

Preparing a Family Business for Sale in the UK – Things To Consider

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The sale of a family business is a complex process. Almost invariably, it will raise issues that need to be considered and addressed pre-sale. Navigating those issues will be the key to achieving a successful outcome for both seller and buyer. This article examines key areas to consider and raises points for family business owners when deciding to sell.

Pre-Sale Structuring and Tax Planning

- **Before going to market, evaluate the business's existing corporate structure.** Are any changes to that structure needed? The more complicated (or messy) the structure, the harder it can be to sell, the longer it may take to sell and the more likely it is that buyers may ask for indemnification in respect of risk that may be inherent within it. To simplify a structure for sale, sellers may need to spin-off non-core assets, consolidate multiple entities into a single holding structure, or separate personal assets (such as real estate or vehicles) that may have become mixed with business assets over time. In addition, the impact of the existing structure on the business's financial statements should be considered. Financial statements that are easy to understand and that show the business can operate on a stand-alone basis will be key to realising value.
- **Tax planning should begin well in advance.** Sellers need to understand the taxes that they will pay on a sale and structure the sale in a manner that is as tax-efficient as possible. This will mean, first, whether to structure the sale as an asset sale or a share sale, as each will have different (often significant) tax consequences for both parties. Sellers should also assess any available tax reliefs and the timing of the sale in light of any anticipated changes to tax legislation.
- **The shareholder register should be ready for sale.** This will be a major focus for buyers. This may mean buying out minority shareholders, resolving dormant or disputed shareholdings, and ensuring that all prior share transfers (including any share buy-backs) have been properly documented and registered. Any informal arrangements regarding equity participation should be

formalised. Likewise, any shareholders agreements should be checked for pre-emption rights, put and call arrangements or any other share transfer provisions (for example, in respect of the value at which shares can be sold) that may impact the sale process.

How Will the Business Work Without the Existing Owners?

- **Who will the new managers of the business be?** This is often a difficult question to address. It can be hard to sell a business that has operated for a long time with the same management team in place. A seller will need to consider this and related questions, such as whether the current owners of the business will be interested in driving the business after the sale. Whilst that team may have been integral to the business for many years and have in-depth knowledge of the business and its customers and suppliers, any sale process will need to consider how the business will operate without them and who the new management team will be. Transitioning to a new management team takes time and thought and needs to be planned early.

Types of Buyer and Valuation

- **Who will the buyer be?** There can be significant differences between a trade buyer and a professional investor. A sale to an industry buyer may offer strategic synergies and a potentially higher headline price, but may also involve significant changes to the business post-closing and potential holdbacks or deferred consideration. A sale to a financial buyer, such as a private equity firm, may allow some of the existing management to retain a stake in the business, which may be attractive, but may also involve complex financing arrangements and ongoing reporting obligations.
- **Understand how a buyer is likely to value the business.** This should help a seller to set realistic expectations and to negotiate effectively. Valuation of family businesses can be complex. Common methodologies include multiples of EBITDA, discounted cash flow analysis and comparable transaction analysis. Buyers may apply discounts for factors such as customer concentration, reliance on key personnel, or the absence of audited financial statements, so sellers need to ensure they can address these areas if necessary. A seller may wish to retain the services of a financial advisor in order to assist with this process.

Pre-Sale Due Diligence

- **The due diligence process on the sale of a family business can be very challenging.** Early planning is the key to a successful process. Sellers should aim to identify areas or items that they anticipate may be of concern to potential buyers and address them prior to a sale or, if this is not possible, be ready to explain how they will be resolved as part of the sale process. Matters such as outstanding litigation or employee claims, potential environmental matters, key contracts

that are up for renewal, or minority shareholders who may need to be dragged as part of the transaction all need to be considered.

