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Selling owner-managed businesses

Abraham Lincoln's quote "Give me six hours to chop down a tree and I will spend the first four sharpening the axe" is particularly relevant in today's M&A market. Whilst hope builds for more benign M&A conditions, ensuring your business withstands the scrutiny of a buyer's due diligence remains key to a successful transaction. Preparation is everything writes James Goold, partner at global law firm Taylor Wessing.

Understanding buyers' needs

Diligence requirements have tightened in recent years as buyers, particularly those from the US, seek greater assurance on businesses' quality and sustainable growth potential. The shifting of risk under key sale terms from sellers to warranty and indemnity (W&I) insurers has also meant enhanced diligence requirements as buyers look to maximise coverage.

Sharpening the axe

Key areas to focus on when preparing for a sale include:

Commercial relationships – whether with customers, suppliers, agents or licensees, formal documentation will give the buyer confidence in their investment and the underlying business plan. Review key contracts to assess the contractual basis of strategically important financial commitments and revenue-generating relationships. Identify termination rights on the sale and understand their commercial implications.

Intellectual property and related rights – defective IP ownership can scupper value, especially in IP-rich businesses. Verify key IP is owned and where relevant registered, and seek confirmatory assignments, if necessary. Having processes for monitoring possible IP infringements will reassure buyers, and resolving infringement disputes before the sale will remove uncertainty.

Ongoing disputes – actual and potential disputes and investigations should be monitored, assessed and managed to minimise their impact on the value of the business. In an increasingly regulated world, demonstrating regulatory compliance, from GDPR to industry-specific regulations and ESG, is essential.

Employment and immigration – keep employee records and policies well maintained and updated. Have employment contracts of an appropriate standard, particularly for senior managers. Misclassification of contractors' and self-employed workers' employment status can lead to significant tax liabilities, so identify the position before a sale. Verify employees' right to work status.

Share issues and tax – issuing shares to employees and directors at below market value, or not in compliance with tax-favoured option schemes, can pose significant tax liability risks. This is a hot topic for HMRC, and buyers will look to pass these risks to the sellers through indemnities. Investigating any possible risks upfront can avoid significant issues later in a transaction.

Third party consents – where a trade sale is likely, give thought to anti-trust requirements. This is principally a buy-side concern, and analysis will depend on the buyer's relevant market share, turnover etc., but target data should be prepared to assist the review. If the business undertakes activities covered by foreign direct investment or national security regulations, these should be understood and factored into the sale process. For specifically regulated undertakings (e.g. in financial services), factor in the required regulatory change of control consents.

How to secure value on a sale

In conclusion, it is vital to ensure a business's key commercial arrangements are contractually secure, its rights adequately protected and its legal obligations met. Equally important is a well organised data room, so bidders can readily assess these factors – particularly if under the pressure of a highly competitive auction process, when understanding the business at speed is essential. Sourcing the right adviser can be key to navigating such complicated issues.

Contact us

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