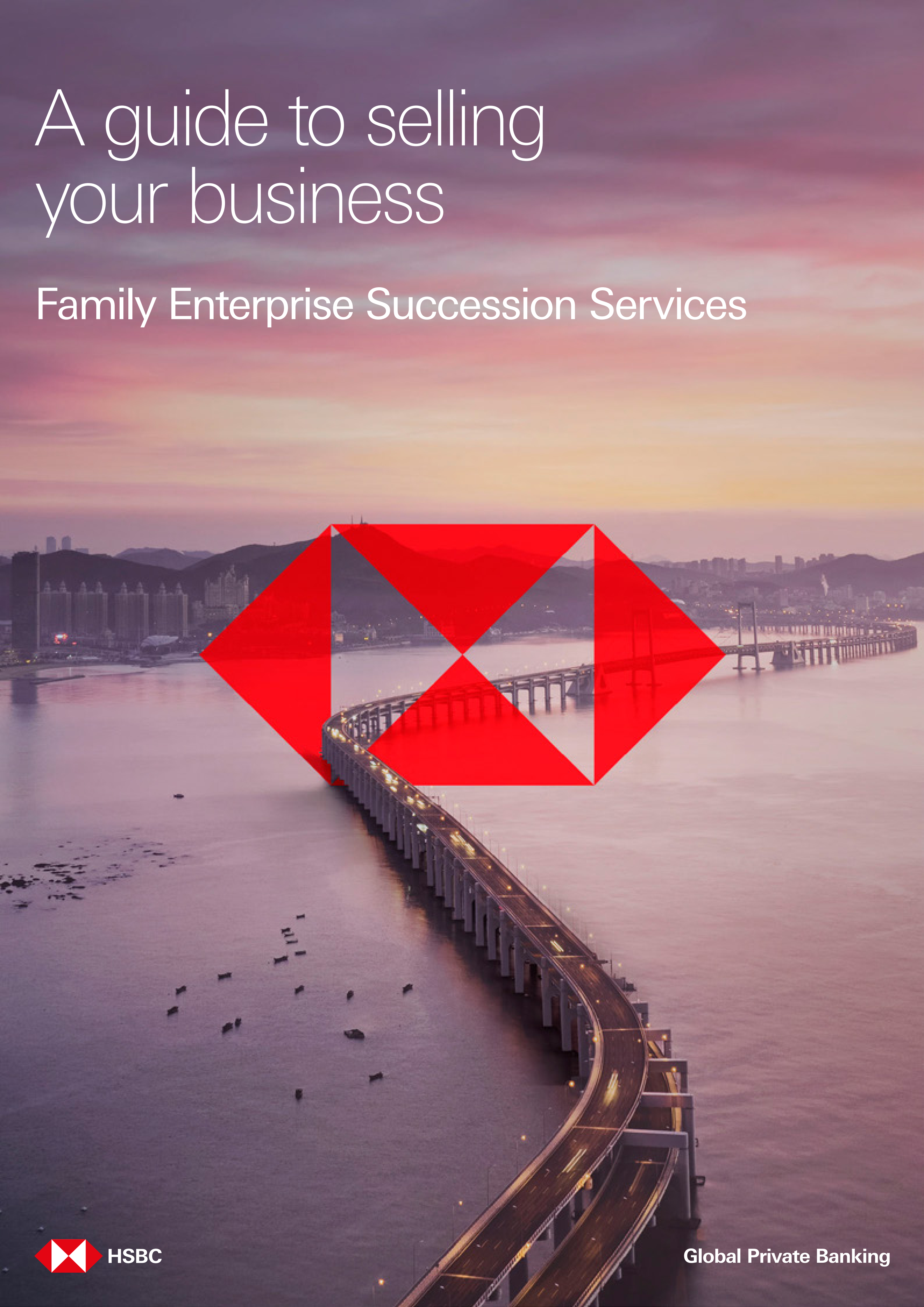
A guide to selling your business

Family Enterprise Succession Services



HSBC

Global Private Banking

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Introduction

Your business started with a plan. Make sure you leave it with one.

