

**THE 10 BIGGEST MISTAKES PEOPLE MAKE  
SELLING THEIR BUSINESS**

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## PART ONE

### THE DEAL PROCESS TAKES LONGER THAN BUSINESS OWNERS IMAGINE

It's not this linear, and it does not always go this smoothly, but here are the steps in a typical sale of a business<sup>2</sup>:

1. Seller gets referrals to a good **business broker** or **investment banker**.
2. Seller gets a sense of the **current enterprise value** and the **possible value after “grooming”**.
  - 2.1. Often adjusted 12-month EBITDA × a “multiple.”
  - 2.2. “EBITDA” = Earnings Before Interest, Taxes, Depreciation and Amortization expenses = cash flow.
3. Seller considers growing the business by acquisitions or expansion to achieve a higher multiple of EBITDA.
4. **Groom** the business and get ready for the sale process.
  - 4.1. Includes estate and charitable gift planning.

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*This outline should be viewed only as a summary of the law and not as a substitute for legal or tax consultation in a particular case. Your comments would be appreciated and are invited.*

<sup>2</sup> These steps are typical with an investment banker involved or, after step 6, with an attorney but no intermediary. With a business broker, the process would be somewhat different.

5. Intermediary identifies prospective buyers.
6. Intermediary provides “blind” data to interested buyers (business in not identified by name or location).
7. Intermediary gets a Nondisclosure Agreement (“NDA”) from the most promising prospective buyers, identifies target business.
8. Intermediary provides prospect with more specific info about target.
9. **Intermediary introduces buyer No. 1 to seller**, keeps buyers No. 2 and No. 3 “warm.”
  - 9.1. Note: (**This is where a seller without an intermediary typically starts, but *without* buyers No. 2 and 3.**)
10. Intermediary, buyer and seller discuss sale terms, deal structure.
11. Buyer and seller each get separate **tax advice** about possible deal, structure.
12. Intermediary, buyer and seller **shake hands** on general sale terms.
13. Buyer drafts – and gets tax and legal advice about – the letter of intent.
14. Buyer provides letter of intent to seller.
15. Seller gets tax and legal advice about the letter of intent.
16. Seller gets buy-in from co-owners.
17. Buyer and seller negotiate and then **sign letter of intent**.
18. Buyer begins **due diligence process**.
19. Seller responds to buyer’s due diligence requests.
20. Buyer prepares **purchase agreement**, employment agreement, consulting agreement, covenant not to compete, escrow agreement, lease, licensing agreement
21. Seller reviews buyer’s agreements and prepares promissory note and security agreement; terminates agreements buyer does not want to continue

22. Seller assembles the information and schedules (to the purchase agreement) necessary to make the representations true (much of which was provided in the due diligence process, but this time the seller is promising that it is true and providing indemnification if and rep is not true)
23. Buyer organizes **acquisition entity**, if necessary
24. Parties identify any conditions (other than payment) that must be satisfied before closing
25. If asset sale, seller shareholders and directors approve sale
26. At “**pre-closing**,” parties sign all docs, but don’t close
27. Conditions to closing are all satisfied or waived
28. **Deal closes**, transfer documents and payment exchanged
  - 28.1. Intermediary paid from sale proceeds
  - 28.2. Incentive payments to key employees paid by target
29. Buyer and seller issue joint press release and announcement to customers and vendors
30. Parties carry out **post-closing obligations**, such as removing seller from bank and lease guarantees
31. Seller facilitates transfer to buyer
32. Seller and buyer file **tax returns** reporting the deal
33. Buyer determines whether to make any indemnification claims
34. Buyer and seller resolve any **indemnification claims**
35. Buyer **disburses remaining holdback**
36. Seller collects remaining sale proceeds on **promissory note**
37. On full payment, seller **releases security interest**

38. **Statute of limitations runs** for buyer bringing claims against seller

**PART TWO  
THE MISTAKES**

10. Waiting too long to get **tax advice**.

- ◆ After the handshake and before the letter of intent is a good time to get tax advice about the proposed deal; before the handshake is better.
- ◆ After the letter of intent is too late.
- ◆ The night before the closing is way, way too late.

