

**Suite 1104****SALE OR LIQUIDATION**

*Preparing to Sell Your Business*  
*Family Succession*  
*Selling to Management/Employees*  
*Selling to the Trade*  
*Selling to the Public*  
*The Act of Closing the Business*  
*Dissolving a Corporation*

**1104.01 INTRODUCTION**

Selling your business could be the most important financial deal you'll ever make. For many owners, selling the business they've spent years building up can also be emotionally difficult. And unless you've sold another business previously, you'll have no experience to draw on.

Before selling your business, you need to carefully assess your reasons for doing so.

You need to consider four key questions:

- What are my objectives as the owner of the business? For example, you might want to realise some or all of your investment in the business to fund your retirement.
- What are my objectives as manager of the business? For example, you might want to retire as soon as possible or prefer to keep running the business.
- What are my objectives for the business itself? For example, the business might need new investment in order to grow.
- Who else will be affected and what will they want? For example, other shareholders, managers and employees, and even key customers and suppliers.

**PREPARING TO SELL YOUR BUSINESS**

Selling part or all of the business may be the best way to achieve your objectives. You might, for instance, want to sell your business outright, leaving you with no financial or management involvement.

But a sale may not always be the best solution. And, of course, it may not always be realistic either.

There's a range of other exit routes that may suit your needs better. If, for example, you want to retire but already have enough money, you could pass the business on to your children. Or a stock-market flotation could give you access to capital to develop your business while making it easier to sell part or all of your stake in the business.

## **1104.02      WAYS TO SELL YOUR BUSINESS**

Most businesses are sold in a trade sale to another business. Alternatively, you may be able to find a private-equity buyer. For example, a venture capital firm might be prepared to help management buy the business.

There are several different sale options:

### **Partial or full sale**

You may want to sell the entire business. Sometimes the purchaser prefers you to retain partial ownership and continue to run the business. This can give the purchaser confidence that the business will do well.

### **Sale of assets**

You can sell assets such as equipment, intellectual property or your customer list rather than selling the business itself. This may be attractive to a purchaser who does not want to take on liabilities and obligations. For example the purchaser might not want to take on your employees. You will be left with whatever assets and liabilities are not included in the sale.

### **Immediate or phased payment**

You can ask for payment in full when the sale is completed, or you may be prepared to accept payment in instalments. The purchaser may well prefer to pay in instalments. But you will be at risk, for example if the purchaser cannot make future payments.

Your choices can affect whether buyers are interested and how much they are prepared to offer. They can also affect the tax treatment of the sale.

You can download a practical guide to disposals from the Deloitte & Touche website (PDF).

## **1104.03      WHEN TO SELL YOUR BUSINESS?**

Selling at the right time can have a significant impact on the price you get for your business.

If possible, plan ahead so that you can pick the best moment rather than being rushed into a quick sale. For example if you plan to retire in five years' time, it's a good idea to start planning the sale of your business now.

The general state of the economy – and your sector in particular – can have an effect. It's easier for a trade buyer to fund a purchase when their own business is doing well, interest rates are low and banks are keen to lend.

The state of your business is a more important factor. Aim to sell when the profits are increasing and look likely to grow further. Consider the impact of sales cycles or seasonal fluctuations in your business – you might have fuller order books at a particular time of year, for example.

## **Choose advisers to sell your business**

You will need an accountant and a lawyer. The accountant concentrates on the financial aspects of the sale, such as preparing accounts for the business. The Lawyer focuses on legal issues such as drafting a sale agreement. You also need to use a specialist tax adviser to handle business – and personal tax planning.

Most businesses also choose to use a specialist corporate finance adviser. The corporate finance adviser is involved at an early stage and helps you choose the timing, find potential purchasers, groom the business for sale and negotiate the sale. The adviser can manage the whole sale process, leaving you free to continue running the business.

Of course you will have to pay your advisers. Many advisers charge an hourly rate. Alternatively, you may be able to negotiate a fixed rate for a particular piece of work. Some advisers, particularly corporate finance specialists, are prepared to negotiate a success fee as part of their payment. For example, you might pay lower fees if you don't achieve your target price.

## **Show a strong financial performance**

A first step is to ensure that your finances are in good order. Although this should be the case at any time, planning to sell your business can push you to focus on this area. One major area is control of working capital, through reducing stock levels and controlling creditors. There may also be opportunities to cut costs, such as renegotiating supply contracts and eliminating unnecessary perks. You can also sell underused equipment to reduce debt.

