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3 Reasons Why Most SMEs Are Not Saleable

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There Are Three Main Reasons Why SMEs Are Not Ready for Exit and That Make Most Unsaleable

Having looked at many, many companies and owners in hopes, I found there to be three reasons or trends that are causing these dire statistics:

1. Incorrect owner perception around exit planning: there are generally six reasons I come across, most often, that are causing deals to collapse
2. Owners are not preparing themselves adequately enough for what I call the 7Ds
3. Most owners lack a process, a system to follow to help get them from where they are now to an exit-ready position

Incorrect Perception

Time

A common trend I see is that owners plan their exits far too late. Many people do not realise that it ideally takes up to five years to prepare and implement an exit strategy.

There are two reasons why I say five years:

First—it takes a lot of time to get a business ready for sale. It is not like selling a house. Remember, the owner is still having to run the business, so the five years gives the owner the time to realign the business and prepare it for exit, especially when it comes to preparing for the due diligence phase.

Second—from a buyer's perspective, what we want to see is positive, sustainable trends in a business because this will add confidence as well as value to the business. Because buyers will typically want to see at least two to three years' worth of accounts, this time allows the owner to show a buyer what is really happening within the business and what is realistically achievable in the future. Very often I see a business where the sales and profit are fairly static but then suddenly there's a jump over the last few months. This is when the owner has conducted some massive sales and marketing activity, and they use that growth to value to the business. In most cases, if not all cases, buyers see right through that because no one knows if that growth is sustainable or not. So, time allows a buyer to see what is really happening to the business and what can be realistically achieved going forward.

Valuation

This is the biggest reason why deals collapse. For the owner, valuing their business is typically incredibly emotive, but not only that, it is also very subjective. That is why if you were to ask 100 people to value a business, you will probably get 100 different answers. So, looking at the facts and removing a lot of emotion will definitely help the owner to value their business realistically and objectively.

Risk

Buyers are fully aware of there is always going to be risk involved. It is the owner's job, the seller's job to minimise this risk as much as possible. SME owners need to realize that it is easier and less risky for a buyer to acquire a business with a turnover of £3 to £5M rather than £500k. This is because larger companies tend to have resources and the management teams already in place, whereas the smaller businesses do not. So owners need to look at how they can reduce the risk within their business as much as possible.

Transferable Value

This is very often the forgotten element of business valuation. Transferable value is what a business is worth to a buyer without its previous owner. In other words, it is determined by how well the business runs without that owner. Transferable value should not be confused with profit either. You could have an owner looking to exit in the next three years for approximately £1M. Fortunately for them their business, from a financial perspective, is worth around £1M.

However, because the business is so reliant upon the owner and their expertise and experience to produce the goods, there is very little value that can be transferred to a new owner. So, when the owner leaves, there is no guarantee that the business will be as successful with someone else in charge. It is because of this lack of transferable value that it will make the business unsaleable.

Deal Structure

This the second biggest reason why deals collapse. A lot of owners believe there is only one way to structure deal, and that is to receive a huge cheque on completion. Now this may happen, but it is incredibly rare. Knowing there are various ways of structuring an acquisition will help feed into your personal wealth strategy and give you as many options as possible from a financial and time point of view.

Business Brokers

You tend to find that the good brokers work with businesses worth at least £2 to £5M or more. When you enter the mid to lower market, especially with valuations less than a £1M, you tend to find brokers that are not so good. The ones I have dealt with, and there have been many, are really underserving the market. They are giving owners false hope by agreeing to represent their businesses. They do this because a) they do not know what makes a business saleable, and b) they don't know how to value a company (apart from applying 3 to 5 times multiple). Their main aim is to sign up as many businesses as possible, charging the seller a marketing fee of anything between £3k to £40k, and if they sell the business, well, that is just a bonus. Other brokers charge the buyer either monthly or a percentage of the sales price, and other brokers have a hybrid model, where they charge both the buyer and seller. It is this mid to lower market that needs a complete overhaul.

