



## Top Ten Reasons Business Owners Need a Business Appraiser and a Business Broker

Many small business owners are individuals who have started or acquired a “lifestyle” business—a business that provides the owner with a job and enables the owner to maintain their desired lifestyle. Most of these business owners have considered or will consider an exit strategy from their enterprise. Consideration of an exit strategy may be prompted by many factors such as retirement, a desire to achieve liquidity to pursue other business ventures, owner burn-out, illness, etc. In addition, exit planning may be part of an investor’s overall strategy of acquiring, growing and increasing the value of the business, and exiting the business through a merger or acquisition as a means of creating transgenerational wealth. Throughout the process of buying, owning, and selling a business, the owner must rely on the experience and advice provided by professionals such as legal counsel, accountants, financial advisors, management advisors, etc.

However, when contemplating an exit strategy many business owners attempt to guide themselves through the process without professional business brokerage or business appraisal services. This approach is filled with many pitfalls and may serve to actually destroy value in the process of exiting the business. The following top ten reasons have been compiled in order to give business owners an insight into the benefits of having a professional business broker and business appraiser involved in the process of selling their business.

### 1. Maximize Transaction Price

Most small business owners are skilled at running their business but do not have the background that is conducive to successfully negotiating a transaction involving their business. Lacking negotiating skills may result in leaving money on the table in the transaction. As this is not an optimal outcome for the business owner, it is wise to have an experienced, professional business broker/transaction advisor to negotiate for them to maximize the transaction terms.

Mercer Capital recently completed a study relating to the role of transaction advisors in securing higher deal terms than transactions that did not include a

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professional transaction advisor. The study involved examination of transactions in the banking industry beginning in 2001. (The banking industry was selected given the availability of financial information relating to banks as well as transaction information. Given the federal regulation of the banking industry, more financial and transaction information is readily available than in other industries.) Mercer Capital's study indicated that those sellers who retained a transaction advisor received a 20% higher price to earnings multiple and a 15% higher price to tangible book value multiple than those sellers who did not retain a transaction advisor.

Clearly, retaining professional transaction advisors can help business owners achieve maximum return on the transaction as compared to the "for sale by owner approach." Negotiating transaction value and terms is no easy task, particularly when the emotions of the owners may be involved directly in the negotiating process. A transaction advisor removes the emotions on both sides of the deal-making process and works to achieve optimal results for the willing buyer and willing seller.

## **2. Independent Valuation for Financing & Negotiating**

Many small businesses utilize leverage to invest in value-creating projects, fund operations during down years, etc. Often times, this leverage may exceed the credit available based on the business's fixed assets alone. In some cases, the financial institution may be willing to lend against the company's goodwill, which is identified in the process of a valuation. The ability, then, of a small business to borrow based on the value of the goodwill may expand the universe of value-creating investment options available to the owners. Periodic valuations may establish a track record of value which could be used to facilitate a recapitalization of the firm, enabling owners to further seek value-creating projects, distribute funds to the shareholders via special dividends, etc.

In addition, an independent valuation from an appraiser not affiliated with the business broker or any of the business's other advisors provides an objective opinion of value that is useful in negotiating a transaction price. An independent valuation gives the acquirer of the business a level of confidence that the value conclusion is not biased by the owners or their advisors. This is extremely useful when negotiating transactions from a goodwill, time, and tactical standpoint. Furthermore, a history of periodic or annual valuations may provide the owners and business broker with a foundation for negotiating even more favorable deal terms.

## **3. Owners Stay Focused on Running the Business**

In preparing the company for the sale, the owners must adopt the appropriate mindset that provides a level of commitment to the process that is conducive to a successful and optimal transaction. A great deal of time is needed to effectively market the business and negotiate a successful transaction. If the business owners are attempting to manage this process themselves and continue to run the business, it is likely that one side is going to suffer. Typically, the business suffers from less owner involvement when owners choose the "for sale by owner" route.

Hiring a professional business broker allows the business owner to continue doing what they do best—effectively running the business. Nothing is more embarrassing or more difficult to overcome than attempting to sell a business that the owners have neglected, resulting in lower revenues or unfavourable trends in financial performance, while pursuing a sale of the business themselves. Owners can be consumed and overwhelmed by the demands placed upon them by the business and the marketing and sale process. By managing the marketing and flow of information between the business owners and prospective buyers, the business broker removes a tremendous burden from the shoulders of the owners/management of the business. This should allow for continuous, uninterrupted management of the business in an effective fashion and an optimal outcome for all parties involved in the transaction.

#### **4. Set Reasonable Expectations**

Most owners of small businesses believe they know what the company is worth. As they may have worked to build the business, often from the ground up, they feel that their intuitive value conclusions accurately reflect the fair market value of the firm. In many cases, they are biased in their views towards the firm, and therefore, have an inflated sense of value associated with the business. Their value may differ substantially from the value that could be realized in an arms length transaction between a willing buyer and a willing seller. Without a formal valuation of the company, the owners of a small business often have nothing other than a gut feeling to support the value that they attach to the business.

