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CORPORATE KNOW-HOW

SELLING A BUSINESS: SECURING THE PURCHASE PRICE

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HOW TO SELL A BUSINESS

SECURING THE PURCHASE PRICE

When selling a business, what constitutes the best offer can be influenced by a wide variety of factors. Is a quick and clean exit the priority? Is the seller keen to ensure a smooth transition to an up and coming management team? Is hitting a certain financial threshold more important than how and when it gets paid? The answers to the above questions could lead to very different purchase terms, even for the same business, reflecting the matrix of factors driving what is frequently a life changing crystallisation of wealth.

Previously we looked at the ways that buyers might seek to mitigate their risk in an acquisition by delaying a proportion of the purchase price and where possible qualifying whether deferred payments should even be made. This article looks at the flip side of price structuring, instead focussing on how a seller could secure elements of the purchase price that are delayed – or at least obtain comfort around the buyer's ability to pay them.

From a risk management perspective, the ideal scenario for a seller will be for the whole purchase price to be paid in cash upfront on completion of the sale. This places the funds entirely in the seller's control, without reliance on the ongoing solvency of the buyer or the performance of the seller's former business. Such a deal structure is unlikely to appeal to a buyer that is concerned about their ability to recover future liabilities from a seller or wishes to incentivise a seller's engagement post-sale and therefore the commercial pressure to accept some form of deferred payment element can prove irresistible. Below are four common methods of obtaining more comfort that the maximum value in the purchase price is achieved while also allowing a seller to gauge how much confidence a prospective buyer has in their ability to meet their own financial obligations.

(1) ESCROW ARRANGEMENTS

If part of the purchase price is being deferred for payment after the date of sale, escrow accounts offer one of the safest ways of securing those monies. Whether secured in the client account of either party's solicitors, or with an independent escrow agent, escrow accounts ensure that neither party can access the funds outside of specific circumstances agreed between the parties. Although not always popular with buyers, who often prefer unfettered access to their funds, they can offer a middle ground between a buyer's concerns that a seller will take their money and disappear, against a seller's concerns that the buyer may not have the required funds available when the deferred payment falls due post-sale.

(2) GUARANTEES

Guarantees are a useful option for sellers who may have doubts about a buyer's longer-term stability, or would like a connected company (or companies) of the buyer to stand behind their obligations.

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Securing a buyer's obligations with guarantees from additional parties, particularly where the prospective guarantors are profitable trading businesses, can provide a great deal of comfort – especially where significant value in the purchase price is being deferred post-sale. Requesting a personal or corporate guarantee can also be a good way to gauge a buyer's confidence in their own finances going forward and may prompt disclosure of other financial commitments previously unknown to the seller. A buyer's reluctance to provide a guarantee, combined with other red flags around their financial stability could help to paint a clearer picture of exactly who the seller is planning to transact with and whether it remains the right decision.

(3) CHARGES & DEBENTURES

Although not necessarily as common as the options set out above, obtaining a charge over certain assets of the buyer or even the shares in a business being sold to the buyer can offer a valuable source of security to a seller. Outside of an escrow arrangement, pursuing a buyer for unpaid elements of the purchase price can be an uncomfortable prospect when there is no guarantee that the buyer will have the funds to pay a liability once determined. Provided that the asset in question holds its value, holding a charge over it ensures that a seller can enter into enforcement proceedings via the Courts with the confidence that if they are successful, they will have something to set off against their losses.

(4) STAYING INVOLVED

Not strictly a legal security arrangement, but remaining in the business post-sale is worth mentioning nonetheless. Whether this is desirable for the seller or the buyer depends on the transaction, however, staying involved in the business that has been sold is a good way for a seller to maintain awareness over the business' performance and the financial stability of the buyer. An ongoing management, employment or consultancy role can provide much more insight into a business than may be afforded from the outside, where a seller would need to rely on the buyer to promptly advise of issues that could affect payments.

Information rights can be included within the sale documentation, ensuring that outgoing sellers have access to management accounts or debtor books, although by the time such information is made available it can often be too late to take action to secure any unpaid amounts. Not only can a close working relationship post-sale with a buyer be a useful way of monitoring the ongoing performance and financial stability of the seller's former business, it can also provide an opportunity to head off warranty claims through direct involvement with the management of any claims.

While not comprehensive, the above commentary shows just how varied forms of security can be, adaptable to the structure of a transaction and the objectives of its parties. Just as a buyer's allocation of risk in how the purchase price can change over the course of a transaction, so should a prospective seller feel comfortable in requesting new or additional security as a transaction progresses and new details of the buyer come to light. Although it can seem trivial when buyer/seller relations are at their peak, and there is no sign of financial difficulties on the horizon, taking the time to ensure that the purchase price is appropriately secured will be time well spent in the event of a default by the buyer.

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Whether you are considering acquiring a business, selling a business or you are advising on such matters, our specialists in the Corporate team at Collyer Bristow would be happy to provide you with the support you need.

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