Seven Mistakes to Avoid When Planning an Exit

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Many entrepreneurs start with a sale of their business in mind. Others will have founded and run their business for many years and have strong emotional ties.

Whatever the circumstances, most owners will seek to sell their business at some point in their career and it will often be the most important financial transaction of their life.

Before considering a sale, you need to be aware of these seven mistakes that too many entrepreneurs make when planning a sale of their business.

1. Don't think you know it all

'Entrepreneurs often believe that if they start a company and own it, they are skilled enough to sell it. That often isn't the case.'

David Jackson, CEO of marketing research specialist Site Intelligence, has participated in three exits. He says that selling a company requires skills and knowledge that will put most business owners 'outside their comfort zone'.

Mark Barlow, a founding partner of marketing and communications group Hasgrove, agrees. 'Successful business owners have all got egos - it's part of their make-up. But it's also true that they don't know what they don't know. It's not until the exit that this becomes clear.'

As Barlow observes, a know-it-all tendency is natural for people who have built winning businesses. The solution is to swallow your pride and ask for guidance, as he discovered when he sold his first consulting business, IT Counsel, to building and construction group Amey in 1999.

'Everyone was delighted with our exit,' he says. 'But we could have got there faster, cleaner and in better shape from a valuation point of view if we'd had someone to help us.'

An experienced mentor would have pointed out that the contracts Barlow had with many of his government clients were, like all public sector contracts, non-transferable to an acquirer. Since nearly half of IT Counsel's business was with the public sector, it was a critical oversight.

Alan Jones was the CEO of Shuttle Technologies, which developed a chip for USB devices in the days before they were popularised. Jones sold the company to Nasdaq-listed SCM Microsystems in 1998 in an all-share deal worth $33 million (£16.5 million).

'At an early stage, we brought in a chairman for the company who had already sold a business,' says Jones. 'It's what I classify as "grey hair"; someone who had been there and done it before.'

Though Jones' chairman helped him to prepare the business for sale, he still regrets not taking specialist tax advice.

To his chagrin, he ended up paying full tax on the shares he received in return for his company. 'I'm still quite bitter about it,' he states. 'To anyone selling a business, I would say get good tax advice, and make sure that you pay for it.'

2. Don't take it lightly

Most first-time business sellers underestimate the amount of time, effort and sheer hassle involved in a typical sale.

Barlow describes his exit of IT Counsel as 'mind-blowingly onerous'. After eight months of negotiations, he and his acquirer travelled to Oxford with their respective legal teams to seal the deal.

'I expected it to take a day. It took four days, and each one of them we were up until two or three in the morning. At some points we were on the point of saying, "Let's just get a cab home and tell them where to go."'

Unless you're well prepared for it, this emotional and physical strain may cloud your judgement and affect the smooth running of the business at the most critical point.

Jackson of Site Intelligence warns: 'If you are selling, you have to understand that you are giving up the business entirely, and to see it as a commercial transaction. Personal feelings shouldn't come into it.'

3. Don't let greed get in the way

Wanting to get the best valuation for the company you have slaved over is understandable. But asking for too much can be a turn-off for prospective buyers, according to Tony Hayday, who sold his own direct mail business, DPS, before setting himself up as an investor.

'Overvaluation is very, very common,' he

states. 'If you're a start-up and you pitch it too high (or too low, for that matter) people like me will just walk away.'

On the flip side, there's a danger of being seduced by what might be an illusory gain. Jackson sold his first company, computer training business ScreenScience, to AIM-listed Adval Group in an all-share deal.

'If you are selling purely for shares, your destiny has been handed to somebody else,' he says. 'Inevitably, there will be a lock-in period, so you can't crystallise your gains for some time.

'It doesn't represent an exit – you have just exchanged one set of equity for another.'

4. Don't miss the boat

Naturally, working out exactly where you are on the growth curve is easier said than done. And there are unforeseen events – like the dotcom crash or 9/11 – that can wipe millions off your company's valuation through no fault of your own.

After Barlow had received several approaches for IT Counsel, he took his co-founder and two other partners to a golf club to discuss whether to sell.

'I wanted to keep the company, but after we'd debated it, the other three voted to sell. I was the majority shareholder so I could have overruled them, but I decided to accept their views.'

