An Introduction to Selling Your Business

Business Information Factsheet

BIF150 · November 2016

Introduction

There are many reasons why someone might consider selling their business: they may be about to retire; they may have been made an attractive offer of employment; or the business may be about to fail. Whether a business owner chooses to sell their business to their employees, business partners, shareholders or a third party, selling a business can be a complex and lengthy process. The approach to the deal will depend on the owner's reasons for selling, and it is vital to seek professional support and advice in order to achieve the best result of a sale.

This factsheet explains how to prepare a business for sale. It covers the legal and tax issues, how to plan the sale, the process of finding a buyer and how to negotiate a sale.

Planning the sale of a business

For someone who has set up and run their own small business for many years, selling it may be an emotional experience and planning for such a change is never easy. However, it is essential that any decisions taken are rational and objective. If the business owner is about to retire, they may be able to time their retirement to maximise the sale price. Selling due to ill health may require a quicker sale, but if the business is in a good state, it need not be immediate. If the business is in crisis, a low selling price may be necessary for a quick sale before the owner loses more money, although selling it at all may be a challenge in such circumstances.

Other reasons for selling include receivership, bankruptcy, death, divorce and partnership feuds. Some people simply want to sell their business because they have spotted what they think is a better idea and need the money to exploit it. Others recognise that their strength is in starting a business rather than managing a process that is ticking over steadily or slowly growing a business. On the other hand, there are many people who would like the thrill of owning and running a business, but don't feel that they have the skills or the appetite for risk to start from scratch. Issues that should be considered in the planning process include:

- Is the intention to sell the business outright or retain a minority stake? Do any of the directors or shareholders want to retain involvement in the business in a managerial role?
- How will the sale affect staff and other stakeholders? How will morale be maintained? Will there be any implications for staff relating to employment protection rights under the Transfer of Undertakings (Protection of Employment) Regulations 2006? See BIF 217, A Guide to the Transfer of Undertakings (Protection of Employment) Regulations 2006, for further information.

Using professional advisers

Professional advisers will help secure the best price for a business, minimise any tax liabilities, smooth out negotiations and comply with relevant laws. They will provide an objective opinion on the sale, unaffected by any emotional attachment the owner may have with the business, and they can act as a buffer between the seller and the buyer. Anyone selling a business will need to engage with the following professional services:

- **Financial adviser** - A corporate financial adviser will help the seller consider their options and guide them through the process. Some organisations have considerable experience in disposing of businesses and may even be able to help find potential buyers.
- **Solicitor** - A solicitor will draft and negotiate legal documents and help the seller stay within the law. If the sale of the business includes property, it is advisable to use a law firm that has experience of business conveyancing.
- **Accountant** - Taxation issues are complex when selling a business and usually call for specialist professional advice. An accountant will produce the relevant financial statements and reports for the prospective buyer, and can also organise final payments when the deal goes through.
- **Chartered surveyor** - A chartered surveyor can help to ensure that the value of the various business assets is fully reflected in the asking price. In a forced sale, an accurate valuation of all assets is especially important because other factors, such as goodwill, can be harder to place a value on.

Legal and tax issues

The legal status of the business being sold is very important as it defines exactly who owns the various assets of the business.

Sole traders and partnerships

If the business is owned by a sole trader, they own all the assets of the business and they can decide how the assets are sold. Similarly, partners own their share of the business assets and any sale must be agreed according to the provisions of the partnership agreement. In either of these cases, it is not the business that is sold, as the business has no separate legal existence. It is the fixed assets such as equipment and property, intangible assets such as the business name, intellectual property and goodwill, and stock that are sold.

A number of taxation issues can arise from the sale of a business that is owned by a sole trader or partnership:

- The revenue from the sale of the business is classed as income and therefore the seller's income tax status is likely to change when the business is sold. They must therefore inform HM Revenue & Customs (HMRC) of this change. Go to www.gov.uk/browse/business/selling-closing for further information.
- Capital Gains Tax may be due on the disposal of the assets. However, the seller may be entitled to some relief on gains under the Entrepreneurs' Relief scheme. Go to www.gov.uk/capital-gains-tax-businesses for further information.

- VAT may be payable on part of the transaction. Go to www.gov.uk/vat-registration for guidance.
- Depending on why the business is being sold, there may be implications for inheritance tax.
- Stamp duty may be payable by the buyer.

The timing of tax payments can be critical and it is important to seek professional advice well in advance of any potential sale.

Limited companies

A business that operates as a limited company is a separate legal entity from its owners and in this case, there are two options for selling the business. The business can be sold in its entirety by selling the shares in the business. However, buyers are sometimes wary of taking on hidden liabilities in a business, so they may prefer to purchase only the assets and goodwill of the business.

