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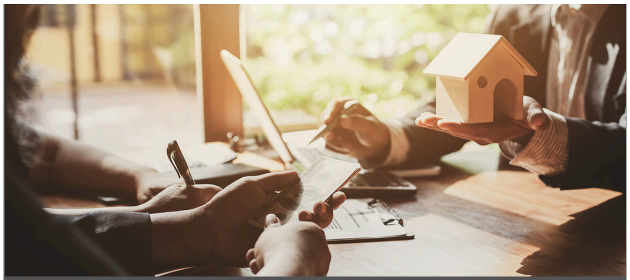
EXITING A BUSINESS VS. SELLING A HOME



Across America today there are millions of baby boomer business owners who are thinking about how they will transition the ownership of their business to someone else as they reap the rewards of a lifetime of business success. However, because most of these owners have no experience with selling a business, they do not truly know what to expect in the process. And for a transaction of this complexity and size, it is likely that what owners do not know will materially hurt them in the process of transitioning their companies.

This newsletter is written to help owners get past the first, and most crucial pre-conception – that selling / transitioning their privately-held business will be similar to the sale of their home. Because so many business owners believe that selling a business is akin to selling a residential home, this newsletter explains the differences between selling a business versus selling a home – or, for that matter, how selling a business differs from the sale of virtually any other asset that you will sell in your lifetime. These comparisons become very significant because, generally, a privately-held business is that business owners' largest and most valuable asset.

It is our objective to make owners aware of these differences in order to begin the process of educating owners who hold this pre-conceived and very false assumption.

The Mental Process of Associations

As human beings we learn through experiences and our associations with those experiences. So when we are presented with a new concept, for which we have no experience, we look to associate the new concept with something from our past.

In the case of the sale of a business, owners often look to a sale of another large asset that they may have experienced in their lifetime, the sale of their home. In fact, the sale of a privately-held business differs from the sale of a home in five (5) material ways that are provided below.

Difference #1 – Valuation & Buyers

Home sale values are based on the comparable sales method for neighboring homes that resemble the house being sold. This means that the seller of a home can most accurately see what their property is worth by seeking the closest comparable sale transactions in their neighborhoods.

This analogy is only partially true for trying to compare the sale of a business. While other companies like yours that have sold in the past is some indicator of what your business may be worth, there are large differences between a static, free-standing structure such as a home versus a dynamic, ever-changing entity such as a privately-held business.

Moreover, the value of a home is not dependent upon who the buyer is. In the world of residential real estate, all buyers are [essentially] equal – they are either qualified for financing or they are not. In the world of business sales, the *type* of buyer that you are talking to is critically important. Different buyers bring different attributes to the business sale – some will pay more than others, and some will have to pay you out over time, i.e. not all cash at the closing. For example, a competitor may pay more for your business than, say an employee who you would like to see own the business but does not have any money for the purchase. That employee would need to pay you from future cash flows and the idea of getting a higher value can be tough. This leads us to difference #2.

Difference #2 – Deal Structuring

When a homeowner sells their home, they get paid the negotiated selling price at the closing. In business sale transactions, the amount of money received at the closing often times represents only a portion of the total proceeds that are part of a larger negotiated selling price. Generally speaking, smaller deals – those less than a few million dollars - are subject to more 'structuring' of payments over time, while larger deals tend to get more cash at closing. That being said, if a company is, for example, highly dependent upon an owner, then there may be a larger earn-out or payment associated with the sale. Again, when you sell your home you certainly do not expect to be paid only a portion at the closing and the balance over time.

Difference #3 – Taxes

When you sell a home, there is [generally] one (1) tax rate. When you exit a business, there are an endless number of potential tax outcomes for the transaction. The most easily recognized tax rate for a sale transaction is the capital gains tax rate. This rate applies to the gain - the amount of value exceeding the cost basis of the stock – that is *realized* in the sale of shares of the company.

However, not all business sales are 'stock' deals that qualify for capital gains taxation. Rather, many are 'asset' deals that fall into a separate category and allocation process to determine the appropriate tax rates. Payments to an exiting business owner under an asset deal can have a variety of tax consequences that will impact what an owner will net from the transaction. This is not the case in the sale of a home.

Difference #4 – Transaction Types

The sale of a residential home includes all of the property and the structure(s) that are on that property. Therefore, residential home sales are an 'all or nothing' deal. Business sale transactions come in a variety of different forms, with owners able to sell all or only a portion of the company's stock. Could you imagine a home sale that included only a few bedrooms and a garage, for example? Naturally that is not possible. However, in the sale of a business, the owner can sell all or only some of the equity and can also have an option of either continuing to stay involved with the business or not work any longer.

Difference #5 – The Impact on Others

Our final and greatest difference between selling a business versus selling a home is the impact that the change in control has on other people. When an owner sells or transitions a company to a new owner, many people are impacted including employees, customers, vendors, as well as the owner's family. While the sale of a home is an important event, it will not have as a dramatic impact as the transition of a company whereby so many people depend on that business from a financial perspective.

Concluding Thoughts

There are certainly more than five (5) differences between selling a business versus selling a home. This newsletter was written to raise awareness to owners who are considering a transition of their company and have not fully thought through all of the implications because these owners do not have the experience and any similar associations. We hope that this newsletter has helped you see that the selling of a business is very different from the selling of your home and we encourage you to seek out experienced advice in this area so that you do not make the same mistakes that owners have made in the past who had this same assumption.

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