Navigating the M&A Market
A successful deal starts long before the sale

Owning and running a thriving business requires energy, passion and commitment. Its ultimate success, however, may be measured by the extent to which an exit strategy is thoughtfully planned and executed. The sale of a business and an owner’s transition from entrepreneur to investor is one that must be carefully considered well in advance of the event, particularly in today’s environment of dramatic economic change.

A strengthening economy is creating favorable conditions for middle-market M&A activity, spurring many business owners to consider a sale. While the urge for swift action may be compelling, the prudent business owner should take pause, proceeding slowly to make sure the deal—and the right financial structure—are in place well in advance of any change in ownership.

This article explores the steps a business owner should take as part of pre-transaction planning to facilitate a successful sale:

– Building the right team
– Preparing the business for sale
– Assessing financial goals
– Ensuring the right structure for the transaction

1. Building the Right Team

Finding a skilled team of advisors is a critical first step in selling any business. Regardless of the industry or type of business, a business owner will need a common core of advisors who can help with information gathering and planning. The advisor dream team will likely include investment bankers, accountants experienced in corporate and personal taxes, attorneys who specialize in business law and wealth transfer strategies, business valuation specialists, and a wealth manager.

Assembling this team can be a challenging undertaking. Often, the first impulse is to engage the advisors who have been helping the business since its inception. Sometimes this can be exactly the right decision. The danger, however, is that as the business, the family and the wealth have grown, the complexities of that business and the nuances around the transfer of that business may exceed the capabilities of long-standing advisors. Prudent advisors who recognize this will be candid with the business owner about the situation, and will work to stay involved in the business while also referring the owner to a specialist. It is important to remember that bringing in specialists does not necessitate the end of a long relationship with a trusted advisor or confidante.
In addition to advisor referrals, personal networks such as other business owners are a valuable resource for finding qualified and specialized advisors. Of course, businesses in certain industries might require additional industry-specific assistance. Peer networks, trade associations and professional groups can be enormously helpful in identifying the need for specialized advice and finding the appropriate advisors.

Why is it so important to have the dream team in place? Myriad factors impact a sale. Internally, the owner and his or her advisors must assess the company’s cash flow, earnings, growth rate, leverage, liquidity, management bench strength and overall health. They must evaluate where the business is in its lifecycle, potential opportunities for organic vs. acquisitive growth, foreign competition and a litany of other business factors. The current market and economic conditions can also be wild cards in structuring a successful deal.

Business owners who do not have expert advice and act too hastily can easily derail transactions. Common missteps at this stage include flawed notions of business value or sale proceeds, insufficient allocation of resources to the transaction process, unsubstantiated projections and inadequate due diligence. Business owners also face the challenge of juggling the demands of the transaction with the ongoing requirements of the business.

2. Preparing the Business for Sale

Once a business owner has the right team in place, it is up to him or her to oversee the activities of the advisors, which begins with drafting a timeline, creating an order of activities and ensuring that the business is properly prepared for the sale. This is often a time-consuming process, so the business owner and team will need to plan well in advance of the actual target sale date.

Perhaps the most important task to prepare a business for sale is to optimize factors that will impact its valuation in the marketplace. An audit by an independent CPA will verify a healthy financial picture, as will ample liquidity and positive price-to-earnings and book ratios. A strong management team and sound business continuity and operational transition plans will be positive signals for potential buyers in the market.

A business owner will also need to evaluate the marketing hallmarks of his or her company for signs of a diversified customer base and brand. A solid marketing plan can create buzz and momentum in the marketplace, and lead to synergistic buying opportunities. It is equally important to consider the legal picture and whether the business has bullet-proof contracts and is protected from litigation.
3. Assessing Financial Goals

Before discussions of the deal begin, it’s just as important for the business owner to consider how the wealth would work for him or her and the family. The discussion can be framed around one deceptively simple question: “How much is enough?” Consider the following factors:

- How much is enough for myself and my spouse to accommodate spending needs?
- How much is enough for my family (i.e., the inheritance)?
- How much is enough for my community (i.e., philanthropy)?

The answers to these questions will drive the family’s wealth management strategy and, in turn, the strategy should have some impact on the form of the business deal or transfer. For example, if charitable giving is a priority, a stock transaction might be more beneficial than a cash deal. If giving wealth to family members is a priority, there are a number of tactics to transfer assets to mitigate the impact of taxes, including outright gifts, discounted gifts, and gifts in trust. Transferring business interests to family should be undertaken well in advance of any event that would increase the value of the interests transferred, such as an IPO or sale.

