Column by John Burley

Preparing Your Business for the Market

You're ready to sell, but is your business ready? Follow these easy steps to ensure it fetches the highest value.

To effectively prepare a business for a merger or acquisition, maximize its value, or even make the decision to sell, you should first understand the process of how businesses are valued. Businesses do not sell like real estate -- or at least they shouldn't -- and the process is not nearly as straightforward. The things that drive value and are important to a buyer may surprise you and aren't always the same business metrics you would use to measure the performance of your business on a day-to-day basis. Understanding key value drivers will go a long way in helping to understand what needs to be done to prepare to sell.

It's about the profits
A common mistake business owners make is thinking that the value of their company is based on revenue. Instead, cash flow and EBITDA (earnings before interest, taxes, depreciation and amortization) are often the primary metrics for determining value. Before going to market, look at tightening up the ship to drive profits. Top-line revenues do matter, but less so if profits are not growing at the same pace and other risks are not being mitigated.

Clean up books and records
Clean books are also crucial. Most small businesses have less than perfect books and records, but the tighter and cleaner they are, the better an advisor will be able to value the company, the more attractive it will be, and the smoother due diligence and closing will be.

For example, be sure profit and loss statements are accurate. Are all accrued expenses correct? Are items like depreciation and inventory up to date? Many companies update such items annually, but if you're thinking of selling you should consider doing mid-year reconciliations. On the balance sheet, look to clean up items like shareholder loans and employee advances. If it's not practical to get these items off the books, talk to your M&A advisor about other ways to handle them. Beyond basic accounting aspects, also look to organize and tighten up contracts with customers, vendors, partners, and employees. Many small businesses operate on loose or oral agreements, but when it comes to selling or valuations, this approach can seriously add risk and degrade value.

Lock in your team
If any personnel changes are needed, try to make them as far in advance of the sale as possible. Stability is important to a buyer.

So is the role of the owner. In many small businesses, the owner is extremely important to the overall business. But this characteristic often degrades value more than anything else because it means the whole business hinges on a single person. If your business is an owner-operator type business and you expect to sell to another entrepreneur who can take your place, this may not be as much of a concern. However, if the buyer is likely to be another company, an investment group, or even an individual who lacks your expertise, it will be extremely important to start delegating your duties to others, or even hire a replacement for yourself. The less important the exiting owners are to the business, the more valuable it will be.

Balance out your customers and vendors

Take a look at your customer base, as well as vendors, suppliers, and partners. Does any single customer account for a significant portion of your business? Are you beholden to any one vendor, partner, or supplier? If so, look to diversify. Put back-up suppliers in place and attempt to spread your revenue across a larger set of customers. If losing your top customer would significantly impact your business, then this will significantly impact your value as well.

Keep in mind that diversifying your products, services, and the industries you serve is a delicate balancing act. If your business is reliant on one industry or a single product, this creates risk. On the other hand, a lack of focus can degrade value as well. There is no one-size-fits all formula, but in preparation to sell, look at this area of the business from an outsider’s perspective.

Preparing to go to market

Once all this is in place, and you're within months of actually entertaining buyers and merger partners, you’ll want to ramp up your advisory team -- or hire them if you haven’t already. In addition to your CPA and attorney, you will need an M&A advisor or business intermediary of some sort. For main street businesses like retail, restaurants, gas stations, and convenience stores, and businesses with less than $1 million in revenues, a business broker may be the right person. For larger or more sophisticated businesses like technology companies, government contractors, and others with over $1 million in revenue, an M&A advisor is probably a better fit. A business broker will help you locate a buyer, while an M&A advisor will value and develop a book on your business, negotiate the price and terms, and manage due diligence and closing.