellectual property that a new buyer would be in a better position to commercialise.
- The operating costs or capex for your business, which at present are excessive could easily be absorbed by the buyers operating structure.
- The new buyer could achieve economies of scale in either sales, through their own distribution or purchasing of materials for manufacture into finished goods.
- You have a group of profitable and entrenched customers who are dependent on your products and services, and that would also find your buyers products a worthwhile purchase.

DISCLAIMER

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FIND OUT MORE

For more information, or to discuss the contents of this document in further detail, please contact me at your convenience.

A handwritten signature in black ink, appearing to read "Mark Ostry". The signature is stylized with a large, looped 'O' and a trailing flourish.

Mark Ostry
Senior Advisor – Groves & Partners
Wednesday, 23rd March 2022