Many are reluctant to hire an independent valuation professional to conduct an initial valuation of the company if they do not perceive the need for one. In many cases, there is little perceived need for the owner of a very small business to have a valuation performed. However, the valuation helps to set reasonable expectations for the business owner who has a preconceived notion of value in their minds. The valuation sets a fair market value that may be realized in a transaction between a willing buyer and seller.

#### **5. Expand Exit Strategy Opportunities**

Most business owners who have not been involved in a transaction before are likely unaware of the various exit strategy options that may be available. Professional business brokers and business appraisers are able to outline the possibilities for the business owner and the likely benefit of each option. Owner financing is an often used and attractive way to structure an acquisition of a business. This may eliminate the need for bank financing and allow the seller the opportunity to defer taxes and earn interest on the seller finance note that results in total deal proceeds in excess of the initial transaction price. An employee stock ownership plan (ESOP) is another exit strategy suitable for some businesses that allows the seller to transfer ownership, often times in a tax effective manner, to the employees of the company (via a trust). A business broker will likely identify potential strategic acquirers for a business (if

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appropriate)—acquirers whose synergies may make an acquisition operationally and financially attractive. A business broker may also identify financial buyers such as private equity groups (typically for larger transactions) who may already have a platform in the seller's industry. This allows for a sale to sophisticated buyers who generally have ready access to capital for acquisitions.

In addition, a business broker will be able to advise the seller on options such as an earnout, whereby the seller is paid compensation over time based on specific performance measures of the company, or consulting agreements that allow for residual income to the owners after the sale of the business. These opportunities and strategies would likely be overlooked by a business owner pursuing a "for sale by owner" strategy, their legal counsel, and their accountants. Professional business brokers will help the business owner expand their exit strategy opportunities and provide options that may otherwise go unnoticed.

## **6. Professional Services with Experience Selling a Privately-Owned Business**

In some cases, business owners will seek the services of a real estate broker to sell their business. This is usually a very unwise approach for the business owner as real estate brokers are typically unskilled at selling a business. Not only do real estate brokers generally lack experience in successfully selling a business, they also do not have knowledge of the unique process and various aspects of selling a business. A real estate "sales" mindset will likely produce suboptimal results for the owners of the business. Placing a "for sale" sign outside a business may have mixed results in attracting a buyer but can greatly damage a business's relationship with customers, vendors, suppliers, etc.

Professional business brokers typically have extensive experience confidentially selling businesses in a variety of industries. This extensive experience is useful when it comes to pre-screening prospective buyers and negotiating or structuring a transaction. Professional business brokers do not have "open houses" for businesses and buyers who are window shopping or looking to kill time on a weekend. Prospective buyers must be carefully pre-screened for financial qualification, so as not to widely disseminate confidential information pertaining to the business. Such dissemination of information could have a detrimental impact upon the business. In addition, professional business brokers' experience is useful when negotiating and structuring a deal in creative ways that satisfy both the interests of the sellers and the desires of the buyers.

## **7. Emotional Aspects**

The process of selling a business is, in many cases, a life changing event for the owners. Many consider the business their "baby." As such, there is a great deal of emotion involved in the process of selling a business.

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It is not unusual for the owners to become very emotionally charged in attempting to decide how best to achieve an exit strategy and again once the initial letter of intent (LOI) is received. Given that the decision to sell the business has already been very emotional for the owners, adding an offer that the owners may feel is insulting only compounds the emotional aspect of this deal-making process. Therefore, a seasoned transaction advisor will help the business owner understand the price and terms relative to the negotiating strategy of the acquirer. It is unlikely, after all, that the terms and conditions set forth in the initial LOI represent the absolute best offer of the acquirer.

Given that the business broker is emotionally removed from the process, he can provide objective advice to the business owner and prevent emotions from running high on both sides. Owners handling negotiations themselves are subject to emotional biases during the process that could damage the professional goodwill with the prospective buyer. The business broker removes this risk and conveys offers and counteroffers to the parties. Removing this emotional aspect helps facilitate the process and may lead to maximizing the transaction price for the sellers.

## **8. Confidentiality**

The key to successfully marketing and selling a small business is confidentiality. The owners of small business do not want customers, suppliers, and the competition to know that their business is available for acquisition. Unlike real estate brokers who hang a "For Sale" sign in front of the property, professional business brokers maintain a high degree of confidentiality. Whilst the professional business broker may advertise the type of business available on websites or in trade journals or papers, no information regarding the company is distributed until the prospective buyer has executed a confidentiality agreement and passed a pre-screening process which may include financial qualifications. This process is designed to ensure that confidential information regarding the company's financial performance, operations, and/or proprietary technologies is not distributed promiscuously to prospective buyers who do not have the financial ability to pursue such a transaction, to the general public, or to competitors and their associates.