You will also want to present your accounts as attractively as possible. Buyers usually prefer businesses that show increasing profits year on year. If possible, your financial performance should be reasonably stable throughout the year. You may be able to bring forward or delay purchases and sales to help with this. You may also want to change some of your accounting policies.

Good sales forecast will help to increase prospective purchasers' confidence in your business – but you must ensure they're realistic and can be supported with evidence. A full order book is a good sign.

It's important that buyers believe your accounts. For example, you should make realistic provisions for ad debts. Buyers will usually see through any quick fixes you try to use to boost profits.

To maximise short-term profits you can reduce longer-term investment. For example you might avoid expenses like advertising heavily or taking on new staff. But avoid excessive cost-cutting – you need to maintain spending in essential areas, otherwise the business suffers and so would the price buyers offer.

## **Streamline your business operations**

The more confidence a buyer has in your business, the higher the price they are likely to offer. It's essential to set out a clearly defined strategy in your business plan.

You also need to show that you've got a strong management team in place. If your business is too dependent on your own skills, it will damage the price it can bring – and could even make it impossible to sell. Appointing a deputy or department managers can enhance a company's value by alleviating that risk. You may also want to encourage key employees to stay by considering appropriate incentive schemes.

Aim to reduce your dependence on too few customers or on one or two key suppliers. Show how your customer base is expanding and formalise any informal deals you have with customers and suppliers.

You should also:

- Ensure you're complying with health and safety, employment and other legislation – consider asking your legal advisers to review the business
- Settle any legal disputes
- Make sure you have clear ownership of any intellectual property
- Ensure property contracts are sorted out
- Put in place suitable management information systems
- Ensure your finances are in good order

Throughout the sale process, continue to demonstrate that you will be flexible and co-operative. Show that you would also be willing to spend some time after the sale helping the buyer get acclimatised to the business.

## **FAMILY SUCCESSION**

Passing or selling the business you've set up to a son, daughter or other family member can be an attractive option. It allows you to maintain an involvement in the business and pass the assets to your heirs.

If you're interested in a family succession as an exit, you'll need to identify a potential successor and focus on developing their skills. It can help to involve your children or other relatives in the business as soon as possible, allowing them to gain an in-depth understanding of how things work.

Allowing them to gain experience working in other businesses can be equally important, as this will give them new strategic insight into your activities.

However, you should bear in mind that you can't be certain that a child or other family member will definitely be interested in taking the business on in, say 20 years' time. If you're starting a business with the clear aim of passing it on to family, you should seriously consider how you could interest the relevant family members right from the start to reduce the possibility of them pursuing other options.

A third party such as a non-executive director or business adviser can help you ensure emotions don't cloud your thinking.

## **SELLING TO EMPLOYEES/MANAGEMENT**

### **Employee Stock Ownership Plans (ESOPs)**

One way to sell the business to your employees is through an Employee Stock Ownership Plan (ESOP). ESOPs are tax-qualified employee benefit plans that invest primarily in stock of the employer. Significant tax advantages may be available to both an individual selling the business to an ESOP and the employees participating in the plan. The many tax incentives and benefits of employees having ownership in the business make such plans attractive even when business owners wish to sell only part of their businesses.

## **SELLING TO THE TRADE**

The most common exit option is selling your business – either to another business or your employees or management.

A trade sale occurs when you sell the business (or parts of the business) to another outside party. It can be the best way to get a good price – but you'll need to develop a business that's attractive to potential buyers.

If your business is not already limited, it may be difficult to achieve a trade sale as the value of a business is likely to be heavily tied to the skills or business relationships the owner has developed. The business may also appear less well established and therefore less attractive to potential buyers.

If you did not start out as a limited company, it is worth considering incorporation before pursuing a trade sale. This will give the business its own legal identity, and selling on the business' trade, assets or customer list should be easier.

This may also make a merger possible – although this would probably mean remaining with the business for longer than if you make a straightforward trade sale.

Your chances of a successful trade sale can be improved by drawing up and following a clear exit strategy and minimising the potential hurdles to a successful exit.

