Preparing to sell in an uncertain market

Although the U.S. economy is in critical condition, you shouldn't approach selling your business as you would a funeral. An M&A deal can succeed — even in the current environment — if you start preparing as early as possible. Effective preparation entails streamlining and shoring up your company's operations and financials, and may require you to make some difficult, but necessary, decisions.

Clean up the books

One of the first actions a prospective seller needs to take is to ensure the company's financials are accurate and easy for potential buyers to examine. Make sure all your revenues are detailed and correct and are broken down logically, by, for example, business unit. Try to remove as much personal-related expenses, such as club memberships or vehicle fuel costs, as possible from your company's financials.

If your company doesn't already use the accrual basis of accounting, you may want to switch to it. Prospective buyers are likely to prefer businesses that use accrual-based, as opposed to cash-based, accounting because it's usually the method they use. Cash-based accounting isn't typically considered "a true and fair view" of a company's financial performance under International Financial Reporting Standards — standards public companies soon will be required to adopt.

"So I told Tom to sell the business or I was moving to Florida without him. I haven't seen him since!"

Perform housekeeping duties

Preparing for sale should give you the opportunity to perform long-needed tasks you might have put off because they never seemed as urgent as other, day-to-day matters. But tackling housekeeping is important now. Trimming and streamlining operations across your organization — from human resources to outstanding debts to supplier relationships — will help make your company more attractive to prospective buyers.

If you can renegotiate or prepay current debts, you'll probably improve your company's marketability.

Perform a comprehensive review of your operations, pinpointing weaknesses and redundancies, and then draft an action plan to address potentially negative findings. If, for example, you discover outmoded equipment you can no longer use, you should probably sell it. Or, if you find multiple employees doing a job that only requires one person, consider reassigning or terminating the extra employee.

Also examine your company's current debts and compile a list of obligations that are due in the near term as well as the ones that carry the most onerous terms. Potential buyers will regard such debts as unattractive — especially in today's poor credit environment. So if there's any way you can renegotiate or prepay them, you'll probably improve your company's marketability.

As you streamline, keep your potential buyer's perspective in mind. This can be difficult if you haven't already identified a specific buyer, but some qualities — such as effective inventory management — will be important to most acquiring companies (see sidebar, "Managing inventory: FIFO or LIFO?").

Don't neglect tough calls

As soon as you make the decision to sell, your company needs to review, and possibly revise, its relationships with external stakeholders. Start with current supplier contracts, deciding which relationships are most critical to the success of your day-to-day business and which ones might have outlasted their usefulness. Also, if you've had difficulty or experienced conflict with any suppliers, now's the time to consider cutting ties.

Look at your customer or client relationships as well and ask if:

- You're too reliant on one or only a few customers,
- Your customers tend to be clustered in one city or geographic region, or
- You're overexposed to certain sectors, particularly those — like real estate, construction and manufacturing — that are more vulnerable to the downsides of macroeconomic cycles.

Most business buyers prefer targets with well-diversified customer bases because diversification generally reduces the risk that a business will suffer insurmountable losses if it loses one customer or if a particular region or sector declines.

It's also never too soon to consider the effectiveness of your employees. Determine which ones are essential — particularly at the upper management level — and make efforts to retain them with incentives such as bonuses or greater responsibility. If staff reductions and unit consolidations are needed, try to conduct layoffs before putting your business on the market. Eliminating redundant staff will cut your overhead expenses and improve your financials as well as save the company's eventual buyer the trouble of making those cuts.

Managing inventory: FIFO or LIFO?

When it comes to managing inventory, companies have two choices — FIFO (a "first-in, first-out" accounting system that records older inventory items as sold first) or LIFO ("last-in, first-out," which does the opposite of FIFO). Choosing one or the other can be a major decision that affects your company's income statements and eventual sale price — particularly in a higher-inflation environment.

FIFO generally makes sense for companies whose goods have high expiration rates, such as food, or whose goods may lose their potency or effectiveness, as in the case of pharmaceuticals and chemicals. Using FIFO generally results in higher income, because it recognizes "inventory profits" — profits derived from inflationary price increases while inventory is being stored. And under FIFO, a company's balance sheet likely will show a higher value for the inventory at hand.

LIFO is a better fit for companies without expiration-related issues. Assuming that inventory prices rise as a result of inflation, LIFO records the most expensive inventory (the most recent arrivals) as being sold first. This method reduces overall profits and the value of inventory at hand on a company's balance sheet.

LIFO accounting can reduce tax exposures on income. And it's often a more accurate method of matching current product costs against current revenue, which is likely to appeal to prospective buyers.

Never too early

In the current volatile economy, a lean and healthy company is more highly valued than ever. With the help of your M&A advisors, do everything you can to shape up your organization, and you'll be better prepared to make a compelling case to buyers.