Forecasting spending needs is critical. Business owners who are contemplating a sale should keep in mind that they will no longer be able to finance a part of their lifestyles through their business operations after the transaction—a key factor that many successful entrepreneurs overlook. Upon the sale of the business, that cash flow dries up and the former business owner will have to rely upon the proceeds to finance his or her lifestyle. An analysis of the type of lifestyle those proceeds can support is often an eye-opening and unsettling experience.

Another consideration in preparing the business for sale is simply preparing the family for the new wealth. In most cases family members will be the ultimate beneficiaries of the wealth that was created by the business. Consequently, consideration should be given to ensuring that the children and grandchildren who will inherit the family wealth will be prepared to handle it. Any complete plan for family wealth management must address issues of wealth education and stewardship, and the impact that the wealth management strategy will have on the family.
4. Ensuring the Right Structure

When structuring an outright sale of the company, negotiations are more an art than a science. There are many ways to structure the sale of a business. Buy-outs, often by private equity groups, have been very popular in past booms and are reviving again with the strengthening economy. Alternatively, the business could undergo a tax-free reorganization such as a merger or stock swap, or it could be recapitalized. Buy-sell agreements are also a form of restricted sale.

Possibly the most contentious issue between buyer and seller is the relative benefit of an asset sale versus a stock sale. Purchasers usually prefer to buy the specific assets of the company. This limits their liability for past activities of the business, and allows them to depreciate the assets from their purchase cost. Conversely, in a sale of company stock, the seller would typically incur predominantly capital gains rather than ordinary income tax and would avoid the hassle and lingering liability of still owning the shell of the original company.

Negotiations over this issue can become quite complex, as there are various alternatives that can offset some of the negatives to buyer and/or seller in both asset and stock sales. These include, for example, techniques for the seller to mitigate the tax burden under an asset sale. Below are some considerations to keep in mind between an asset sale and a stock sale.

Another major decision for the business owner is how much of the company to sell and how fast. If the owner is eager to move on to new endeavors, he or she may want to pursue a complete sale with minimal strings. On the other hand, many business owners prefer to phase out gradually, retaining an ownership interest and possibly an ongoing working relationship with the company. This can be formalized in a number of ways, such as employment or consulting agreements. Discussions regarding earn-out provisions and hold backs can figure prominently in these negotiations.

### Comparison of Asset Sale vs. Stock Sale

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<tr>
<th>Asset Sale (Favors Buyer)</th>
<th>Stock Sale (Favors Seller)</th>
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<tr>
<td>Part ordinary income, part long-term capital to seller</td>
<td>Long-term capital gain to seller</td>
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<tr>
<td>Buyer does not assume liabilities</td>
<td>Buyer assumes liabilities</td>
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<tr>
<td>Assets get basis step-up: Generates increased depreciation deductions for buyer</td>
<td>No cost-basis step-up: Buyer forfeits additional depreciation</td>
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Conclusion

Selling a business can be a seamless transaction, provided an owner takes the time to assemble the right team and build the right plan. It is critical to prepare a business well in advance of the transaction to ensure the optimal terms for the owner and his or her family. In addition to preparing the business, the wealth strategy and the family, the business owner must evaluate spending needs and prepare him or herself for life after the business. With proper advice and thorough planning, a business owner can put his or her life's work to work—to provide for the family, embark on a new business venture or realize other philanthropy goals for the future.

About the Author

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As a senior director for BNY Mellon Wealth Management and global family wealth strategist, Joan works closely with wealthy families and their advisors to provide comprehensive wealth planning. With over 25 years of experience working with large multi-generational families, she specializes in multinational planning, business succession, family governance and philanthropy.

Joan is frequently invited to speak to clients and professional groups such as the American Bar Association, the Hong Kong American Chamber of Commerce, the American Institute of CPAs, STEP and numerous estate planning councils throughout the United States, Canada, the Middle East and Asia. An author of a number of white papers on multinational planning, she was a founding contributor to the GCC Governance Code of Family Business Council-Gulf, and was recently interviewed live on CNBC–Asia.

Joan earned a master of business administration from Rollins College, a bachelor of education from Queens University and a bachelor of music from McGill University. She is a Certified Financial Planner™ professional and has earned the designations of Certified Trust and Financial Advisor and Trust and Estate Practitioner. Joan chairs the Executive Committee of the Florida Bankers Trust Division and previously chaired the Board of Directors of the Community Foundation of Broward.