YOUR BUSINESS SALES

Bridging the price gap between buyers and sellers: Read this before dropping your price

In times of economic uncertainty as we're seeing today, the distance between a buyer's and seller's desired business price becomes increasingly difficult to reconcile. What follows is one of the more creative solutions to this problem.

First we must define the variable that we can adjust to provide a solution. A business buyer wants a price that both adequately justifies the risks involved with a business, and a price that outweighs the returns of an alternative purchase elsewhere. A business seller needs a price that both satisfies their reasons for selling, and outweighs the alternative of continued ownership.

The seller's criteria can't change, nor can the buyer's alternative purchases. Of all of these criteria, the only variable that can be adjusted is the risk, and if the risk is lowered, the buyer can justify paying a higher price. It is for these reasons that earn-outs are becoming increasing popular.

Though earn-outs have their similarities to vendor finance, they are not necessarily designed to circumvent the issues with raising finance. More so, they are designed with two things in mind. The first; to reduce the risk to the purchaser by redistributing it between both purchaser and seller. The second; to allow the vendor to maximise the business's sale price by carrying some of the risk themselves.

So how does it work? In instances where there is high uncertainty regarding the businesses future performance, business owner and buyer agree upon a reduced sales price under the proviso that the reduced amount be paid in full when certain conditions, usually relating to contracts or profits, are met.

An earn-out has the potential to take a risky business element that would have otherwise lost the sale or resulted in a substantial drop in asking price, and turns it into a bargaining chip.

There's a better way than wrestling on price

For example, a business makes a $200,000 profit from a yearly contract which is now up for renewal. There is no assurance that it will be renewed so the buyer perceives this as a risk and asks for an equal reduction in the asking price. The owner knows that this contract will be renewed, refuses to drop the price and they come to a stalemate.

Generally, when a business is sold, all risks associated with the business are sold along with it. An earn-out dictates that the seller maintains some degree of risk after the sale. So in this instance the seller could agree to a $100,000 reduction in the asking price on the provision that when the contract is renewed the remaining $100,000 be paid out by the buyer. So rather than force the buyer to swallow a $200,000 risk, both parties now share the risk equally.

The downside to an earn-out is that though the seller does not retain a share in the businesses, they are inevitably tied to the success of the new business owner. The situation proposed by an earn-out is a breeding ground for distrust so it is absolutely essential that both parties involved have their solicitors design an airtight contract with all bases covered. Earn-outs are complicated and time consuming, but if managed correctly can allow the buyer to mitigate risk, and the seller to maximise the selling value over an extended period of time.

Earn-outs are not for everybody. In today's climate however, as the distance between the seller's lowest price and the buyer's top price becomes harder to reconcile, they are more frequently being utilised as solutions to otherwise unsolvable problems.

The main thing that should be taken from this is that there is always a way to get a business across the line. Negotiations should therefore be approached with a problem-solving and positive attitude. It's a little extra time at the end, but in the scheme of things, if having the business change hands for the best price possible is the goal, it will definitely be worth it.

*Disclaimer: All information in this article is for information purposes only. It should not be taken as financial, legal or any other advice. Individual circumstances of businesses and business owners may vary and they have not been taken into consideration. Always seek independent legal and financial advice for any matters regarding business sales.

Business Of The Month

Commercial Abseil Access Building Services

T/O $1.5M Profits $410k inc. owners wage

This leading and established niche building services company specialises in providing service solutions to otherwise inaccessible areas predominantly using commercial rope access. The continued development of medium to high-rise buildings is driving the need for a specialist solution delivering cost-effective cleaning and maintenance access. This company provides that solution. It should be noted that the current owner does not engage in these activities himself. The business's core work centres around window cleaning but the group also undertakes repair and maintenance work including painting and rendering.

- Niche service: Provides access to inaccessible areas
- Turnover $1.5M p/a
- Profits $410k p/a inc. owners wage
- Training on offer
- A new owner will not have to engage in any abseiling
- Top 5 clients represent 14% of T/O

Business Price:

$800,000

Most of the business is generated from word of mouth. This may represent a good opportunity to increase activity through more active and targeted promotion campaigns. The staff arrangements allow the business to be scaled up as required without any significant increase in fixed overheads.

To sum up, this business is simple to run, requires very little experience, has full training on offer, provides a niche, in-demand service and most importantly; is extremely profitable.

Sales Price: $800,000 inc. equipment, fixtures and fittings, stock and goodwill.

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