## **9. Coordinate Site Visits, Due Diligence, and Closing**

Once the owners of a business have made the commitment to pursue a sale or merger of their company, a great deal of time and attention must be expended on coordinating site visits with prospective buyers, due diligence, and finally, closing. The business broker will work with the owners' other advisors so that they do not spend time on marketing the business and negotiating to the detriment of running the business. The business broker and the owners initially must ensure that preliminary legal work is in order and that the company's most recent annual and interim financial statements (or tax returns) are made available by their accounting firm.

After prospective buyers have been pre-screened and have expressed sufficient interest in pursuing an acquisition of the company, preliminary due diligence begins.

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Preliminary due diligence is a basic analysis of the company, its financial position, etc. to whatever extent permitted by time and the willingness of the owners to divulge information at this stage. Typically, the business broker is able to answer many general questions that may arise. For those questions needing more detailed or technical answers, the business broker conveys the questions to the owners and delivers their responses to the prospective buyer. As part of the preliminary due diligence, the business broker will arrange a discreet site visit to allow the prospective buyer the opportunity to meet with the owners and/or management and see the operations of the business first-hand. Discretion is important so as not to alarm the employees.

Should the prospective buyer proceed to send a letter of intent (LOI), the business broker conveys this information to the owners. It is important that the owners understand the basics of the LOI. The business broker will review the LOI to address some of the following issues—stock purchase or asset purchase and amount/form of consideration, employment and other agreements that will need to be executed before closing, expected closing date, refundable deposit or “good faith money”, expectations for confidentiality as the process proceeds, and other issues as necessary.

It is rare that the owners of a business will accept the first offer and the conditions set forth in the initial LOI. Rather, this is a starting point for further negotiations centered on the price, terms, closing date, etc. The business broker will discuss the initial LOI with the client and make recommendations regarding the future course of action based on the specifics set forth in the LOI. Typically, at this point, the business broker will discuss with the client their expectations and desire to continue discussions with the potential acquirer.

Once an agreement has been reached on price and terms, due diligence begins. At this point, recall, the potential acquirer has had limited access to the target company’s financial information, operations, legal documents, management, etc. The due diligence phase is where the acquirer delves deeply into the financial information of the company and other aspects to ensure that the information presented thus far correctly and fairly represents the actual financial, competitive, and operational position of the company. In this phase, the business broker remains as the middleman in coordinating access to information, overseeing the collection and delivery of the requested information in a timely manner, and moving the process forward.

Once the acquirer has completed the due diligence phase, the business broker coordinates a closing with legal counsel. This typically includes a review of the purchase agreement, which incorporates the terms and conditions provided in the LOI with any changes or modifications stemming from matters arising in due diligence.

The business broker will typically consult with the client’s accountants and attorneys to ensure that the purchase agreement is structured in accordance with the interests of the client. Any recommended changes are conveyed to the acquirer by the business broker and the client’s attorney. Once the final purchase agreement has met

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the satisfaction of all parties, the final closing date is scheduled for the signing of the appropriate documents and disbursement of the necessary funds.

## **10. Financial Analysis and Fairness Opinions**

It is not uncommon for the business owner pursuing a sale of the business to require additional financial analysis services from a business appraiser during the sale process. This financial analysis may involve updates to the original valuation based on changing circumstances after the initial report, analysis relative to potential synergies and the impact on value to a strategic buyer, industry analysis and/or research, financial modeling, fairness opinions as to offers and the structure of an offer, or financial analysis for use in supporting a counter offer to a prospective buyer. This additional analysis is beneficial to the business broker and business owners in supporting their negotiating position. In addition, the independent nature of the analysis and valuation from the business appraiser, who has a familiarity with the company, is helpful in raising the confidence of the prospective buyer, who may be reluctant to accept the claims from just the business broker and the owners.

Consequently, the financial analysis services offered by a business appraiser are useful in negotiations in situations where an initial valuation was not performed. In addition, the prospective buyer and sellers may agree to utilize the services of the independent business appraiser to be the final arbiter of disputes arising during negotiations. This allows both sides to remain amicable when negotiations become tense. Should the buyer acquire a majority interest with the owners retaining a minority interest until a future buyout, on-going analysis and valuations by the independent appraiser are crucial in ensuring a positive goodwill between the parties moving forward.

## **Conclusion**

The process of selling a small business is often more complex than business owners realize. From the decision to sell the company to closing the transaction, the path is often fraught with potential pitfalls that may derail the deal or create unnecessary and unwanted disruptions, which only serve to place additional stress on the company's owners. From the previous discussion, business owners should be able to recognize the need for a professional business broker and business appraiser in order to successfully achieve the desired results of the sale of the business.