Selling your business is complex and emotionally demanding. Deciding to do so should take a great deal of consideration.

Yet, our experience and numerous surveys of business owners show that this is often not the case.

A business sale process can be triggered by unexpected events: a family situation; an issue between business partners; concerns about future trading prospects, or an unexpected offer for the company. But it can also happen purely as a result of a lack of planning ahead.

Being prepared for the expected or the unexpected should help you achieve a more positive outcome for yourself and your family, your personal finances and the business itself. In this guide, we set out a series of key steps to help you through these three areas.

Preparing your Business for Sale

Selling your organisation takes some organisation.

It may be your life's work. Or a family concern that has been through several generations. Or an enterprise you have grown quickly. Whatever type of business you own, you are likely to have a clear picture of its strengths and its weaknesses. When you mull over selling it, there are eight key areas to think about.

The sale objectives
Start with a clear understanding of what you want to achieve. Maximising value is the obvious goal, but it may be about more than that. For example, you might be looking to leave your business right away, and want a quick and clean sale. Alternatively you may be looking for a more gradual winding-down, and be prepared to stay on for a period to support the transition period. If you have a long-established family business, you may like to consider protecting key employees, the location of the company or the community in which it is based, or its products and services. It is critical to identify and prioritise your main objectives, as well as any potential deal breakers, up front.

Team of advisers
Assembling the right team of advisers is essential. They're responsible not only for your future finances, but also for something you've dedicated so much of your life to.

You will need to assess their track records in business sale transactions in your sector and at a level relevant to the size and likely value of your business. Personal chemistry is also important.

They will have to discuss sensitive and challenging issues with you, and you need to feel that they're on your side, even when times are difficult.

Your team should also help you explore a range of potential buyers, including much bigger or foreign businesses, and they should be able to cope with their different approaches and demands.

The story

At the heart of it, getting your story right is aligning what you are selling with what they are buying. You know your story best; the hard part is recognising what a buyer might see as valuable. Their perception of value might not be in the area of the business you have been focusing on.

Consider how your business is perceived in the markets in which it operates and what differentiates it from competitors. What questions will the buyer ask? What information will they want to see? And what issues do you know lie under the surface? Addressing these questions and building the story will be a good start to your preparations.

Your systems and data need to be in good shape – in sales, operations, and finance – and the sooner the better.

In sales, customer contracts and other documentation should be in order. All production facilities should be well presented; asset values and depreciation should make sense; and quality reviews, safety records or other regulatory and compliance documentation should be up to date.

Human resources and administrative functions need to pass inspection, too. So it would be good to carry out a thorough review of the risk register or a fundamental risk-review exercise.

Management accounts, financial accounts and accounting policies all need to be in good order. Finance operations must be running smoothly. Ideally, the financial performance of your company would be in line with the key industry performance metrics. Any variances – positive or negative – should have clear explanations. Finally, any family assets, personal assets, or non-business-related items need to be separated from business-related finances.

The aim is to present your company as one that's in good working order with few, if any, surprises. Questions can be answered swiftly and accurately. If that can be accompanied by steady growth and stable profitability, the buyer will be optimistic about future target profits and cash flows, and you will minimise areas for potential negotiation.

The management team

Selling your business may be hard enough; tackling the issue of owner dependency can be even harder.

Business owners seeking a clean break need a management team who can take the business forward. For owners heavily involved in the operations and synonymous with the brand, the question will be whether they can withdraw without damaging the business's value. Even owners who have built a strong management team often believe their own role to be crucial to success; they may have trouble letting go.

Demonstrating that the business organisation and management can support continuity is critical to maximising buyer interest and value.

Time and timing

External factors, business and personal considerations can all affect the timing of a business sale.

Thinking ahead can help you to be prepared if you do receive an unexpected bid. For several reasons, however, it is ideal to maintain as much control as possible over the timing.