Preparing a business for sale

It is not usually possible to complete all the necessary preparation in the last few weeks before putting a business on the market. There are steps that can be taken to prepare a business for sale that can enhance the price, although it may be necessary to start this process years in advance.

It is important to consider the following points:

- Is it possible to reduce as far as practicable all discretionary expenditure, for example travel, entertainment and running expensive cars?
- Look carefully at all essential expenditure. Are there ways this can be reduced without cutting back on vital areas? Potential buyers will look for consistent expenditure patterns across the business.
- Set up processes to ensure that customers pay on time, so the business can demonstrate a good, creditworthy client base and a positive cash flow.
- Make sure that any property is well maintained. If the business operates from a leasehold property, review the arrangements for tenure and rent reviews and check the terms of your lease to ensure that it can be assigned (a third party can take over the rental agreement).
- Machinery and equipment should be kept in good condition, ideally with ongoing maintenance contracts.
- Where possible, make improvements to working capital by reducing excess stock levels and making better use of creditors.
- Many businesses depend on the skill and experience of certain key employees. Employees should be kept informed in order to minimise the disruption the sale may have on them.
- Buyers will be keen to ensure the continuity of supply, so can the loyalty of key customers and suppliers be secured with long-term contracts? If the business operates under licence, it should ensure that the licence is transferable to any potential buyers.

The sales memorandum

A sales memorandum is a brief summary and profile of the business. It enables potential purchasers to decide whether they have enough interest in buying the business to take further steps. Commercially sensitive information should be excluded, while any positives could be highlighted. Misleading statements, however, should be avoided.

The following areas should be included in the memorandum:

- Business overview.
- Ownership.
- Reasons for sale.
- Management and employees.
- Assets.
- Financial summary.

It is usual to send a disclaimer with the memorandum and any further business details, stating that the sellers do not guarantee the information given.

It is important to be clear from the outset what is being sold - shares or assets - and present this in such a way that serious buyers can quickly understand the price. Potential buyers will require detailed accounts so they can carry out their own evaluation of the value of the business. See BIF 283, Methods of Valuing a Business, for further information.

Finding buyers for a business

While business owners need to reach as many potential buyers as possible, discretion is also important in order to maintain customer and employee confidence. It may be necessary to approach buyers directly and they may come from a number of sources, including competitors, suppliers, customers, new market entrants or existing staff.

Before providing any confidential information, it is important to ask a potential buyer to sign a confidentiality letter or agreement (this usually relates only to information that is not publicly available), after which the sales memorandum will be released, with a deadline for their response.

If it is necessary to advertise the sale of the business, it is possible to get listed in online directories of businesses for sale such as Daltons Business (www.daltonsbusiness.com), BusinessesForSale.com (http://uk.businessesforsale.com) and RightBiz (www.rightbiz.co.uk).

It is also possible to use a business transfer agent or an estate agent who is experienced in handling business sales. A business transfer agent can help to locate a buyer in confidence, but they do not usually act as financial or business advisers.

Negotiating the sale of a business

As with any negotiation, it is important to set objectives for the sale of a business.

The valuation is the basis for setting price objectives. There will be an upper limit from which negotiations may start, and a lower limit that usually depends on how quickly the owner needs to sell.

Potential buyers could be persuaded to make an initial offer. This helps eliminate those not even close to the favoured selling price. Serious buyers can then be given more detailed information on the valuation and be invited to a series of meetings, views and inspections. Potential buyers should also clarify any conditions of purchase they specify at this stage.

A Heads of Agreement document should then be drawn up. This is not a final contract; it is merely a good indication of commitment to the sale for both parties.

Hints and tips

- The planning process for the sale of a business must be started as early as possible.
- Professional advice should be sought early in the process and any decision-making should be based on the advice received.
- A realistic selling price should be set from the outset.
- It is important that the business continues to run smoothly throughout any sale negotiations.

Further information

BIF 38 Choosing and Using an Accountant
BIF 120 A Guide to Buying a Business
BIF 171 A Guide to Understanding Bankruptcy
BIF 217 A Guide to the Transfer of Undertakings (Protection of Employment) Regulations 2006
BIF 283 Methods of Valuing a Business

Useful contacts

The British Private Equity & Venture Capital Association (BVCA) is the industry body for the private equity and venture capital sector and can help with finding a corporate financial adviser.
Tel: (020) 7492 0400
Website: www.bvca.co.uk

Cobweb Information Ltd, Unit 9 Bankside, The Watermark, Gateshead, NE11 9SY.
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