Barlow has no regrets: 'We sold in 1999, right in the middle of the Millenium Bug issue. The Millenium Bug was great for our business, but when the clock went past midnight on 1 January and the world didn't end, a lot of IT consultants were laid off. So from a timing point of view it was perfect.'

Since then, Barlow has advised start-ups in his sector that 'if someone wants to buy it, then sell it'. Jackson has a similar view: 'You have to look at the risk of running it versus the reward you could get today. My feeling is, the minute you feel as though new competition is coming, or the market is changing, or when you've done really well and people see the value, that is the time to take some advice.'

5. Don't neglect the details

While all your effort is going into sales and marketing your business, less gripping areas of work may be neglected – such as bookkeeping. This can have serious consequences when potential buyers start to look into the company's accounts.

Simon Campbell sold the Spanish arm of his web applications company, Conexia Multimedia, last year for a six-figure sum. He concedes that Conexia's accounts were ill-prepared for the scrutiny of a potential acquirer. 'I don't come from a financial background, so I just got on with stuff and put money into the company to get it going,' says Campbell, now MD of paper mail-via-web business ViaPost. 'To put the books in order when you haven't been keeping records properly is a real pain.'

That pain is intensified when due diligence begins. '[A potential acquirer] is going to dig into the numbers, the contracts, all the details,' he says.

'You might think it's quite straightforward and easy for you to explain, but they haven't lived and breathed the business for years, so you need to put it very clearly so they can understand it.'

6. Don't forget any of your stakeholders

While you may make a packet out of the sale of your business, it's likely that not everyone in the company will be delighted by the prospect. In businesses where your main asset is your staff, it's especially important to stave off the green-eyed monster.

Barlow notes: 'In a people-based business, you have to take employees along with you. This means not just limiting rewards to the shareholders – I believe employee share option schemes are essential.'

It's a point echoed by Jones, with one proviso. 'I'm extremely proud of the fact that everyone in [Shuttle Technologies] did well out of the hard work they put in,' he says. 'But I would advise locking in senior employees. If there is the potential for them to cash in fully on their options at the point of sale, an acquirer will value the company lower.'

It isn't just staff you have to watch. Richard Alberg sold his online assessment business, PSL, in which over half the shares were held by external parties, to recruitment group Kenexa in 2006.

'Our investor shareholders didn't want to give warranties or have ongoing obligations

based on anything that might come out of the woodwork [after the sale],' says Alberg. 'That threatened to suddenly fragment our shareholder base.'

Though negotiations were complicated by differing interests within PSL, Alberg managed to keep everyone on side. 'We asked one investor to take the lead for all our investors,' he explains. 'In the end it only caused inconvenience rather than serious problems.'

7. Don't leave it to chance

Perhaps the most common failing of all is to assume your exit will happen naturally if your business is successful. 'In the early days,' says Alberg, 'we were running a business that was directly driven by events in the marketplace, but without a clear vision.'

Campbell had a similar issue with Conexia. 'A lot of [Conexia] was based around me as a commercial driver of the business,' he says. 'When we were packaging up the business for sale, the real question was, what was the value of the company without me? That was why most of the business has ended up being closed down rather than sold on.'

Jackson of Site Intelligence points out that the nature of your business should dictate your financial strategy for an exit. 'If you are a company that has been trading for some time, showing solid but not massive growth, almost inevitably your value will be based on bottom-line performance. You will want to optimise your profits but not in a way that distorts the figures.

'If, on the other hand, you are a technology business with great strategic potential in the hands of the acquirer, your valuation will be about those factors the acquirer puts value on, such as fast sales growth and investment in technology. It is hard to achieve those things while optimising the bottom line.'

Whatever your business, the consensus is that you need to steer yourself away from operations towards strategic goals.

Barlow counsels: 'Get the right people around you and get yourself away from the coalface. Stop going out to customers and being part of the delivery team, and have a clear and complete vision of when and how you are going to exit.'

For more information and advice on exit strategy, contact Guy Rigby, head of entrepreneurs at Smith & Williamson on 020 7131 8213 or email guy.rigby@smith.williamson.co.uk.

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