Firstly, selling at the right time in the economic cycle, or in the cycle for your industry or market sector, is an obvious factor in the price you are likely to achieve.

Another key factor, though perhaps harder to determine, is the optimum stage to exit in the life of your business. Selling too early might mean that the buyer – not you – will enjoy the benefits of the company's growth. Wait too long and the business's prospects may have flattened out, with a knock-on effect on the value.

Also, it is important to understand how the sale process will affect your business, as it can be very unsettling for people. This applies not only to management and staff, but also to customers and suppliers. Think about when will be the right time to start having conversations with your team, and how they're likely to react.

Finally, consider what might happen if you have prepared yourself, your business and your team for the sale of the business, and the sale does not proceed. This, too, can affect your business's performance.

The buyer universe

In high-level terms, buyers can be split into two groups:

Trade buyers (sometimes referred to as strategic buyers) typically operate in the same industry or sector and are looking to create synergy with their existing business. They may want to expand or consolidate market share; extend their product or service range; bolster or establish a presence in new markets; or create internal or vertical synergies. They may also be looking at more intangible value – intellectual property, brand, reputation or heritage, or a specific area of excellence.

Financial buyers, on the other hand, are generally seeking to acquire a business for the potential return on their investment. They may be able to bring value to the company in optimising some of their operations or capital structure. Their actions after acquiring a business will be guided by that goal.

In certain cases, you may also find that some or all of the management would like to buy the company with a view to continuing its success. It is not unusual to see management teams pair up with financial buyers to finance a transaction.

While not a category in its own right, international or overseas buyers should be kept in mind. They are likely to be seeking to create a footprint in a new country or as a basis for international expansion, but avoiding the need for greenfield investment. They can be hard to identify and their motivations may sometimes be unclear.

Business plan

You had a plan for your business. In preparation for a sale, you need to review that plan objectively but through the eyes of potential buyers. At the core of this will be the trading prospects of the business, and the profits and cash flows that can be generated.

Buyers might perceive value in the business as a whole, but it is equally likely that they will have an interest in a specific part of it. If there are obvious areas of interest to potential buyers, present your projections in a way that makes the value clear to them.

This exercise may highlight areas that buyers undervalue, and that you might decide to remove from the sale. It might also expose areas of unrecognised potential, allowing you to achieve a higher price.

Valuation

The value of the business will be in the form of a range rather than a single figure, depending on the buyer and their type of interest. You will have to form a view of the minimum acceptable value to you, which is more easily done once a valuation exercise is performed.

For trading businesses, the valuation is typically calculated as a multiple of profits. There are two factors at play here – the level and trajectory of profits, and the multiple the buyer is willing to pay. However, certain sectors, industries and business types have valuation methodologies specific to themselves.

Clearly, a track record and projection of solid profitability is optimal, in a way that erratic or falling profits are not. Other factors include: the prospects of the sector in which the business operates; a strong and high-performing management team that will stay with the business; scalable business activities that can be replicated and grown in a cost effective way; and a strong brand that can be used to penetrate new markets.

Preparing you and your Family for the Sale of your Business

You are not just dealing with money. You are dealing with emotions.

Do not underestimate the personal impact of selling your business. It is likely to be a fundamental change to the way you lead your life—from how you spend your time, to the relationship you will have with your newly generated wealth. With planning and preparation, you can cushion the emotional impact of selling your business.

Many business owners hesitate to do more than a minimal amount of planning and preparation on the personal front. They cite an almost superstitious belief that they don't want to "count their chickens before they hatch" or "jinx the deal".

This is entirely human, but it's also counterproductive. Planning and preparing won't only make it easier to separate yourself from the past; it will also make you better prepared to get the most out of what comes next.

The emotional aspects of a sale.

Before you start planning, identify and address the emotions you feel. Typically these emotions take four main forms: the sense of loss triggered by the sale of the business; the emotions that will arise from the sale process itself; dealing with the impact of the sale proceeds; and finally, anxiety about what the future holds.

