Selling a business

Introduction

The sale of a business as a going concern usually involves the sale of the assets of the business i.e. the goodwill, plant, fixtures, fittings and stock. Where the business is operated as a private limited liability company there may be advantages in selling the shares in the company.

In both forms of sale there are taxation, financial, and accounting issues, which must be considered and for this reason we advise you to ***consult both your accountant and ourselves before you offer your business for sale.***

In the remainder of this paper we will discuss the issues involved in the sale of the assets of a business.

Purchase price

In addition to the value of the plant, fixtures, fittings and stock included in the sale of a business it is usual to add an amount for goodwill. The breakdown between goodwill and plant, fixtures and fittings is very important because if you sell the plant, fixtures and fittings for more than their depreciated value the amount by which the sale price exceeds the depreciated value will be treated as profit on which you must pay tax. For this reason it is desirable for a vendor to increase the value of the goodwill to the highest price the vendor can negotiate with the purchaser.

The purchaser will require details of the plant, fittings and fixtures included in the sale price. Prepare a schedule of the chattels and give the schedule to the agent. Do not value the individual chattels. Leave it to the purchaser to determine if the chattels are worth more than the depreciated value. If you intend to start another business exclude from the schedule any chattels you want to take with you.

How do you value a business?

There is no one method that can be used for all businesses. Different factors affect the value of a small business from those affecting a large business. As a general rule, an experienced business valuer will consider three methods:

1. Asset-based which focuses on the assets of the business;

2. Earnings-based which focuses on the future earning capacity of the business; and

3. Market based which focuses on evidence of recent sales of similar businesses.

An experienced valuer will use all three methods in determining the value of a business.

What is different about small businesses?

A small business is typically owner operated. The accounts are probably unaudited and contain hidden benefits for the owner. It is more reliant on the owner's skills and motivation. The primary reason for ownership may be employment rather than investment. Most New Zealand businesses are small. 92% have 9 or fewer employees.

What factors affect the value of small and mid-sized businesses?

Historic profits, trends and future growth prospects are vitally important. There is also a number of non-investment factors affecting the price the market pays for smaller businesses. Buyers may pay more for a business that offers an attractive lifestyle such as a holiday camp, bookshop or beach store. In times of higher unemployment there is a strong demand for businesses providing employment for the buyer and possibly family members. Businesses that offer a challenge, independence and growth may command a premium.

Is price different to value?

Yes. A valuer will usually provide an opinion of fair market value. Basically this is the cash value a willing buyer will pay a willing seller where both parties are fully aware of the relevant facts and neither is compelled to buy or sell. In the real world price may vary significantly from value depending on the motivation of the parties and their respective negotiating skills. The value of a business and the price paid varies from place to place and at different times. For example, a business in Auckland will generally sell for more than a similar business in Whangarei or Gisborne. A business that does not demand strong language skills, such as a takeaway bar, will sell well in times of heavy immigration.

7 ways to get the top price for your business!

Price it right!

If you price your business too high the serious buyers won't even look at it. Price it too low and you are throwing away hard-earned money. An experienced business broker can guide you on what the market is paying for similar businesses to yours and what else is on the market (your competition).

Present it right!

You will get a better price if your business is sparkling clean and tidy - right from the outside signage to the interior, office, and storage areas. And your plant and equipment should be in good operational order and repair.

Prepare for the sale!

Buyers (and their accountants) will want to see up to date figures - financial accounts, daybooks, banking and GST returns. Also leases should be available for inspection and have a reasonable term to run. Being ready with this information keeps the sale moving along.

Allow time to sell!

On average businesses take 3 to 4 months to sell. If you have to sell in a hurry you are in a weaker negotiating position and likely to get less. Sell at the right time for you.

Write down your systems!

Show the prospective buyer how easy it will be to takeover. List your suppliers and major customers, the jobs to be done, the hours of operation, service providers and what records must be kept.

Be totally honest!

When discussing the business with a potential buyer tell it "***warts and all***". Even if it is only a small fib that the buyer catches you on you will lose his/her trust - and probably the deal.

Worse, if it is a large lie ("***a misrepresentation***") then you could end up in court. We live in an expensive and litigious age and there is all sorts of legislation affecting business sales.

Use a business broker!

Do what you do best - carry on running your business in the best possible way. An experienced business broker can guide you on price, advertise and market your business widely, maintain confidentiality, qualify genuine buyers, protect you from the legal pitfalls, produce offers and prepare contracts - and use their negotiating skills to get you the best possible price.

Goods and Services Tax (G.S.T.)

GST is a factor to be considered in the sale of a business. Certain criteria must be met if the sale and purchase of the business is to be zero rated (i.e. no GST is added to the sale price) under the Goods and Service Tax Act. If the sale is not zero rated and GST is payable it is important to check with your accountant as to when the GST is payable, otherwise you may be faced with a bill for GST before you receive payment of the sale price.

For a sale to be zero-rated the business must be sold as a going concern to a person or company registered for GST at the date the agreement for sale and purchase is signed, if the sale is conditional, or by the date the agreement is declared unconditional.

Lease of premises

The duration of the lease and rights of renewal are very important. Some financiers will not consider advancing funds to purchase a business unless the lease has at least 6 years to run. It is common for a lease to restrict the type of business (the use) that can be carried on in the premises. If your business is not very successful and you wish to transfer the lease to a purchaser who wishes to use the premises for some other use it will be necessary to obtain the written consent of the landlord to the change of use.

When you transfer the lease to the purchaser you will remain liable under the lease until the term of the lease including any rights of renewal expires or the lease is changed in some important manner without your consent. For this reason when you sell your business it is important to find a financially sound purchaser because if the purchaser becomes bankrupt, or being a company goes into receivership, the landlord will look to you for the rent and all other payments due in terms of the lease.

Turnover warranty

The standard business agreement for sale and purchase includes a turnover warranty, that is a statement of the turnover for the business, including GST, exclusive to the business for the period of the warranty. Do not make any representations that the turnover is higher than the figure shown in the accounting records. Remember that a turnover warranty is not a guarantee that the turnover will remain at the figure included in the agreement - it is simply a statement of what the turnover was for the period of the warranty.

Restraint of trade

It is common for an agreement for the sale and purchase of a business to restrain the vendor from operating a similar business within a defined area and for a specified time. If you wish to continue in the same type of business you must give careful consideration to the area and period of restraint.

Staff

If the business employs staff, before you offer the business for sale, check with your accountant on any wage and redundancy issues in case the purchaser does not wish to employ all the staff.

There are certain categories of staff, such as those that provide cleaning and catering services, who have the right to elect to transfer to the purchaser. It is important that you obtain legal advice to determine whether any of your staff fall into these categories.

Name of business

If you are considering starting another business you must decide if you wish to retain the right to continue to use the name of the business. If the name is well known the purchaser will want to take over the name and telephone number as part of the price for the goodwill.

WARNING

We have only attempted to highlight some of the factors to take into consideration when selling a business. It is essential for you to involve professional advisers at the earliest opportunity and most importantly not to sign an agreement before you have obtained professional advice.

An agreement for sale and purchase is a binding legal document. Always carefully read the agreement. With the advent of the facsimile machine we recommend that you instruct the agent to send us a copy of the agreement ***before*** you sign the agreement and then to telephone us and we will answer your questions.

For More Information

Visit our website at www.gellertivanson.co.nz or call us on (09) 575 2330.