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Running the Show **The Art of the Sale**

There are lots of different ways to sell a company. Each has its pros and cons.

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For many entrepreneurs, selling a business can be almost as complicated as running one.

Whether they turn the company over to trusted managers, or sell it in a way that rewards employees, or just sell it to an outside buyer, the wrong approach could have serious financial consequences -- for both the entrepreneur and the company.

Here's a look at the pros and cons of some of the most common sales methods.

OUTRIGHT SALE

Probably the simplest method of cashing out of a company is selling it to an outside buyer. This approach makes sense when an owner's family has no interest in continuing the business, for instance, or when the owner can't figure out how to meet the challenges the business faces. (Or, of course, when the owner gets an offer that's too good to pass up.)

In an outright sale, there are two general approaches owners can take. They can sell the company's assets for cash or notes and then distribute the proceeds among themselves in liquidation. Or they can just sell the buyer their stock, or the units in their limited-liability company.

But keep in mind: Stock sales tend to benefit the seller, while asset sales benefit the buyer. Why? Asset buyers are generally protected against prior claims relating to the operation of the newly purchased business, says George R. Kamperschroer, a managing partner at business law firm Neider & Boucher in Madison, Wis. In other words, buyers are just getting the company's physical equipment, facilities and customers, as well as intangibles such as trademarks and goodwill. The previous owners are generally responsible if, say, an environmental claim arises about one of their former properties, or an employee hired on their watch files a discrimination suit.

If buyers purchase the stock of a company or the units of an LLC, they are buying the company itself -- and are exposed to all of those potential problems.

"Most sales of small, closely held businesses are structured as the sale of the assets of the business," says Mr. Kamperschroer. "Buyers prefer this because they do not want to get stuck with what we call the unknown liabilities of the business." (Some experts note that an attorney can provide protection from those liabilities in a stock deal.)

For some older small businesses, there's also a tax issue. Today, most businesses, particularly those that generate between \$5 million and \$35 million in revenue, are structured as S corporations or LLCs. Before the Tax Reform Act of 1986, businesses were more often structured as C corporations, although many have since converted to S corporations. The big difference? S corporations and LLCs are "pass-through entities," so they don't pay corporate taxes on their income. Instead, individual owners pay taxes on that money, as if it were personal income.

But in a C corporation, the company itself pays tax on its income, and the owners *also* pay tax when income is distributed to them as dividends or in liquidation. So, when selling the assets of a C corporation, owners face a double tax bite.

MANAGEMENT BUYOUT

Selling the business to its current managers is also a popular option. An owner might go this route when the company has a trusted, entrepreneurial management team that wants to carry on the business. But there are potential drawbacks.

For one thing, the sale price may be smaller. "With a buyout loan from a bank, the manager-buyers probably are not going to be able to come up with the same price for the seller as if he sold it out on the market," says C. David Chambliss, managing principal of Abraxas Business Services in Atlanta, a business-brokerage firm. The reason is that banks that fund loans for companies being bought out typically are quite conservative on credit underwriting -- in part, because it's tough to predict how the company will perform under the new owners.

That raises another possibility for sellers: The new owners might not be able to handle running the company. If owners see their former business faltering, they may feel obligated to step back in and set things right. "If it doesn't work out, you may end up getting the business back and trying again," says Mr. Kamperschroer.

EMPLOYEE STOCK PLAN

Many business owners sell their company through employee stock-ownership plans, or ESOPs. They're a complicated option but have some big advantages.

The first step: The company being sold creates an independent trust for employees. That's the ESOP. The trust then buys up the owner's stock -- at a price set by an independent valuation company -- and holds it for the employees. When the employees retire, they can sell the stock back to the company; by law, the employer must buy it at fair market value.

For many owners, ESOPs are a way to reward loyal employees. Congress is also pushing the plans, giving them big tax benefits: An owner who sells shares to an ESOP and reinvests in U.S. equities may defer capital-gains taxes on the sale until getting rid of the new investments.

Still, there are some potential turnoffs for entrepreneurs. The value of ESOP share purchases is set by an independent third party, which might mean a lower price than owners would set themselves. And the company must have the cash to buy back the shares when employees retire. If lots of employees retire at once, for instance, the company might come up short -- which would mean leaving employees in the lurch as well as facing legal sanctions from the government.

"That falls into the category of 'buyer beware,' " says J. Michael Keeling, president of the ESOP Association, a Washington, D.C., organization that represents ESOP companies and employees. "The seller can walk away, but most sellers do have a core value that they don't want to leave the employees with an uncertain future -- they have a tie, a loyalty."

RECAPITALIZATION

Owners can also cash out of a business by changing the company's capital structure. This is often the best approach for owners who want to sell their stake gradually, or who want to get some cash out of the business without giving up control.

Let's say a company has an outside investor who's interested in the business but doesn't want to commit to buying it just yet. The company might issue preferred stock to the potential buyer. So, the owner would get an infusion of cash, and the buyer would have the chance to get familiar with the company's operations without taking the full plunge.

Or maybe an owner wants to "take some chips off the table" and get a chunk of money out of the business, says Joseph H. Astrachan, executive director of the Cox Family Enterprise Center at Kennesaw State University in Georgia and editor of the Family Business Review. For instance, the company might take on debt to buy a portion of the owner's stake (a move that takes some sophisticated tax planning, Mr. Astrachan warns).

One final note. For all of these methods, one general rule applies: Get a good adviser. Owners should do their homework and find someone who has had a successful experience selling. It's also important to make sure there's chemistry, says Mr. Astrachan. An adviser who shares a company's goals and values is more likely to go the extra mile in setting up a sale.

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