

# Dentons Global Thought Leadership:

## The options and process for the sale of a family business

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In our previous white paper, **Succession Planning for Family Businesses**, we explored a range of exit strategies. Now, we discuss one of the most challenging and critical transitions: the sale of a family business.

For many entrepreneurs, the culmination of years of dedication, risk and personal investment is the sale of their business—a process fraught with complexity. While seasoned entrepreneurs often embark on their business journey with an exit in mind, understanding the myriad exit strategies remains crucial regardless of the timing. This guide aims to navigate you through that intricate process, ensuring that when the time comes, you are prepared to transition with confidence and success.

### Preparing the business for sale

Making the business attractive to potential buyers is both an art and a science. This involves not just operational readiness but also strategic positioning to appeal to the right buyers:

- **Identify and understand potential buyers:** Tailor your preparation to align with the interests and values of these buyers. Understanding what they are looking for can help you position your business as an attractive purchase.
- **Risk assessment and mitigation:** Conduct thorough risk assessments to identify any potential issues that could deter buyers or devalue your business. Addressing these proactively can make your business more appealing.
- **Corporate governance:** Even in family businesses, formalizing operations can significantly increase attractiveness to buyers. Ensure your business's internal processes, contracts and records are well-documented and in order.

These steps not only make your business more attractive to potential buyers but also can significantly increase its market value.

## Types of buyers

Understanding the landscape of potential buyers is crucial for positioning your family business for sale. Buyers generally fall into two categories:

- **Financial buyers:** Typically interested in the return on investment, financial buyers, such as private equity funds, assess businesses for their growth potential and profitability. They aim for businesses that promise attractive yields and a profitable exit strategy.
- **Strategic buyers:** These buyers are looking for synergies with their existing operations. Companies that offer complementary products, services or customer bases are attractive to strategic buyers who seek to integrate new acquisitions to drive long-term shareholder value.

Knowing the motivations and objectives of these buyers can guide your preparation and marketing strategy, potentially influencing the sale's terms and price.

## The management team

A good management team is pivotal for owners aiming for a clean exit. This enhances the business's value by demonstrating operational independence from the owner, potentially opening doors for a management buyout (MBO) with external capital.

## Sales processes compared

### Traditional model

- Begins with broad expressions of interest and moves to indicative offers, due diligence and, finally, firm offers.
- **Advantages:** Broad market exposure and potentially quicker initiation of serious interest.
- **Challenges:** Risk of widespread dissemination of sensitive information; due diligence may lead to price and term negotiations unfavorable for the seller.

### Alternative model

- Starts with an invitation to a select group of qualified buyers for an in-depth review.
- **Advantages:** Limits exposure of sensitive data; terms are agreed upon early, making due diligence confirmatory rather than exploratory.
- **Challenges:** Relies heavily on the advisor's ability to identify and engage all potential buyers, possibly missing out on interested parties.

## Methods of valuing a family business

Two primary methods are frequently employed:

- **Assets + goodwill:** Ideal for smaller enterprises, this focuses on the tangible assets and an additional goodwill component based on profitability.
- **Multiple of earnings:** Common for larger businesses, where the price is a multiple of EBIT or EBITDA; it factors in the company's operational profitability and potential for growth.

Regular valuations and strategic planning can help business owners align their expectations and strategically increase the business's value over time.



## Methods of selling

When selling a family business, owners have two primary avenues: The buyer purchases shares in the business or purchases the assets. Each method has distinct implications for both seller and buyer:

- **Purchase of shares:** In this method, the buyer acquires the business's entire share capital, effectively taking over the company along with all its liabilities, including tax and contractual obligations. This approach necessitates a comprehensive due diligence by the buyer to scrutinize the business's legal, tax and financial standing, often resulting in a more detailed sale and purchase agreement with extensive warranties.
- **Purchase of assets:** Here, the buyer acquires specific assets of the business, such as equipment, inventory and intellectual property, without assuming its liabilities, which remain the seller's responsibility. This method generally requires less due diligence from the buyer's perspective, as the focus is on the tangible assets being acquired rather than the business's overall legal and financial health. The seller may need to address any remaining liabilities, potentially including the liquidation of the company.

