By Paul T. Rushton, Esq.

The sale of a closely-held business is typically one of the most important and stressful events in a business owner's life. The dual challenge of addressing the requirements of selling a business while continuing to operate the business in its ordinary course can perhaps best be described as being in the "eye of a storm." This can be particularly true for a closely-held business that is managed by a small number of individuals without the assistance of in-house counsel and/or accountants. However, by taking the following steps before embarking on the sale process (or, in the "calm" before the "storm", if you will), the owners and managers of a closely-held business can reduce the level of anxiety attendant upon a future sale of the business and minimize the prospects of incurring liability in connection with the sale:

Assemble a Capable Team

In order to prudently prepare for the sale of a business, the owners and managers of the business must assemble a team of individuals within the business, as well as outside professionals, who possesses the requisite skills and experience to properly address the various issues and tasks that will arise as part of the sale process. In addition to selecting outside lawyers, tax advisors, and possibly brokers who have experience in handling transactions of this type, the owners and managers of the business also need to identify those individuals within the business who have access to the documents and information that will be required as part of purchaser's due diligence for the transaction. It is also important to select those individuals who can be trusted to maintain the confidentiality of the transaction until the sale is consummated. In a smaller closely-held business, there may be a limited number of individuals who can serve in this role. Accordingly, it is important to identify those individuals in advance and allow them the necessary time to prepare for the potential sale of the business before the sale process commences.

Conduct an "Internal Audit"

As part of the sale of a business, the potential purchaser and its representatives will normally conduct an extensive due diligence review of the business and require the selling party to produce numerous documents and information related to the business. Further, the purchase agreement for the transaction will require that the selling party represent and warrant various facts and circumstances pertaining to the business and disclose certain information related thereto in schedules to be attached to the agreement. To reduce the stress associated with producing such documents and information during the sale process and to increase the likelihood that the disclosed items will be accurate and complete, the owners and managers of a business should consider conducting an "internal audit" of the business in advance of the sale. The purpose of this internal audit should be to identify and compile the various documents and information that will likely need to be produced/disclosed in connection with a sale of the business (e.g. all existing contracts of the business). In addition, steps should be taken to ensure that such documentation and information is organized and stored in a manner that will allow for such items to be easily identified and disclosed to a potential purchaser of the business. Finally, protocols should be established to ensure that the documentation and information is updated in a timely manner as changes to the business occur over time.

Resolve Potential Concerns

An ancillary benefit of the “internal audit” process described above is the potential to identify areas of concern in the business and resolve such concerns in advance of a future sale of the business. For example, the owners and managers of the business, in consultation with its outside professionals, may conclude as part of this process that the financial statements previously prepared for the business will not pass muster with a potential purchaser and/or may result in a lower purchase price for the business. In such case, the owners and managers of the business should consider having audited (or at least reviewed) financial statements for the business prepared by a reputable and qualified accounting firm in accordance with Generally Accepted Accounting Principles (GAAP) (or, if not wholly in accordance with GAAP, with any exceptions to GAAP clearly delineated and ready to be disclosed to the potential purchaser of the business). Also, if the internal audit identifies a failure of the business to obtain a necessary qualification, license or other governmental approval in one or more jurisdictions, the owners and managers of the business can remedy such failures in advance of the sale. Similarly, if a review of the corporate documentation of the business identifies one or more deficiencies, such as a failure to properly document and/or effectuate the transfer of ownership interests and/or election of the current managers or officers of the business, the necessary steps can be taken to resolve and properly document such issues prior to the sale.

Maintain Flexibility

The owners and managers of a business should also attempt to maintain flexibility with respect to a future sale of the business. For instance, in negotiating or renegotiating business contracts, efforts should be made to avoid provisions that require the consent of the other party to the contract to be obtained before the contract can be assigned to a potential purchaser of the business or requiring consent to a “change of control” in order to maintain the contract in effect. Additionally, before making any grants of ownership interests to employees of the business or family members of the owners, the owners should reserve a “drag-along” right to allow for the owners to require the sale of the business without the consent of the recipients of the granted ownership interests.

By taking the above steps and other appropriate actions in advance of a sale of a business, the owners and managers of the business can rest assured that they are better prepared for the rigors that await them if a future sale of the business comes up on the horizon.

On October 30th, Paul presented a seminar titled “Preparing for and Effectuating the Sale of a Closely-Held Business” at the THINK Center in Downtown Wilkes-Barre. Paul’s presentation identified several actions that should be taken by business owners before embarking on the sale process. Watch the full presentation below: