TODAY'S Business *Scene*

THE NEWSLETTER FOR PRIVATELY HELD BUSINESSES

Mountain States Business Brokers

IN THIS ISSUE

DON'T KILL YOUR DEAL

If there is anything I have learned from 12 years in this profession it's that poor records kill more deals than everything else combined. It's not lack of tax return profit, landlords, lawyers, bankers or accountants. Its poor records.

The typical small business will have a spouse or children on the payroll, family car payments, tuition, vacations and all their Sam's Club charges expensed through the business books. Buyers and bankers are compelled to assume that all charges on the books are business related unless you can prove otherwise.

Make sure your record keeping is clear and concise enough to allow you to prove those expenditures were unrelated to business operations. If buyers get the feeling they can't trust your records they probably won't trust you enough to buy the business either, and even if they do they won't pay you full value for the business.

Ben Mahrle, CBI
Managing Broker

Price and Value: *Any Difference?*

The question most often asked by those considering placing their businesses for sale is: "What is my business worth?" The question that should be asked is: "How much can I get for my business?" Worth and value are words that in many cases are interchangeable. Leading business appraiser Shannon Pratt, in his book *Business Valuation Body of Knowledge*, states that "Price is the face value at which a specific transaction occurred. It may have been arrived at arbitrarily, by negotiation, by contract, by court order, or by some other means. It may or may not comport to any definition of value discussed herein."

"Fair Market Value" is a term that sounds tailor-made for a business owner who wants to know what his or her business might sell for. The U.S.Treasury Department offers this definition of Fair Market Value: "The price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts." This might work in theory, but not in the real world. The word "negotiation" is not used, so arriving at this Fair Market Value is assumed to just happen. The sale of a business simply doesn't work that way.

Continued on Pg. 2

The International Business Brokers Association (IBBA) defines the price at which an actual transaction occurred as: "The total of all consideration passed at any time between the buyer and the seller for an ownership interest in a business enterprise and may include, but is not limited to, all remuneration for tangible and intangible assets such as furniture, equipment, supplies, inventory, working capital, non-competition agreements, employment, and/or consultation agreements, licenses, customer lists, franchise fees, assumed liabilities, stock options, stock or stock redemptions, real estate, leases, royalties, earn-outs, and future considerations."

www.msbizbrokers.com • info@msbizbrokers.com
phone: 970-221-9950 • Denver: 303-592-9950

The price that a business may sell for is generally far removed from its value. Value tends to be an exact price for a specific date and must be able to be defended by the appraiser. There are many different types of value, based on the purpose of the valuation and/or the reason behind the decision to sell: divorce, insurance purposes, bank loan, partnership issues, buy-sell agreements, tax concerns, ESOPs – the list is lengthy. In many cases, each reason may result in a different valuation.

When a seller asks what he or she might receive for their business, there is no right answer. It depends, for one thing, on how badly the seller wants to sell. Regardless of who places a price on the business, it will be the marketplace that ultimately determines the price. The seller may not agree with this, but he or she will have to accept it or face the fact that the business most likely will not sell, regardless of asking price or perceived value. It all boils down to a buyer's perceived value of the business.

Professional business brokers know the marketplace, what businesses are selling for, what buyers are really looking for, why they may be buying, and most importantly how to deal with perception of value.

The Highest Price Versus the Best Deal

Naturally, sellers want the highest price they can get for their business. In some cases, however, it might not be the best deal. For this reason, every offer should be scrutinized carefully. When an offer is presented, the first thing a seller looks for is the price. If it is lower than anticipated, the seller's first reaction is to give it back, initiating the case for its being much too low. A seller should consider an offer carefully and avoid a hasty reaction.

Here are a few alternatives that might offset a lower price:

- an offer with no or very few, and easily satisfied contingencies
- a consulting agreement or other deferred compensation
- a quick closing
- all cash, if that's important
- employment contracts with relatives or long-time employee(s)
- business vehicle to remain with the seller
- buyer has a long success record indicating long-term survival
- short-term payment period if seller financed

When a professional business broker is involved, he or she can point out those areas that may offset the price, down payment or the structure of the deal. After all, the important thing is not what a seller gets, but what he or she gets to keep!

Unreported Income – "Show Me the Money!"

Prospective buyers don't want to hear about "what the business really makes" – they want to see the books and records that show what is down in black and white. Here is the old story about proper accounting procedures, or lack of:

> A Greek restaurant owner had his own bookkeeping system. He kept his accounts payable in a cigar box on the left-hand side of his cash register, his daily cash returns in the cash drawer of the register, and his receipts for paid bills in a shoe box on the right side of the cash register. When his youngest son graduated as a CPA, he was appalled by his father's primitive bookkeeping methods. "I don't know how you can run a business that way," he said. "How do you know what your profit is?"
>
> "Well, son," the father replied, "when I got off the boat from the old country, I had nothing but the clothes on my back. Today, your brother is a doctor, your sister is a speech therapist, and you're a CPA. Your mother and I have a nice car, a city house, a country house, and plenty of money for retirement. We have a good business and everything is paid for. Add all that together, subtract the 'clothes on my back,' and there is your profit."