The sale

It is highly likely that you will feel a sense of loss when your "baby", however big it is in reality, is no longer there. The enterprise you have nurtured for so long will no longer be yours. This will be even more acute if the company bears your name or has been in the family for generations.

The deal

The second area of emotion concerns the deal itself. A huge amount of effort and strong feelings will go into preparing the business for sale, and the pressure will rise as the sale date nears. Potentially significant wealth is intertwined with the fortunes of the company, and much of this will be in the hands of others – your advisers and the buyer. Will the economic environment hold steady? Will the sale actually take place? What happens if something goes wrong?

The proceeds

Until now, it is likely that a significant portion of your wealth will have been on paper, in the form of shares in your business. Your income will have been driven by what you have drawn from the business, whether by salary, bonuses and/or dividends generated, and you may have been reinvesting any surplus wealth back into the growth of the business.

The arrival of the sale proceeds, very likely a significant sum, may well be something that you and your family have not experienced before. How to structure and invest it? For what aims and objectives? Is it enough? Will it affect the relationship you and your family have so far had with money and wealth? These are questions you'll need to consider.

Your future

This is the big question, and the one that people are less likely to ask themselves until they're faced with it. What's next for you and your family? After the sale, your routines will have changed, as will your finances. How will this affect you? Clearly the sale of a business will give rise to many positive opportunities as well: how will you take advantage of these?

Once you have pinpointed your areas of concern, our experience suggests that these emotions can be tackled by creating a clear vision in three areas:

- A vision for the wealth;
- A vision for your future; and
- A vision for your family's future

A vision for your wealth.

Creating a vision for your wealth may need a more philosophical, longer-term reflection on the purpose of the wealth, rather than an immediate focus on what to do with it. You may recognise that sudden, significant wealth can come with both positive and negative effects.

After due consideration, your vision may be to secure your lifestyle for your lifetime. You may wish to preserve your wealth for you and your family, including future generations, or to reinvest and grow it. You may have philanthropic aspirations as well.

A long-term vision created by and for you alone may not be enough. Is it inclusive? Has your spouse or partner been involved? Have your children and possibly even your parents had input? And, finally, does everyone agree with your vision?

If the answer to any of these questions is no, it is likely that things will get difficult down the line. Frustration, unmet expectations, and perceived unequal treatment are at the heart of family difficulties that can be caused by wealth.

Whatever form the vision for your wealth takes, understanding it will help you formulate clearer objectives when you start planning your financial future.

A vision for your future.

A critical area for consideration is what you will do next. Given the focus on growing and developing your business, and more recently on the sale process, it is not surprising that planning for your future might have taken a back seat.

Whether you are seeking a full retirement from your business, taking well-earned time out from a full-time role, or looking to move to a new and different role, this transition is likely to benefit from planning and preparation too. There are many potential roles out there – from setting up a new venture, to volunteering your time and expertise. The challenge is to identify which is right for you.

As someone who has owned and run a business, you are used to being in control. Ask yourself whether you would be comfortable in a role with less direct control, such as an investor. Also, what do you enjoy most about running a business? Are you at your best as creator, in a management role, or could you move into a more advisory, governance role?

A vision for your family's future.

You will have thought about your vision for you and your wealth; now you should think about how the sale of your business may affect wider family relationships. This is counted in decades, and will include:

- Marriages, separation and divorce
- Children and grandchildren
- Education
- Long-term illness and elderly care
- Bereavement

Beyond the sorts of life events listed above, the sale of a family business will change the lives of your family members. How you spend your time, how you get things done and what family members expect from their own future will be reshaped by your wealth.

You should pay particular attention to what it means for your children, because they are likely to have been less involved in the management of your business and your wealth than your partner. Our experience shows that the next generation's level of understanding of parents' intentions tends to be much lower than parents think.

Family context, history and principles will have a bearing on how your family's relationships are affected by the sale of the business. But it's not just about that; external factors play a role, too.