Each method offers different strategic advantages and risks, with the choice largely depending on the business's circumstances, the seller's goals, and the buyer's preferences.

## Earnout agreements

These agreements align the seller's compensation with the business's future performance, mitigating the buyer's risk by ensuring the business continues to thrive post-sale. While earnouts offer potential for additional compensation if the business hits certain targets, they also come with complexities and risks that need careful consideration and structuring.







## Selecting the deal team

Assembling a team of seasoned professionals is crucial. This team should include:

- Lawyers with expertise in business transactions within your business sector.
- Accountants skilled in financial analysis with an understanding of the tax implications of the sale.
- Advisors or business brokers with a deep network and successful sales track record in your market.
- Investment bankers for larger deals, offering structure and access to a broad range of potential buyers.

## The roles of investment bankers and business brokers

Choosing between an investment banker and a business broker depends on the size of the deal and the nature of your business:

- **Business brokers:** Ideal for smaller sales, business brokers are akin to real estate agents for companies, handling transactions typically below a certain financial threshold. They are best suited for deals where the purchaser is likely to be an individual or a small group.
- **Investment bankers:** For larger transactions, investment bankers offer a more comprehensive service, developing a narrative to attract institutional buyers or sophisticated investor groups. Their involvement is more intensive, often reflected in their fee structures, which may include a monthly retainer in addition to a success fee.

Your choice will be influenced by your business's size, the complexity of the sale and the type of buyer you aim to attract. Each offers distinct advantages and requires careful consideration in order to align with your objectives for the sale.





## Common tax problems

Tax issues often emerge as significant concerns during the due diligence process, impacting the negotiation and final terms of a business sale. Common tax-related problems include:

- **Employment status discrepancies:** Misclassifying employees as self-employed can lead to tax liabilities.
- **Questionable termination payments:** Payments thought to be tax-exempt might actually be taxable.
- **Profit extraction tactics:** Strategies used by shareholders to minimize taxes could border on tax avoidance.
- **VAT/GST noncompliance:** Incorrect handling of input tax recovery can indicate compliance issues.
- **Lax expenses and benefits policies:** The absence of clear policies or enforcement indicates potential for tax discrepancies.

- **Corporate tax compliance errors:** Overstated deductions or inaccuracies in financial reporting can lead to disputes.
- **Capital allowances and R&D overclaims:** Claims that exceed legitimate amounts or are based on flawed reasoning can attract scrutiny.
- **Transfer pricing noncompliance:** Lack of formal policies can signal risk to tax authorities.
- **Tax filing delays:** Late returns and resulting penalties reflect poorly on tax compliance.
- **Lifestyle business concerns:** Personal expenses masked as business expenditures can lead to tax complications.

Addressing these issues early on can significantly smooth the due diligence process, enhancing the business's appeal to potential buyers.





## Executing the sale

Executing the sale of a family business is a nuanced and pivotal phase and involves several critical steps:

- **Engaging with potential buyers:** Start by securing confidentiality agreements to protect sensitive information before sharing an information memorandum. This document offers a business overview without revealing confidential details, helping buyers decide on pursuing the acquisition.
- **Fielding offers and negotiations:** Evaluate each proposal with your advisors, focusing on the buyer's financial capacity, strategic alignment and the deal's overall feasibility. Negotiations will address not just the price but also terms, transition support and other conditions.
- **Due diligence:** Post-preliminary agreement, the buyer embarks on a thorough review of your business. Your preparation, including organizing financial records and contracts, is crucial to facilitating this process and building trust.
- **Finalizing the sale:** Upon completing due diligence and resolving any issues, draft and sign the sale agreement, detailing the transaction's terms. This leads to the closing, where the deal is formally concluded.
- **Transitioning the business:** Often, a transition period follows the sale, where you'll assist in transferring knowledge and practices to the new owner. A clearly defined transition plan benefits both parties, ensuring a seamless handover and continued business success.

This streamlined approach ensures clarity and actionability, guiding sellers through each phase of the transaction towards a successful sale and transition.