Developing the following characteristics can also help to make the purchase of your business a realistic proposition:

- Show year-on-year increasing profitability
- Create a high-quality product or service
- Develop an innovative product or piece of intellectual property
- Build a strong customer base
- Recruit a high-quality team
- Maintain premises and assets in good condition

You could also sell your business to managers or employees. Buyouts are not usually something you plan for but occur when employees or managers hear the business is up for sale and would like to extend their stake.

This option may not always be as profitable as selling to a trade buyer.

Remember there's a natural conflict of interest when managers or employees are involved in assuming control of your business. If you've agreed to sell to them, you'll need to ensure neither your business activities nor its value suffer.

## **SELLING TO THE PUBLIC**

### **IPOs and DPOs/Float your business on the market**

Floating your business – selling share on the stock market – can be highly rewarding financially. It lets you realise your investment in the business by making it easier to sell part or all of your stake.

But any financial exit from the business is likely to be partial. Potential investors will be wary if you sell all your share – and you may not be permitted to do so.

Any float will also affect other existing shareholders or investors. The shareholders agreement may give existing shareholders pre-exemption or voting rights which may make a float more difficult or reduce the amount you realise for your investment.

Relatively few businesses can realistically expect to float as they are unlikely to be able to raise funds to finance the necessary growth to attract investors.

## **THE ACT OF CLOSING YOUR BUSINESS**

Closing your business isn't necessarily an option that's forced upon you by poor trading conditions or financial difficulties. It may suit both you and your business to close it when you decide to exit. There are a number of circumstances where planning the closure of your business will be the most practical option.

For example:

- Your business may be too dependent on your particular skills to make a sale realistic
- Family members may be uninterested in taking charge
- Unfavourable economic climate
- Ill health may force you to retire before you've had a chance to develop the business sufficiently to make an alternative exit viable..

The getting out of business typically includes the following steps. You may want to incorporate them in your post-venture plan:

- Reach Agreement and Obtain Authorization from Owners to Dissolve Your Business Entity.
- Designate a Leader & Organize a Team.
- Engage Professionals & Consultants as Team Members.
- Prepare a List of Assets and Perform a Physical Inventory
- Develop a Schedule for Implementation
- Release Announcements & Notices
- Implement the Plan
- Conclude or Transfer Contract Obligations
- Close Operations
- Dispose of and Transfer Assets
- Prepare Final Financial Statements & Tax Returns
- File Articles of Dissolution
- Prepare and Issue Special Filings, Notices, Information Returns, and Taxes
- Receive Tax Clearance Notice
- Close Bank Account
- Store Business Records (7 years minimum)

#### **1104.04 PREPARING YOUR BUSINESS FOR SALE**

Selling your business involves several stages that need to be completed to achieve a successful outcome. Typical steps include:

- Preparing your business for sale
- Valuing your business
- Identifying potential buyers
- Marketing your business
- Meeting and negotiating with potential buyers
- Completing legal due diligence with the buyer
- Finalising the sale agreement and transferring ownership

In order to maximise the value of your business, it is worth spending some time prior to the sale getting your business into shape. This could include cutting costs, reducing debts and reducing excess stock to get your finances into good order. Potential buyers are also likely to require detailed financial information, including audited accounts and forecasts before they will consider making an offer.

You can help make the whole sales process smoother by preparing this information in advance.

There are several methods of valuing your business. It is advisable to seek specialist help from your accountant, solicitor or from a corporate adviser. You may also secure more information from the following:

- Suite 504 – Purchase of an Enterprise
- Suite 506 – Valuation Principles
- Suite 508 – Land and Property
- Suite 796 – Mergers and Acquisitions

## **1104.05 INITIAL MEETINGS WITH POTENTIAL BUYERS**

Once you've identified potential buyers for your business, the next step is to gauge their interest by holding initial meetings with them. The approach you take towards negotiating with potential buyers is crucial.

The aim is to build a relationship with possible buyers and discuss some of the key issues your business faces.

If you haven't done so already, you should ask your legal adviser to draw up a non-disclosure agreement for prospective buyers to sign.

After this it may be appropriate to allow serious buyers to look around your premises. This could help accelerate the sales process – though you may prefer to wait until you've received indicative offers before you do this as confidentiality is vital and you may want to avoid giving away too much information at this stage.

To allow potential buyers to make an indicative offer for your business you'll need to provide them with accurate financial information, including audited accounts and forecasts for the year ahead.

