Preparing for a sale

Preparing for buyer due diligence to maximize value and the chances of a successful sale **Interviewed by Sue Ostrowski**

You may not be selling your business today or tomorrow, or even next year, but if it's a future possibility, you need to be preparing now.

"If somewhere down the road you think you might want to sell your company, you need to be concerned now about the due diligence review the buyer will conduct," says Thomas Vaughn, member, Dykema Gossett PLLC. "The buyer will want to do due diligence on your company and to review your books and records. And, if you wait until the transaction starts to get your house in order, it's going to be a tremendous, time consuming undertaking to get prepared at that time. In fact, it might be impossible to be ready in a timely fashion if you've waited too long."

Smart Business spoke with Vaughn about how to prepare your business now for sale later.

Thomas Vaughn
Member
Dykema Gossett PLLC

What are some things a company should be doing regarding its records?

If your records are in great shape, that sends the message to the buyer that the management team knows what it's doing. That will help you with the sale and increase value.

For instance, one basic thing is to maintain good stock transfer records. One of the first things you have to show is who owns the company. If you do not keep good records of who received shares, and to whom they were transferred, when it's time to sell, you will have to try to recreate that record. This could prove difficult.

If you issue shares and don't record them, you could have someone who has an ownership interest in the company that is not a party to the transaction. When they stake a claim later, that can be a big problem. Alternatively, if your records show that someone has an ownership interest when, in reality, they no longer do, you will have to ask them to sign a document saying they no longer have an ownership interest. If the company has become very successful, that could be a costly issue.

What other documents need to be in order?

Having up-to-date minutes of shareholder meetings and board meetings are critical to show that proper corporate formalities have been followed.

Another important area, from a due diligence standpoint, is maintaining good control over the company's contracts. It is critical to keep them in an organized and indexed fashion so that you can easily access them.

It's not unusual for a closely held company to sign agreements and just stick them in a file. When you have to produce all of your agreements for a buyer, it becomes a massive job to go through those files to be sure you have produced all of your agreements. If a potential buyer sees that the company has been maintaining good records, it will feel a lot more confident that it is getting all the information it needs to complete its due diligence process.

What does a company need to think about regarding human resources?

It's critical that all incentive plans for your employees be well documented. If you're offering people equity for their services, the arrangement needs to be embodied in an agreement that sets forth under what conditions they get the equity. I also recommend buy-sell agreements so, if someone departs, you have the ability to get their equity back. This avoids having to deal with adverse minority shareholders when you are trying to sell the company.

The other area in which companies run into problems is their benefits plans, particularly if you have multiple related companies. Often they are operated as separate businesses with separate employees, and different employee benefits. However, federal law provides that, if there's common ownership of companies, under certain circumstances, those companies have to be viewed as one plan for testing and other purposes. Fixing your employee benefit plans so they comply with the law can be time consuming and costly.

How can intellectual property play a role in a sale?

Today, companies that have proprietary technology with strong IP protection bring the highest sale prices. Usually, that includes having very good confidentiality and non-compete agreements signed by all of your technical employees and outside consultants. If your business has proprietary information, a potential buyer will want to know that the IP can't just walk out the door and show up at its competitors. It also includes implementing and following a thorough IP protection strategy, with processes and procedures set forth on paper.

It is important to document the development of your technology to support its proprietary nature and assure the validity of your IP rights. For instance, demonstrating how the company developed its software is really important from a due diligence standpoint. Buyers want to know whether the software is proprietary or based on open source code available to other parties.

These are just a few examples of the types of documents that a company should be maintaining to assure a smooth due diligence process. Too often, maintaining good books and records is not a priority at many closely held companies because it is not perceived as adding any immediate value.

But if you have any intention of eventually selling your company, it is critical to take these steps now to maximize the value of your company later and ensure a smooth sale process. All too often a buyer comes along, puts a number on the table and begins to do due diligence. If the buyer figures out the seller's books and records are in disarray, they could come back with a lower price, or just walk away. <<

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