The extent to which these factors may have a role to play may well depend on where the respective generations are in their lives, and how their life stages interact with each other. For instance, as a parent you are likely to be a member of the senior generation or a baby boomer, whereas your children are probably Gen X, Millenials or Gen Z. The relationships between the generations matter because each generation sees the world in their own way, has different expectations and objectives, and reacts to situations in contrasting ways.

Take time to reflect on the paths you and your family have been on—in terms of education and of personal, career or family development—and where you each want to go next.

Preparing your Personal Finances

When you're done with your business, what will you do with your wealth?

While your immediate focus is likely to be on preparing your business and yourself for the sale, you should also take time to consider your ultimate destination. As the saying goes[1], "If you don't know where you are going, you will probably end up somewhere else".

In our experience, for those who have thought about it, the range of objectives varies widely. Some are thinking about retirement. Others look to take off the table the undercurrent of risk that goes with running a business by building a ring-fenced pool of investments.

Others, still, want to reinvest some or all of the proceeds in starting or investing in and growing a new venture. And yet others want to provide for their family. Philanthropic motivations are important for many. And of course, some want to do a combination of these things.

Clarifying your objectives can help you chart a course to achieve the outcome you want. Then you can balance the demands that will undoubtedly be placed upon you with the need to protect the wealth you have generated.

Also, what if you were to die prematurely or suffer serious injury before your business was sold? To be prepared, you should have already taken the necessary steps to make sure that you and your family's interests are adequately protected. In particular, address these questions:

- Is your will up to date, and have you put in place an enduring power of attorney?
- Do you and your family have appropriate insurance in place?
- If you are the sole owner and director, who takes control should you pass away?
- If your company has more than one owner, is there a well-drafted shareholder agreement in place to provide legal clarity about how your shares are dealt with? This agreement can include an option giving the other owners the right to buy your shares, or your heirs the right to sell after your lifetime. Shareholder cohesion and unity of purpose is usually critical to the future success of any business, so the importance of having an effective "Business Will" in place cannot be overstated.

Crucially though, you must understand how all of the above elements fit together. Also, who within your family or group of trusted advisers knows what protections are in place or what to do should the need for the protection be triggered?

In the next sections we address some of the broader personal financial planning considerations you should keep in mind before and after the sale.

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[1] Laurence J. Peter

Structuring your wealth.

Anticipating the successful navigation of the sale, you will need to consider how to structure and invest the proceeds to achieve your objectives. How you go about this is a personal decision, but not a straightforward one.

Some of the key issues you need to consider are set out below:

- In the longer term, who is to benefit from your wealth and estate?
- And importantly, when, how and in what proportions do you plan for them to enjoy that benefit?
- If you are not there, who will manage this for you?
- Will your family have sufficient funds to meet important obligations?
- Is your wealth or family spread across a number of jurisdictions?
- Are you concerned to protect your wealth from family disputes, difficulties around succession or events such as divorce?
- How will you achieve your philanthropic aspirations?

A range of structures or approaches are available to assist, although they do vary from jurisdiction to jurisdiction. For instance:

- Trusts and other dynastic structures can facilitate your longer-term succession planning and provide protection against potential threats to wealth such as: incapacity; death; divorce; business litigation; family fallouts; loss of privacy
- A clear articulation of the governance arrangements for the wealth structures you have in place will help your family and advisers understand the present and future goals of the family, its wealth and businesses, and will provide clear guidance to them regarding their management
- Some families set up or use family offices or investment companies, particularly where there's an intention for a shared approach to the management of the wealth and family affairs
- Insurance solutions are appropriate for some families, as they can enhance investment efficiency and provide estate planning benefits, as well as providing protection in case of unforeseen events
- If you want to protect your ambitions to give back to society, you can use philanthropic structures
- Or you could decide to keep things very simple and invest in your own name

Fiscal considerations.

You may decide to move into another venture, retirement or some combination of these. In any case, you will want to know the capital amount you need to secure the right income to fund your lifestyle and achieve your wider objectives. This should be calculated net of tax, inflation, and management charges.