Clearly, releasing commercially sensitive financial data – possibly even to a competitor – is a worry. Ask your advisors how best to go about this.

It's also worth providing potential buyers with a valuation of your business drawn up with your advisers. This will give them an idea of what you're expecting.

After your initial meetings, you should whittle down the field by inviting buyers to make written indicative offers which include:

- The price they're prepared to pay
- How they plan to structure the deal
- Proposed timetable for completion of the deal

### **How is the deal structured?**

Price is just one of the key factors to consider when weighing up offers for a business. For example, the potential buyer's proposed timetable for completing the deal is important – the uncertainty of a drawn-out sale could be damaging to your business.

You also need to be sure the prospective buyer can meet the price they're offering. The offer will be worthless if they can't finance it, so examine what proof of financial backing they have. This could include mortgage or loan agreements, share certificates, evidence of personal savings such as pass books or offers from venture capitalists to fund the purchase.

Consider how the deal will be structured. A one-off cash payment may be the most appealing option, but it's possible you'll have to accept some form of deferred payment. An upfront payment may not be the most tax-efficient option, either.

You may be offered a combination of cash and shares in the purchaser's business. But it's really only worth accepting shares if they're in a quoted company. Your buyer might also prevent you from selling your shares for some time.

If you are offered deferred payments, establish whether or not they are guaranteed. Buyers may want to lessen their risk by making future payments based on the business' future performance – known as an earn-out.

While earn-outs may increase the final amount you receive, there are inherent risks. It's a good idea to have some form of continued management involvement to influence the meeting of the performance targets. But your continued involvement for a designated period might anyway be part of an otherwise straight sale.

Remember that you're likely to have to pay Capital Gains Tax (CGT) on the sale of your business. Speak to your accountant to discuss how you can minimise your liabilities for CGT and make the most of the relief's available.

### **Your responsibilities and liabilities**

A key part of any offer will be the responsibility you have to take on for any business liabilities such as employees, outstanding debts and tax obligations warranties and indemnities.

Warranties provide legal confirmation that certain facts relating to the sale of the business are accurate. For example, you might have to guarantee that financial information you've shown to the buyer is accurate and that the assets you claim to own exist. The buyer may be able to claim against you if the information is later found to be incorrect.

Indemnities are promises to reimburse the buyer for any losses resulting from specified future events. For example, you may have to indemnify the buyer against any penalties resulting from tax or inspections into accounts drawn up before they took over the business.

Giving the commitments may help you get a higher price. But you need to clarify exactly what you stand to lose. Before you agree any warranties and indemnities they should always be scrutinised by your team of advisers.

### **Choosing and negotiating with a buyer**

Once you understand all the offers on the table you can narrow down the field and start negotiating with your short-listed potential buyers. Your adviser can lead the discussions and provide you with advice at every step.

You can create competition between prospective buyers by playing one party off against another so that they raise their offers. Be prepared to play poker – the interested buyers will negotiate but are unlikely to pull out at this stage.

Once you have identified your preferred buyer it's essential to develop a relationship based on trust. Discuss the deal only with this candidate and don't try to negotiate better terms at this stage. It's important you understand any offer before accepting it, particularly any liabilities you will be taking on.

You then need to agree **Heads of Terms** with the buyer; this is sometimes known as a “letter of intent”. This is a legal document setting out the key points for the deal. For example, what the buyer has agreed to buy (e.g. shares or assets), the payment structure (i.e. how and when they will pay), who will pay the costs, a list of assets, details of contracts and responsibilities to employees.

It acts as a written record of the key features of your agreement which can be used to brief your lawyers or accountants. It will also provide an exclusivity period during which you are not allowed to negotiate with anyone else. Your professional advisers will help you draw this up.

Parts of the document may be legally binding – it might set out responsibility for the payment of legal fees if one party pulls out, for example.

You should also inform other interested parties when you have done this.

### **Undergoing due diligence**

Once initial sale terms are agreed your buyer will want to investigate your business to check that the claims you’ve made about it are correct.

This process is known as due diligence and involves the purchaser reviewing commercial aspects such as contracts, staff and key customers, often using independent experts. But provided this due diligence is trouble-free and neither party has any last-minute surprises, the sale should be relatively safe.