Lack of Preparation

Deal

This is where you meet someone at a networking event, you hear via the grapevine, or you may be approached directly by someone who is looking to buy your business. This is what I tend to do—approach owners off-market to see if they want to sell. Now if you know your company's valuation and how you want to structure the deal, then you will be in a very strong position to proceed. In my case almost all the owners I've spoken to who are interested in selling either had unsaleable businesses, the businesses were too owner-dependent, and/or the valuation the owners were putting on the business ludicrous, as in 20 to 30 times EBITDA. So, if you and your business are not ready, you could miss out on a deal, a potential sale.

Decide
If you get to decide to exit your business, then you are one of the fortunate people. Providing you have followed an exit strategy and you have everything in place, the sales or exit process should not take too long. However, if things are not in order, then this could add months to the exit and it will probably have an impact on valuation.

Distress
This is where the owner has had enough, they are stressed, burnt out, and they just want out. We call these owners "motivated sellers". And all they want is for the pain to go away and to move on to something else. This normally occurs where there is a bottleneck or a systems or management issue within the business.

Disagreement
These are disagreements between co-directors or shareholders. This only becomes an issue when there isn't a robust shareholders' agreement that spells out exactly what needs to happen should a disagreement arise. This invariably results in one of the party/ies leaving the business and not being able to realise the full potential the business had.

Disease/Disability
None of us knows what is around the corner, and that is why having a plan in place to prepare for these eventualities is vital in protecting your business and wealth.

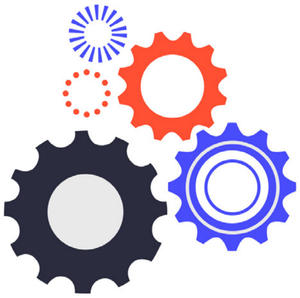
Divorce
I don't think any of us get married with the aim of getting divorced, at least I hope not! But this is something that will certainly have an impact on your wealth. Again, unfortunately it happens quite often.

Death
I hear a lot of owners tell me they are never going to retire, that they plan on working until they die. I fully appreciate that, as I probably place myself in that category. However, death is not an exit strategy, death is an event.

If the business is not prepared for that event, it will cause a lot of problems for that owner's family and/or employees. So, again it is important to have a plan in place to help those who will have to deal with this event in your absence.

A One in Two Chance
The statistics are that around 50% of owners will be forced to exit their business. This shows how vital it is to always be prepared and to have an exit-ready business. And that is why I say it is a luxury if you get to decide to exit your business because for many people they will not have this option.

Lack of a Process



I'm finding more and more owners who love what they do but find themselves getting bogged down in the mundane running of the business. This means they find themselves just firefighting and sorting out problems. They feel that they're taking one step forward and two steps back, so they're caught and struggling to gain any traction to move the business forward. They need a process to help them move towards their goals, so that when they must exit their business, whether forced or planned, they are in a good position.

To best prepare and position a business to eventually exit, a business owner must be able to accurately determine the value of their business. However, many owners do not know what their business is worth. I have found that owners typically over-value their business by at least 2.5 times what is actually worth. They also do not have a clear understanding of their business, personal, and financial plans, both for in the present and down the road when they exit.

For the most part, most owners know the general direction of where they are wanting to go when they exit, but many do not know the exact details of where they need to be.

More importantly, whether or not they know where they are and where they are going, they don't know how to get there. They don't know the steps or have a process to help to get to their destination.

To find out more about how to exit your business successfully please visit **www.businessbydesign.co.uk**.

In the hustle and bustle of running a business it is very easy to take your eye off the ultimate end goal—successfully exiting your business. Keep focused and do not be afraid to ask for help.

Would you like to make sure your business is ready for sale? Learn more about how we can assist you. Please contact Cliff at Business By Design for a free confidential phone call to see how we can assist you.

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