Preparing for a Sale Before You Want to Sell

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"Not right now" might be sooner than you think.

"By failing to prepare, you're preparing to fail." "Luck is what happens when preparation meets opportunity." "Hope for the best, prepare for the worst." Most business leaders are familiar with these and other quotes surrounding the importance of preparation, but coming to grips with the inevitable future is easy to put off until tomorrow, or next year, or.... We cannot emphasize enough the benefits of planning ahead. Although not all-inclusive, we offer here some thoughts on what can be done today to prepare a business for maximum value in a sale.

We have written on this topic a number of times in the past (see: Preparing a Business for Sale parts I, II, and III). Readers of that series will remember that there are some critical near-term steps to be taken before marketing a business for sale. But, sometimes a planned sale might be years, or decades, away. Without clear visibility into when it might take place, owners often default to assuming that apart from growing and operating the business, other sale-preparation steps are never quite urgent enough to receive time and attention over other more pressing matters. In reality, what seems like many years away typically sneaks up on them, and they almost always wish they had started preparing earlier.

There are several distinct steps and strategies that can be taken well in advance of a sale to increase the likelihood of success.

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We'll put them into a few buckets, starting with arguably the most difficult.

People

Professional Management Team: Entrepreneurial business owners often conflate their career as an operator with their time as an owner. It is not uncommon for an owner to also be the Head of Sales, Head of Operations, Chief Customer Experience Officer, and more. The owner is the lifeblood of the business, and while that has its benefits, potential buyers will perceive it as a risk. Businesses are more valuable when they are less dependent on one person, particularly when that one person may be receiving a large sum of money in a transaction that could alter personal priorities. This risk can be addressed by building out a professional management team that can carry the business through a transaction and continue to lead it into the future.

It takes time to find the right management team that is capable of maximizing future opportunities and evading potholes; finding team members that work well together is not easy. Some may come from within the company's existing ranks, some may come from competitors, and others may come from a completely different field.

By beginning the process of building a professional management team early, there is more time for iterations and failures before finding the right group. Once this group is in place, an owner is able to reduce his or her importance in the business and therefore support a higher valuation. Again, we are not claiming the process to be simple or straightforward, but a business owner should recognize that either they can do it and get rewarded for it, or the next owner can do it and capture the value created for themselves.

Independent "Sounding Board":
Privately-held businesses rarely have an independent Board of Directors. Boards can be viewed as overly bureaucratic and cumbersome, and most entrepreneurs prefer to have the freedom to make whatever decisions they think are in the best interest of the company. But, Boards of Directors, whether with authority or in an advisory capacity, do serve a useful function for a business: providing independent, experience-based advice when considering major strategic and capital decisions.

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An alternative that we have seen deployed successfully is the use of a "Sounding Board." This is a group of trusted advisors that can be called on to provide advice, direction, and counsel to business owners as they navigate the challenges of running and growing a profitable business. It is less formal than a Board of Directors, may not meet on any consistent schedule, and may never vote on a single decision. The value is in having a go-to group of people that understand the business and can provide a unique perspective to a given situation.

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This Sounding Board might include professional advisors, mentors, former bosses, friends, successful community members, or even family members. The exact composition is not important. What is important is that the group is capable of providing honest, unemotional advice. Including at least one person with experience in buying and selling private businesses can help as they are able to view decisions through the lens of "how will this impact the sale and value of the business down the road?"

Operations

Consider Acquisitions:
Private equity firms often employ a "buy and build" strategy focused on acquiring an initial platform and growing that business through add-on acquisitions of smaller companies. According to PitchBook data, out of 6,569 U.S. private equity acquisitions in 2022, 77% were add-on acquisitions, and that number continues to grow. If that is the likely path for a business, why let the new owner reap all the benefits?

Acquisitions of course do not come without risk. It is critical to make sure that a transaction is being done for more than just growth for growth's sake. Strategic acquisitions can be a tool for addressing weaknesses in a business (e.g. management depth, product development, customer concentration, physical capacity, etc.). They can also be a way of creating a larger, more diversified enterprise that may appeal to a wider audience of potential buyers.

We have observed many success stories in which a privately-held business has demonstrated itself to be a platform for acquisitions, has executed a small handful of transactions, and has a clear pipeline of additional M&A opportunities for a new owner to pursue. This is a highly attractive profile for any acquirer, and the sellers are rewarded through a strong valuation and competitive market for the business.

Reduce Future Uncertainty:
Since risk is half (or more) of the valuation equation, taking steps to reduce real or perceived risks ahead of a transaction can have a direct impact on the eventual value of the business. Risks will be specific to each company and business model, but some strategies for reducing questions about the future include:

- Entering extensions for any property leases that might be maturing near the target transaction date, and adding provisions for "reasonable" landlord transaction approvals;

- Formalizing long-term customer contracts with major accounts that are currently on annual renewals or POs;
- Considering employment agreements with key team members, including stay-and-perform bonuses to motivate them through, and after, a sale; and
- Engaging with new suppliers to create redundancies and reduce dependence on any one vendor.

Housekeeping

Sorting and Organizing:

It is not uncommon for privately-held businesses to own assets that aren't directly tied to the operations of the company. These can include investment properties, aircraft, boats, personal cars, and more. In a transaction, these assets will likely get excluded and retained by the sellers. To paint the cleanest picture of the operating company's cash flows and assets, it can be useful to remove or distribute these assets out of the company well in advance.

If operating real estate is owned within the company, the properties should be split off into a separate entity with new arm's length lease agreements including fair market rents. This has several benefits. It allows a buyer to assess the true cash flows of the operating company, allows the seller to potentially retain the real estate as an income generating investment post-closing, and may allow the seller to achieve a higher total valuation through the sale of the properties and the company separately (see: Unlocking Value Through a Sale Leaseback, Spring 2021).

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Estate Planning:

Flexibility around estate planning and tax optimization diminishes as you get closer and closer to a transaction. It is critical to begin working with an estate planning and wealth management team early to maximize optionality. Some strategies need to be implemented years ahead of a transaction to maintain compliance with tax regulations. It takes time to think through goals and alternative mechanisms so starting far in advance is highly recommended.

When to Begin?

There is no "one size fits all" blueprint for preparing a business for sale. Each business and ownership situation is unique. But regardless of the situation, more preparation is better than less, and strategic preparation alongside a team of experienced transaction advisors will almost certainly pay dividends down the line. To return to our use of common quotes: "The best time to plant a tree was thirty years ago, the second best time is today."

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