Don’t start due diligence until you’ve agreed a price and terms with the buyer. The investigation period is negotiable – but should last at least three weeks. The process can be speeded up if you and your staff are as co-operative as possible.

Your buy and their advisers will probably need to spend some time at your business’ premises reviewing original documentation, but try to ensure as much work as possible is carried out off-site. The process must be controlled to guard against it being used as an excuse for renegotiating the deal.

The due diligence process is likely to cover:

- The business’ past and forecast financial performance
- Accounts
- Valuation of property and other assets
- Legal and tax compliance
- Any outstanding legal action against the business
- Major customer contracts
- Intellectual property protection

### **1104.06 THE SALE AGREEMENT**

As the due diligence process nears its conclusion you and your advisers should finalise the sale agreement. This will contain the exact details of the sale, much of which should have been outlined in the heads of terms. There will have been compromise on both sides to obtain a final document that is acceptable. But you should maintain a dialogue with all parties to ensure the final agreement is acceptable and contains no hidden surprises about your future liabilities.

Your advisers should ensure you fully understand the terms of the agreement you are signing and the full extent of any indemnities and warranties you have agreed to.

A guide to business disposals from the Deloitte & Touche:

[http://www.deloitte.com/ddt/cda/doc/content/CF\\_disposalnew.pdf](http://www.deloitte.com/ddt/cda/doc/content/CF_disposalnew.pdf)

## **DISSOLVING A CORPORATION**

BY John Loesch

If you want to distribute any corporate assets to shareholders you will need to formally dissolve your corporation and wind up its affairs. You may also want to formally dissolve your corporation if you are concerned about potential future liability from the corporation's products or services.

The legal effect of dissolution varies among states. In states that follow the Revised Model Business Corporation Act ("Revised Model Act"), a dissolved corporation continues its corporate existence but can no longer conduct any business except that necessary to wind up its affairs. The winding-up process includes the following actions by the corporation:

1. Collection and sale of assets that the corporation does not intend to distribute to shareholders.
2. Notification of corporate creditors of dissolution.
3. Payment of claims.
4. Distribution of remaining assets to shareholders.

In states that follow the Model Business Corporation Act, ("Model Act"), dissolution ends the existence of the corporation except for lawsuits against the corporation and certain shareholder corporate actions. Dissolution does not occur until after the winding-up process is completed.

**WARNING:** The Corporation must file IRS Form 966 within 30 days after the adoption of a resolution of plan to dissolve. IRS form 966 in Adobe format:

<http://ftp.fedworld.gov/pub/irs-pdf/1966.pdf>

### **1104.07 DISSOLUTION OF A CORPORATION INVOLVES:**

#### **1. Corporate Action**

Usually the shareholders approve a dissolution action proposed by the board of directors. The voting requirement necessary for dissolution ranges between a simple majority to 2/3rds of all voting shares.

Requirements:

- Board of Director's Proposal to Dissolve Corporation
- Approval of Shareholders

## 2. Filings with State

After the shareholders decide to dissolve the corporation, the appropriate forms must be filed with the state. Voluntary dissolution procedures vary among the states and you should always consult local counsel to insure that you are complying with the state law applicable to your corporation.

State laws on voluntary dissolution fall into three general categories:

**Two-Step States:** States that follow the Model Act require a corporation to file a statement of intent to dissolve before starting with winding-up process. After that process is completed (i.e., shareholders), the corporation files Articles of Dissolution. Ten states currently use this act.

**One-Step States - Start of Winding up:** States that follow the Revised Model Act permit a corporation to file articles of dissolution before starting the winding up process. 35 states currently use this act.

**One-Step States – End of Winding Up:** Five states only require the articles of dissolution to be filed; however, the form cannot be filed until after the winding-up process has been completed.

Some states will also require you to file a statement from the state-taxing agency that the dissolved corporation is current on its state taxes. Again, check with your counsel to determine what documents that must be filed with your state.

## 3. Notification to Creditors

### Known Claims against the Corporation

You must notify all the corporation's creditors by mail of its dissolution. The notice must give the following information to the creditor:

- The corporation has been dissolved (Revised Model Act states) or has filed statement of intent to dissolve (Model Act states).
- The mailing address to which creditors must send their claim.
- What information must be included in claims.
- The deadline for submitting claims – usually 120 days from the date of the notice.
- Statement that claims will be barred if not received by deadline.

