Proactive planning for an exit is vital to the successful sale of your business

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It would not be unreasonable to assume that when a person decides to sell any significant asset, they will plan ahead to ensure that the best deal is achieved. For example, when you decide to sell an investment property you may obtain a market valuation and spend some time and money improving the property, in order to increase its value and stimulate more interest in your property from potential buyers. You would probably market the property during the summer months, when the weather is (generally) more pleasant. Such planning is usually motivated by the need to generate maximum financial return on the sale of the asset.

So, when it comes to one of your most significant assets i.e. your business, the importance of proactive planning cannot be over-emphasized, yet we have seen numerous cases where owners of small-medium sized businesses have not planned ahead or have planned very little for a smooth and successful exit or ownership succession in the future. Too often these business owners are consumed by current operations and/or the next innovation in order to stay ahead of the competition.

For many entrepreneurs who have spent most of their adult lives building and growing their business, the opportunity to fully exit the business is a once-off event. Would you rather proactively plan ahead for such an exit or would you leave it to chance?

Ideally, the planning process for an exit should commence at least 2-3 years ahead. The below examples of proactive planning activities are not only relevant in the context of an exit/sale, but also makes good business sense:

a) Know your market, what your competitors are doing and regularly update the list of potential strategic buyers. Timing an exit, is as important as the exit itself. By gathering regular intelligence on the market participants and specifically potential strategic buyers, a seller will be able to benefit from first-mover advantage and will also be better prepared to engage the prospective buyer during the pre-deal discussions and throughout the deal process.

b) Undertake an internal due diligence well in advance of an exit. A pre-exit due diligence is essential and allows a prospective seller to identify any major areas of weakness in or threat to the business, including underperforming areas or aspects of the business. A well-planned internal due diligence allows the prospective seller sufficient time to implement interventions that mitigate those risks. The prospective buyer is less likely to take advantage of such risks in order to motivate a reduced Purchase Price and /or less favourable deal terms and conditions. An internal due diligence would also allow the seller to better articulate the strengths and opportunities of the business, which the seller can leverage during Price negotiations.

c) Improve the level of financial rigor and reporting. Many owners of small-medium sized businesses operate the business as a lifestyle concern, with the lines between "personal" and "business" being somewhat blurred. This potentially leads to valuation or pricing issues and/or business risks that may result in lost opportunities for the seller. Appointing a reputable accounting and/or auditing firm at least 2 to 3 years before a planned exit is a worthwhile investment and will assist in the preparation of robust financial information and audited accounts. This will aid in supporting buyer confidence in the integrity of the financial accounts and reporting standards of the business being sold.

d) Obtain a valuation of your business and understand key drivers (i.e. assets) of value. It is not uncommon for sellers to receive an unsolicited offer and the seller not having a clear idea of what the business is worth. Too often, the prospective seller attempts to 'backward solve' the problem by determining an Asking Price based on the amount of after–tax cash they need, taking into account their personal circumstances. This may result in unrealistic price expectations that could potentially ruin a deal. Without an independent valuation of the business, a seller is unlikely to have an objective view of the fair market value of the business and the minimum value below which a deal may be rejected. An informed seller that understands the value drivers of the business and its prospects, will be better able to respond to unsolicited offers and will also be in a stronger negotiating position. A regular independent valuation will also assist multiple owners of the business to buy and sell shares internally or raise equity funding, if required.

e) Build an 'owner-independent' company by transitioning the business away from owner dependence. The ultimate financial goal of running a successful business is not only to generate profits/cash, but rather to maximize return through the sale of the business. A business that relies heavily on its owner-manager is considered to have higher risk, as the business may suffer should anything happen to the owner. In addition, a prospective buyer of an owner-reliant business is likely to insist that the seller commit time (12 months or longer) and know-how to the business post the sale, to ensure a smooth transition. This may not be ideal, if the seller's intention is to step away completely from the business, a few months after the sale.

Other benefits of building an owner independent business include:

i. It provides other staff members with the opportunity to assume leadership roles, thereby providing both personal and professional growth. A strong management team, will add value to the business when assuming leadership roles, ultimately strengthening the management of the business.

ii. By spreading the leadership responsibilities, the owner is able to enjoy more freedom to focus on those areas of the business that he/she is passionate about, instead of struggling to keep pace with all of the affairs of the company.

iii. It also creates a platform for a more stable and scalable business that relies on robust systems, policies and processes, instead of an individual.

f) Carefully manage investment in working capital and fixed assets. The effective and efficient management of working capital and non-current assets, as well as, related short-term and long-term funding requirements, are critical to optimising and preserving the financial health of the business and ultimately contributes to maximising value. If this is an area of weakness, the prospective seller should instill discipline around working capital management and capex as soon as possible, but at least two years prior to a planned exit. This allows a clear trend to be observed, which will allow the seller to better understand and efficiently manage the average working capital requirements and long-term capital funding needs of the business. Both these elements may have a significant impact on the final transaction price achieved, which takes into account material changes in these balances between *Effective date* and *Closing date* of the transaction.

g) Become adept at preparing robust financial projections for periods of 3 to 5 years, where possible. If this is not possible, then at least prepare a robust one-year budget. Design and implement a 'bottom up' approach to forecasting and monitor actual versus budget over a number of years. Tweak the forecasting process to ensure continuous improvement in and overall reliability of the forecasting process. This process will allow the prospective seller and/or management team to:

i. set stretched, but realistic targets to achieve the forecast growth in the business;
ii. proactively respond to variances between actual performance and budget; and
iii. create a track record of preparing forecasts, backed by defendable underlying economic and growth assumptions and opportunities.

These forecasts, would typically form the starting basis from which the prospective buyer develops its own projections for purposes of their valuation and offer.

Conclusion

Even if the current business owner(s) do not intend to sell the business in the foreseeable future, the above planning strategies and activities will only serve to strengthen the operations, improve the financial performance and ultimately increase the value of the business.

When it comes to selling/exiting your business, seek advice from trusted professionals who have the appropriate experience and expertise.

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