- **Ownership of key assets and possible related-party transactions are other focus areas.** Does the business own its key intellectual property assets or are they still owned by the one or more of the individual family members? Contracts with family members or with entities owned or connected to family members — whether for services, supplies or property leases — may not be at arm's length and may impact how the business will work on a stand-alone basis. These are all areas that impact value. Sellers should identify all such arrangements, assess whether they will continue post-sale, and be prepared (if necessary) to renegotiate them as part of the transaction. Addressing these issues early should mean that a seller can negotiate their impact productively, rather than being reactive to a buyer's requests as part of the due diligence process. The process of identifying and rectifying issues prior to sale takes time, so sellers should start this process early and give themselves plenty of time to work through the implications of what is proposed.
- **Locate key documents and build a clear and comprehensive dataroom.** A well ordered dataroom (virtual or otherwise) is likely to have a positive impact on buyers and to lead to a smoother transaction process.
- **Maintaining confidentiality throughout the sale process is critical.** Information flow and access to the dataroom should be carefully controlled and all potential buyers should sign non-disclosure agreements prior to receipt of commercially sensitive information. Sellers should be particularly careful when dealing with competitors or strategic buyers who may have commercial motivations beyond the acquisition itself. A staged disclosure process — releasing more detailed information only as discussions progress — can help protect the business.

Employment Matters

- **Look closely at existing employment arrangements.** Buyers will scrutinise the financial impact of family members on payroll and those with informal or off-market arrangements. These arrangements can impact operations and profitability, so a seller should review all employment contracts and consider whether any arrangements need to be amended, or terminated prior to the sale. Communication with employees is another sensitive matter. Premature disclosure of a potential sale can be very damaging and lead to uncertainty, reduced morale, and departures of key staff. So, sellers should develop a communication strategy that maintains the confidentiality of the sale process while dealing with the practical realities of the due diligence process. In many cases, key employees will need to be informed and possibly incentivised to remain with the business through and after the transaction.

Regulatory and Compliance Matters

- **Ensure all necessary licenses, permits, and regulatory approvals are in place and up to date.** Historical compliance issues or ongoing investigations should be identified and, where possible, resolved prior to sale. A clean compliance record will enhance the attractiveness of the business to potential buyers and lead to fewer possibilities for post-closing claims.

Warranties, Indemnities and Restrictive Covenants

- **Engage in the process.** Warranties are statements of fact about the business that cover matters such as the accuracy of financial statements, ownership of assets, compliance with laws, and the absence of undisclosed liabilities. In any sale, the buyer will expect the seller to provide warranties about the business. Providing false or misleading information or failing properly to consider the content of the warranties can give rise to damages claims against the sellers after completion, so the warranties (and the associated disclosure process against them) must be done carefully.
- **Try to limit indemnity exposure.** In addition to general warranties, buyers may seek specific indemnities for identified risks — for example, in respect of ongoing litigation, tax exposures, or environmental liabilities. Sellers should seek to negotiate appropriate caps and time limits on their liability under the warranties and indemnities and consider warranty and indemnity insurance.
- **Be aware of restrictive covenants.** It is typical for buyers to require selling shareholders to give non-compete and other restrictive covenants, to prevent the sellers from competing with the business, soliciting its customers or employees, or using confidential information for a specified period after closing. Sellers typically give these covenants; however, they should always consider these provisions carefully, as they may significantly limit their future activities.

Post-Sale Involvement

- **Will the sellers stay involved in the business?** The sellers may remain involved in the business for a period after closing, for example, to help with transitional arrangements or because of an earnout or some form of deferred compensation. The parties should consider how this involvement might work in practice — whether, for example, the former owners will retain a seat on the board for a period or whether they will remain involved on a consultancy basis. The dynamic between existing staff and the former owner will also need to be carefully considered and managed, to ensure that the business runs smoothly under new ownership.

Conclusion

As we hope this article demonstrates, selling a family business can be a challenging but ultimately rewarding process. Early planning, together with the proper advice, will be key to ensuring a successful outcome. Please contact any of Oliver Williams, Edward Tran or Thomas Laurer if you would like more information about any of the topics raised in this article.

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