Don't put this off. It is important to know as early as possible whether the expected sale proceeds will meet all of your future needs. In extremis, this may influence your decisions about proceeding with or the timing of the sale, or your post exit plans.

Doing this before entering sale negotiations will help you to understand how flexible you are prepared to be on the structure of the sale. Are you looking for a clean exit? What degree of deferred consideration or ongoing commitment would you tolerate? How much flexibility is there in the offer price? Asking yourself these questions will allow you to test your plans, and help ensure you achieve your personal financial planning goals as you leave your business behind.

Well ahead of any sale, you should check your position and potential options in relation to the range of taxes that you might be faced with. If you leave this too late, you may find you have lost the opportunity to optimise your position.

Investing your wealth.

Let's assume that: you understand your overall wealth objectives; you have appropriate protection in place; and you've explored the fiscal planning and structuring. Now there's one final area to consider: the investment of your wealth.

Your wealth may be in a number of different forms. So you might need to assess the issues relating to this for each form, as well as at the overall level across all forms of your wealth. Here are a number of key issues to explore:

Investment objectives
These are typically expressed in terms of the level of return that can be generated, balanced against a level of risk that can be tolerated, with an understanding of the time horizon over which the investments' objectives are anticipated to apply.

You can consider the level of return you're seeking as income generated from the investments, or a level of growth in the underlying capital values of the investments, or perhaps a balance of the two. The level of risk you can tolerate is not just about the loss of principal, but also the degree of volatility in the values of the investments. The time horizon is important as it will clarify the points in time the investments will need to be accessed.

Diversification
Diversification in your investment strategy should allow you to protect yourself from a number of risks. Using different investment products and/or structures can protect you from fiscal and legislative risk. Spreading the ownership of the assets across your family can help you to spread fiscal risk. And, finally, diversification of asset types, commented on more below, can enable you to avoid concentration risk.

Asset allocation
The mix or blend of investment types, or asset allocation, that you choose will be a key driver in the level of return you're likely to achieve as well as the amount of risk you are likely to take within your portfolio of investments.

Asset allocation recognises that each type of investment has different return and risk characteristics, and that by seeking to balance those, you're aiming to reduce the level of volatility within the portfolio whilst aiming to increase the return.

Advice and management approach

Advised and managed or self-advised and self-managed? Where will you get the advice and management for your investments from? For some people the answer is to do it all themselves. For others, it's to retain or appoint investment advisers and managers. Be sure to propose the question regarding the level of advice needed in respect of all of the types of investment in your portfolio; you may need to appoint more than one adviser or manager.

Performance reporting and custody

It's important to be able to see the different performances of your investments together, particularly where you hold your investments in a variety of forms. Then you'll have a holistic picture of the level of return being generated and the level of risk embedded within those investments. Review their performances continually against your investment objectives to make sure your strategy remains appropriate for your needs.

You also need to understand the nature of the providers and arrangements through which your investments are being held – the custody arrangements for your investments. This area is often overlooked, with more focus applied to reviewing the objectives and performance of your investments.

Custody risk comprises several areas and is critical to the safety of your wealth. The primary issue is one of counterparty risk – the strength and liquidity of your custody providers. Just as important as the counterparty risk of your main custodian is the understanding of the sub-custodians they employ. Other areas of concern are the level of transparency and control in the arrangements you have in place. This relates to the arrangements for title of the assets and the level of segregation in place, which will define the extent to which individual client assets can be identified.

How can we help?

When you are ready to start planning your business exit, we can help you understand what you need to know. We can help you to find a balance between your head and your heart, and reach the outcome that's best for you.

Together, we can explore what a good exit might look like for you. In support of this, we specialise in a number of areas that are key to the business exit process. These include investment structuring, passing on wealth to future generations, and securing your wider legacy.

Having worked with business owners all over the world, we understand entrepreneurs and their vision for wealth. As their partner, we help them grow, manage and preserve their wealth effectively.

To learn more about the ways HSBC Private Banking can support you during the planning and execution of your business sale, please contact your Relationship Manager.

www.privatebanking.hsbc.com

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