## Engaging with the family throughout the lifecycle of a family business

Engaging family members and stakeholders throughout the lifecycle of a family business is critical to maintaining harmony and alignment. This should happen even if no sale is contemplated. Here's a suggested approach:

- **Discovery:** Begin with a comprehensive discussion to understand the perspectives and expectations of all family members and key stakeholders.
- **Drafting a succession plan:** Use insights from the discovery phase to draft a succession plan, then share this draft for feedback, ensuring all voices are heard and considered.
- **Finalizing a succession plan:** Refine the succession plan based on feedback, solidifying a roadmap that has broad support.
- **Adjusting the plan:** Remain flexible to pivot the succession plan towards a sale strategy if it aligns better with the family's goals and business realities.
- **Executing the sale:** Implement the business sale process with ongoing communication, ensuring that family members are kept informed and involved at each stage.

Continuous dialogue and feedback are essential at every step, ensuring that the process is inclusive and reflective of the family's collective vision and objectives.

## Preparing for life after the sale

After selling a family business, the transition to the next phase of life involves significant planning and adjustment. Considerations include whether to establish a family office for managing the proceeds and investments or to operate as independent family units. This transition also marks the shift from being a family in business together to a family of individual investors and interests. Detailed strategies and guidance for navigating these decisions will be explored in our next white paper, focusing on laying a foundation for success in this new chapter.





## Conclusion

The sale of a family business is a monumental step that requires meticulous preparation, strategic planning, and the right support team. By understanding the sales process, valuing your business accurately and preparing effectively, you can ensure a smoother transition and a successful outcome for all parties involved.

Dentons, the world's largest law firm, advises family businesses through all aspects of their lifecycle. **Dentons Exit+** is a cross-disciplinary team comprised of legal, M&A advisory, wealth management and accountancy experts who help families and entrepreneurs develop and implement effective strategies for selling their businesses and preparing for life after exit. Dentons Private+ is a "one-stop," global legal services concierge that supports high net worth families and helps private offices organize their affairs during and after this process.



## Henry Brandts-Giesen

Henry is an expert in wealth planning, family office design and governance, family business succession, trust law, fiduciary risk management, family/private wealth/relationship property-related dispute resolution, residency by investment, cross-border wealth structuring, transitional residency tax planning, private funds, strategic philanthropy, captive insurance, global tax reporting and compliance, and financial regulation relating to private wealth.

Henry is general counsel and strategic advisor to single-family offices, investor migrants, foreign investors, multi-family offices and trust companies, entrepreneurs, private fund managers, limited partnerships, family businesses, philanthropists, athletes, player associations and sports agents.

Jurisdictionally neutral, Henry develops global strategies and provides and procures global solutions for global clients from within and beyond the Dentons platform.

## Edward V Marshall

Edward V. Marshall is the Global Head of the Dentons **Family Office and High Net Worth** (DFO) group. Edward is a family office insider and a renowned family office researcher, advisor and author. He is regarded as a thought leader in the family office space, distinguished by his service to complex families around the world. He is also a risk and threat management specialist and works with families to reduce their cyber, physical, financial, operational and reputational risk profiles.

DFO is a global cross-practice group that services Dentons' clients who are family businesses, investors, family offices or high net worth individuals. The team works closely with families considering a family office, families with an existing family office and advisors to families. The group curates a program of insights, advice and connections to advise the firm's clients and relationships across the globe.

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Chris is a corporate partner at Dentons. His focus is on cross-border private equity and venture capital investments and exits, as well as mergers, acquisitions, and joint ventures. He has developed considerable expertise in corporate governance and is frequently asked to advise boards of directors, shareholders, family stakeholders and corporate leadership on the full range of governance issues that confront them.

An emerging markets specialist, Chris has advised on more than 250 transactions on behalf of leading private equity and venture capital investors in the Middle East, CIS, Central and Eastern Europe, Asia and Africa. He has served on the Global Steering Committee for the Dentons Family Office and High Net Worth group, which provides cross-sector and cross-practice services to ultra-high net worth individuals and their family offices globally. In this role, he conceived and oversees **Dentons Exit+**, a cross-disciplinary team comprised of legal, M&A advisory, wealth management and accountancy experts which help families and entrepreneurs develop and implement effective strategies for selling their businesses and preparing for life after exit. He also created and manages Dentons OneTeam+, an integrated solutions for private client and family offices, fund managers and sophisticated investors.