Great story and it is probably an accurate depiction of many small businesses, even in today's world. Unfortunately, today's buyers are not going to buy a business—not for anywhere near what the business may actually be worth in the marketplace—without checking the books and records. Buyers will not pay for what they can't see. Some sellers want it both ways. Since they haven't reported this income to anyone, they haven't paid taxes on it; and now they want to sell it as a real number. They also seem to forget the most important part – "skimming" is against the law.

Joseph Bankman, a professor of tax law at Stanford University Law School said, "Nothing is as good as taking half your income off the books to start with; that's better than any phony deduction. That's the biggest single source of revenue loss in the tax system."

What these sellers may fail to realize is that the Internal Revenue Service (IRS) has audit guides for many different businesses. It tells them, for example, how to roughly calculate annual sales and expenses of a pizza place by tracking its purchase of cheese. Any seller who doesn't think that the IRS can't figure out income and expenses of most businesses is kidding herself. Too many small business owners think that they are getting away with it – but they just haven't been caught yet. If they kept accurate financial records they probably would get a much higher price for their business, most likely making up for more than what they would have skimmed.

What happens is this: a business owner gets ready to sell and realizes that due to his or her unreported financial dealings, the business won't sell for anywhere what he had hoped for. Now he is in the position of having to reveal to a prospective buyer how he is skimming from the sales, paying help under the table to avoid the usual employee costs, or padding expenses. Buyers do not look favorably on sellers who attempt to justify their price by revealing how they are cheating the government(s).

Here are some tips for business owners who are considering selling:

- Plan now to maintain accurate financial records. When it comes time to sell, you will be able to show a prospective buyer where the money is and what it was used for.

- Keep in mind that a selling price is usually based on the cash flow of the business. The dollar you hide today will most likely be worth two or three times that when it comes to selling price. Think long-term, not short-term.

- Talk to a business broker professional. He or she can provide some education about how businesses are priced. They can also offer suggestions on how to gather the necessary information for a prospective buyer.

By following the suggestions above and reporting all income, by taking only legal deductions and maintaining accurate financial records, when it comes time to sell and the buyer says "Show me the money" – you can!

Mountain States
Business Brokers
1520 E. Mulberry, Suite 200
Fort Collins, CO 80524

TODAY'S BusinessScene
THE NEWSLETTER FOR PRIVATELY HELD BUSINESSES

IN THIS ISSUE

Saying Hello – More Important Than You Think

The telephone rings, the caller receives a message welcoming them, then she is asked to dial the extension of the person she wants to talk to. Since she doesn't know the extension, she has to wait and listen to the office directory; then presses the extension number only to discover that the person being called is not there.

Most Americans have called a credit card company, their bank or any other large company only to get lost in the maze with no way of talking to an actual person. Then there is the "hold music," the commercial while you wait, with more "amusements" popping up all the time. Who knows what the future holds in telephone communication.

While it used to be that the telephone was a visitor's first contact with your business, that tradition is changing. Now it is your Web site. Today's busy buyer now goes to the Internet to look for whatever he or she is considering purchasing. It is even easier for potential clients or customers to find your telephone number from your Web site rather than the telephone book. They can even get directions to your place of business.

In business every call or Web site visitor is a potential customer or client. You can't afford to lose even one. After all, if someone goes to the trouble of finding your telephone number or locating you on the Web, they must be at least half-serious.

Make sure your telephone system is as user-friendly as you can make it. If it isn't, change it. One sale or new client will more than pay for this improvement. What is the status of your Web site? Pay a little extra to insure that it is also user-friendly. Your Web site should provide interesting and useful information on your company, your products or services, your personnel (including contact information), and anything else that will make you look like the well-established professional that you are. The more user-friendly and informative the site, the more business you will get.

Understand that the first contact potential customers or clients have with your business is either the telephone or your Web site – and probably both.

Why Use a Business Broker/Intermediary?

The business broker or intermediary does it all:

- helps in establishing a fair asking price – a price that will attract serious, potential buyers
- works on a completely confidential basis
- qualifies prospective buyers
- shows the business at times convenient to the seller
- handles all of the details including negotiations
- guides buyer and seller through the nuances of the deal
- works with buyer's and seller's advisors
- will, in most cases, obtain a higher selling price than a seller could obtain on his or her own

5146-19-4

www.msbizbrokers.com • info@msbizbrokers.com
phone: 970-221-9950 • Denver: 303-592-9950

© Copyright 2006 Business Brokerage Press, Inc.