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Want to Sell a Business? You May Not Be Ready.

As Buyers Get Pickier, Owners Must Do More To Spiff Up Companies

BY ARDEN DALE

A lot of entrepreneurs think they have the perfect retirement plan: They'll sell the business for a bundle and live off the proceeds. But many of them may be in for an unpleasant surprise when they're ready to bail: They haven't done the work they need to do to get the company ready for a buyer.

Small businesses often lack key elements that buyers look for -- such as proper financial records or detailed documentation about how the business runs. Moreover, lots of owners go into the selling process without researching the market, so they have unrealistic ideas about the price their business will fetch. The result: It can take much longer than expected to close a sale -- sometimes years.

In fact, a recent study by the Alliance of Merger and Acquisition Advisors found that many advisers believe seven of 10 midsize businesses will transfer ownership during the next decade, and that at least 90% are now ill-prepared. In many cases, the problem is that small companies, with limited resources, haven't kept up on the record-keeping and documentation that buyers demand.

A TOUGH MARKET

For their part, buyers are getting more demanding than ever. Faced with increasing competition in all industries, and the threat of an economic slowdown, they're doing exhaustive research on acquisition candidates, trying to catch potential problems.

"What Wall Street has been used to is now coming to Main Street, in that the same type of care is taken with these transactions," says Michael Hoesly, 56 years old, of Madison, Wis., who is completing the sale of his business-brokerage firm and owns several other small businesses. "Now, to do a \$5 million transaction requires due diligence similar to larger public companies. It's the same questions, they're just stripped down to a simpler level."

So, where should a small business start?

Experts suggest that small firms get organized three to five years before they start to think about exiting the business. Some experts recommend a longer period -- say, seven years before. Why the long lead time? Prospective buyers often look for a long history on the business, including financial records, business plans and other documentation. It can take years to make sure a small business is leaving the right kind of paper trail.

Financial statements are a good place to start. Small businesses take a range of approaches to keeping financial records. Those with \$20 million or more in sales are likely to have some form of audited review; some smaller ones keep records that don't even conform to generally accepted accounting principles.

"My sense of the value of the company will go up if I have confidence that the statements have been done by a well-known accounting firm, rather than your brother-in-law, and that they preferably are audited," says Mr. Hoesly.

What's in those statements is just as important. Records should show the best operating profitability and cash flow possible -- so small-business owners should cut back on unnecessary expenses if they expect a sale in the next few years.

"If personal expenses are a little on the generous side -- trade shows in more exotic places, the number of vehicles for business use, for example -- you might want to see if you could scale those back," says Neil Lerner, director of the Small Business Development Center at the business school at the University of Wisconsin in Madison. "You also want to make sure that the owner's compensation was realistic."

A HARD LOOK

Moreover, small firms should take a tough look at manufacturing, safety or other processes essential to the business, and clean them up as much as possible.

"A board of directors can help you do this," says Andrew D. Keyt, executive director of the Family Business Center at Loyola University Chicago. "A lot of small businesses don't have one, but they should think about it. A board can be an umbrella that continues to look out for you." He advises that board members must have solid knowledge of business in general and be independent enough to naysay the owner at times.

Finally, when entrepreneurs are ready to sell, they should get professional help to figure out how much the business is worth and how to handle the sale. Owners often think the company is worth more than it will really fetch in the market, which makes them ill-prepared to sell.

"Business owners have a terrible problem there; it's not their forte," says Mr. Hoesly. "The question is, who do they trust?"

When Norb Kaiser sold his business, Kamco Plastics Inc., in Schaumburg, Ill., he interviewed five investment banks before settling on one to handle the sale. Ultimately, he picked one with a history of making deals in the industry.

But Mr. Kaiser took steps long before then. He says he viewed the business as an investment from the start, so for years he kept his finger on the pulse of the plastics industry, watching the prices fetched by businesses similar to his. He also made sure to get audited financial statements for Kamco.

Even then, it took him years to sell the company. Among other things, troubles at a big customer set the company back, and it had to rebuild sales.

"I wanted to retire when I was 60, and now I'm 66," says Mr. Kaiser. "It took longer than I thought; everyone thinks it will be quicker than it is."

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