### Unknown Claims against the Corporation

The Revised Model Act contains a notice provision for claims from creditors who are not known to the corporation at the time of dissolution – for example, a personal injury claim that arises after the date of dissolution.

Generally, this notice must be published in the local newspaper where your Corporations' principal office is located. If the corporation's principal office is out of state, the notice must be published in the local newspaper where the Corporations' registered agent is located.

The notice must contain the following information:

- The effective date of the corporation's dissolution.
- The mailing address to which creditors must send their claims and the essential information to be submitted with the claims.
- Advise creditors that a claim against the corporation and its shareholders will be barred unless an action to enforce claim is filed within statutory time after the publication of the notice. Statutory time is usually five years.

The Model Act does not contain a provision for notice to unknown creditors. Again, consult your counsel to determine if notice to unknown creditors is available in your state.

#### **4. Handling Creditors' Claims**

**Rejected Claims:** You must advise creditors in writing if the corporation rejects their claim. The rejection letter should also state that the rejected claim will be barred by statute unless the creditor commences an action to enforce the claim within the period set by statute. The statutory period is usually 90 days from the date of the rejection letter.

**Accepted Claims:** Accepted claims that are timely must either be paid or arrangements satisfactory to the creditor must be made for repayment. For example, a creditor may agree to waive the corporation's liability for a debt if a shareholder agrees to repay the obligation.

#### **5. Distribution of Remaining Assets**

After payment of claims, the remaining assets may be distributed to shareholders.

The corporation will need to file IRS Form 1099-DIV to report distributions to shareholders. See IRS Publication 550 Investment Income and Expenses.

[http://www.irs.ustreas.gov/prod/forms\\_pubs/pubs/p5500106.htm](http://www.irs.ustreas.gov/prod/forms_pubs/pubs/p5500106.htm)

**6. Receive tax Clearance Notice.** File in financial records.

**7. Close Bank Account**

**8. Store Business Records.** These records should be kept for at least seven years.

### **1104.08 A SALE CHECKLIST**

The sales agreement is the key document in buying the business assets or the stock of a corporation. It is important to make sure the agreement is accurate and contains all of the terms of the purchase. It would be a good idea to have an attorney review this document. It is in this agreement that you should define everything that you intend to purchase of the business, assets, customer lists, intellectual property and goodwill.

The following is a checklist of items that should be addressed in the agreement:

- Names of Seller, Buyer & Business
- Background information
- Assets being sold
- Purchase price and allocation of Assets
- Covenant Not to Compete
- Any adjustments to be made
- The Terms of the Agreement and payment terms
- List of inventory included in the sale
- Compliance with the Bulk Sales laws of the state
- Any representation and warranties of the seller
- Any representation and warranties of the buyer
- Determination as to the access to any business information
- Determination as to the running of the business prior to closing
- Contingencies
- Possibilities of having the seller continue as a consultant
- Fees – including brokers fees
- Date of closing

### **Sale and transfer of shares**

Share dealing is a complex area and specialist advice can be gained from solicitors, accountants and company law agencies.

### **Transfer and transmission of shares**

Shares in a listed company are transferred through brokers using the Stock Exchange Crest system.

Shares in a private or unlimited company are usually transferred by private agreement between the seller and buyer, subject to the company's own rules and approval of the directors.

In the UK you need to pay Stamp Duty when you transfer shares.

Gains made on shares may be subject to Capital Gains Tax (CGT). In certain cases, shares are transmitted by law. This means that in the event that a shareholder dies or becomes bankrupt the shares and the rights associated with the shares are given to a personal representative or executor.

### **Bankruptcy**

Bankruptcy is a legal mechanism that allows creditors to assume control of a firm when it can no longer meet its financial obligations. Bankruptcy is a result feared by both stock and bond investors. Generally, the firm's assets are liquidated (sold) in order to pay off creditors to the extent that is possible. When bankruptcy occurs, stockholders of a corporation can only lose the amount they have invested in the bankrupt company. This is called Limited Liability. The stockholders' liability to creditors is limited to the amount invested. Therefore, if a firm's liabilities exceed the liquidation value of their assets, creditors also stand to lose money on their investments.