9. Viewing the business as **an owner**, and **not** as a **seller**.

- ◆ At this point, the game is no longer about saving taxes.
- ◆ It's about a beautiful set of books, a couple of beautiful, reviewed or audited financial statements, a well-functioning organization, great products, dependable vendors, and predictable earnings growth.
- ◆ The business should be able to run well without the founder's involvement in every decision.
- ◆ **Grooming** the business involves:
  - ⇒ Reviewing the stock records
  - ⇒ Review the S corporation status .
  - ⇒ Have buy-sell agreements or buy-back agreements with other shareholders – with right of first refusal provisions.

- ⇒ To have a prayer of selling stock, get the non-business assets (the condo, airplane, RV, art) off the balance sheet, possibly by creating a holding company and separating those assets in a separate subsidiary from the subsidiary that operates business and will be the target.
- ⇒ Do labor law and pension plan “audits” to assure the seller can make “clean reps” about these areas.
- ⇒ Organize the business records for a smooth due diligence process.
- ⇒ Paint, make the interior offices pleasant, and consider updating old signage or logos.

8. Leaving valuable **brands, trade secrets** and **secret processes** unprotected.

- ◆ Make it necessary for a prospective buyer to pay for the business in order to use the brands, knowhow and trade secrets.
- ◆ Don’t leave them “in the driveway” to be taken by anyone who wants them.

7. Assuming that **key employees** will stay until the closing.

- ◆ The sale process takes a long time and is stressful for employees.
- ◆ The only way the seller can reduce the stress is to say “The company will pay a bonus to you if and only if you are employed on the closing date.”
- ◆ It’s up to the buyer to keep the employees happy after that.

6. Waiting until after the sale to think about **estate planning** and **charitable gifts**.

- ◆ This planning for the sale proceeds should start when the seller has a sense of the value of the business.
  - ◆ It's not going to be the first thing on the seller's mind at this point, so advisors need to be proactive.
  - ◆ Several great techniques cannot be used after the letter of intent is signed.
5. **Rushing to the closing *or* spending the sales proceeds** before the closing.
- ◆ The process has its own speed. Trying to hurry it up means losing negotiating leverage.
4. **“For sale by owner”**
- ◆ It is not likely that the first buyer who comes along is the best.
  - ◆ It's a great market for a seller with a quality company with strong earnings.
  - ◆ A seller who rushes in without an NDA or a “buyer No. 2” in the wings will eventually exude desperation. The buyer is likely to whittle at the purchase price and to drag out the process. The employees are likely to bond with the “new boss” before the closing. The business can slip out of the seller's fingers before the seller knows what's happened.
  - ◆ The intermediary can provide perspective about the market that other advisors don't have.
  - ◆ The intermediary can save the deal when the parties and their attorneys get locked into positions and won't budge.
3. **Letting the business suffer** as the sale process drags on.

- ◆ The seller needs either a temporary CFO to allow the real CFO to spend almost full time on the sale process, or a temporary CFO to handle the sale process and leave the real CFO to mind the business.
- ◆ The seller will not be able to spend much time on the business. The intermediary, lawyers and CFO will demand the seller's attention. This is why part of the grooming process is getting the business to run without the seller's attention.

2. Becoming **married to the deal**.

- ◆ The seller must be ready at all times to walk away from the deal. If there is no buyer No. 2 in the wings, the seller must be ready to spend another 18-20 months strengthening the business before taking it back to market.
- ◆ Otherwise the buyer – and the seller's employees – will smell the desperation.

1. Asking the **family doctor** to do heart surgery– without an anesthesiologist.

- ◆ Use an expert in selling and buying businesses. A newbie attorney on either side will substantially slow the process and increase the transaction costs for both sides (example: leaving substantive issues to be resolved after the letter of intent, so that the parties are rewriting the purchase agreement more than needed)
- ◆ Get expert tax advice on the transaction – both initially and as the deal morphs.
- ◆ Bring in labor, employee benefit, real estate and intellectual property counsel as needed.

[End of outline.]