When bankruptcy occurs, a federal court official steps in and handles the payments of assets to creditors. The remaining funds are always distributed to creditors in a certain pecking order:

1. Unpaid taxes to the IRS and bankruptcy court fees
2. Unpaid wages
3. Secured bondholders
4. General creditors and unsecured bonds
5. Subordinated debentures
6. Preferred Stockholders
7. Common Stockholders

Obviously, to hold secured bonds rather than unsecured bonds is more advantageous in the event of a bankruptcy. This is where you must examine your risk/reward requirements. As you move down this hierarchy, your risk of losing your investment increases. However, you are "rewarded" for taking more risk with potentially higher investment returns.

How do you predict bankruptcy? Well, no one can do it perfectly. However, one popular method called a Z-score (developed by Edward Altman) has a good track record. To learn more about "Z-scores" go to your local library. We will recap a few of the most important points about learning to analyze a company's balance sheet.

### **Planning the sale**

Know your options before you begin the process of selling your business.

### **Determining Market Value**

Learn which factors affect the valuation of your business, and how having a document prepared by an outside expert can add credibility to your asking price.

### **Finding a Buyer**

Find out how to identify different categories of buyers and understanding their motivations by looking both in and outside your circle of influence.

### **Seller Financing**

With as much as 90% of small business sales involving at least some seller financing, it may be unrealistic to expect to receive a lump sum payment. But financing can be tricky, as agreeing to a long period of payments entails the same type of risk as owning the business and depends on the business' future success. Alternatives may include getting the buyer to use non-business assets as security for the loan.

### **Employee Stock Ownership Plans (ESOPs)**

One way to sell the business to your employees is through an Employee Stock Ownership Plan (ESOP). ESOPs are tax-qualified employee benefit plans that invest primarily in stock of the employer. Significant tax advantages may be available to both an individual selling the business to an ESOP and the employees participating in the plan. The many tax incentives and benefits of employees who

have ownership in the business make such plans attractive even when business owners wish to sell only part of their businesses.

### **Selling to the Public: IPOs and DPOs**

Primarily used to raise investment capital, Initial Public Offerings (IPOs) and the simpler Direct Public Offerings (DPOs) through small company offering registration (SCOR), may be a way of maximizing the return from the sale of your business. If the business is simply trying to obtain financing, there are many other options that should be considered.

## **1104.09 CHECKLIST FOR PROSPECTIVE BUYERS**

The following is a list of information you will need to have available for prospective buyers of your company. You may not have information for every item on this list, but the selling process will be easier and faster if you are well prepared.

### **General Information**

- Reasons for selling the business
- How long has the business been for sale?
- Have there been prior attempts to sell the business which were not completed? With whom?
- What is the selling price? Terms? Seller financing?

### **Background and History**

- Legal name
- State of incorporation and date incorporated
- Form of business (sole proprietorship, partnership, C Corporation or S Corporation)
- Minutes of board of directors meetings, articles of incorporation and bylaws
- Founders and history
- Any acquisitions, mergers or divestitures?
- List of subsidiaries, division, and joint ventures

### **Market**

- Definition of market in which the business operates
- Current market share
- Market trends
- Major competitors
- Products and services
- Sales/profitability of product lines
- Competitive strengths and weaknesses
- Channels of distribution (direct sales, reps etc.)

**People**

- Owners-percentage of ownership
- Officer, directors, managers and key employees-position, age experience. Organization chart.
- Any special skills?
- Total number of employees
- Union or non-union shop? Labor negotiations pending? If union, copy of current contract (s)

**Facilities**

- Location and plant facilities
- Age and condition of facilities
- Utilization/capacity rates
- Leased or owned?
- Environmental studies (Phase I, Phase II, etc) if they've been done

**Operations**

- Production process
- Major suppliers
- Major customers and their percentage of total sales
- Order backlog
- Method of inventory control
- Research and development activities
- Method of pricing products
- Capital expenditures – historical and planned

**Financial**

- Audited financial statements for the past three years and current monthly financials.
- Budget and cash flow information for current year
- Financial projections for the next five years
- Unusual/non-recurring expenses/income
- Description of internal controls
- Capitalization and list of shareholders
- Outstanding debt
- Intellectual property – patents, trademarks, etc.
- Insurance coverage
- Retiree pension and medical liabilities

**Other**

- Names, addresses and contacts of professional advisers including attorneys accountants, bankers, etc
- History and result of any lawsuits brought against the company, including pending actions
- Contracts