

BUYING OR SELLING A BUSINESS: SUCCESSFULLY NEGOTIATING PRICE

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The most difficult issue in negotiating the purchase or sale of a business is negotiating price. Generally speaking, if you reach an agreement on price you can reach an agreement on everything else as well. In negotiating price it is important to remember that there is more to a good deal than price, and the best deal for both parties generally means neither party is “winning” the price argument.

Please note that this article has been written from the perspective of the owner/manager of private business with a selling value in excess of \$1,000,000.00, and applies equally to share sales and asset sales.

PART 1 -A COMMON GOAL AND COMMON UNDERSTANDINGS

Ultimately the buyer and the seller should have the same goal: to make the best possible deal for both parties based upon a fair assessment of the business opportunity in question.

However, in accepting this goal both the vendor and the purchaser must accept that the best deal for both parties rarely means either party gets their best deal on price.

In order to achieve this goal, it helps if a number of common understandings are expressed and accepted by both sides:

- You do not buy or sell a business; you buy or sell a business opportunity. The only thing that can be assessed with any certainty is the past. The future is always uncertain. However the future is all the seller has to sell and all the buyer has to buy. Therefore, each party must seek to understand and influence the other party’s view of the business opportunity on the table. After all, a deal on price and structure will only occur if a mutually acceptable consensus on the future of the business is agreed to. Each party should have as much independent, empirical information as possible to support their assessment.
- The seller’s reasons for selling and the buyer’s reasons for buying will probably have nothing to do with each other. In order to successfully negotiate a good deal, both sides need to honestly disclose why they want to either buy or sell. Without this fundamental knowledge a lot of energy can be wasted as each side negotiates from their own needs and perceptions instead of from the other party’s point of view. If you each know why the other want wants what they want, you can work together quickly to find a common ground for doing a deal. The best deals

really are “win/win” deals. If you think you are in a “win/lose” negotiation, you should walk away.

- Value and Price are not the same thing. At lot of energy can be wasted arguing “value” versus price. The seller usually wants to argue “fair market value”, while the buyer wants to argue price. This table will show you what I mean when I say that value and price are not the same thing:

Fair Market Value	Negotiated Purchase Price
The highest price that could be obtained for the business in question ...	What buyer wants to pay the highest price?
... in an open and unrestricted market ...	The market for private companies is usually narrow and restricted.
... between prudent parties with equal knowledge and negotiating strength dealing with each other at arm’s length...	The seller always has more knowledge of their own business, the parties rarely have equal negotiating abilities, and the parties are not always prudent or at arm’s length.
... who are not compelled to act ...	The buyer is often compelled to sell for some reason, and the buyer can sometimes be compelled to buy.
... and where the purchase price is paid in cash on closing.	Businesses sometime sell on an all cash basis, but there are usually multi-faceted aspects to the consideration and payment structure, and most buyers are not in a position to finance an all cash deal (especially at the seller’s asking price).

- It does not matter how you get to the same price, as long as you get there. Lots of emotion can be introduced into a negotiation when each party tries to convince the other of the rightness and wrongness of their respective calculations and price. This is a frequent deal wrecker. While each side should be willing to disclose and justify their price calculation, it does not matter if you use the same formula or the same variables. What matters is that you justify your assessment, seek to understand the assessment of the other party, and ultimately reach agreement on price.
- There is no “right price”, only a range of reasonable prices. The purchaser will try to reduce its risk and increase its returns by arguing for a price in the low end of the range. The vendor will try to improve its return by arguing for a price in the high end of the range. What matters is that you agree on the range, and then see if you can find a price within that range which is mutually acceptable.
- Price is dependant on structure. Shares vs. assets, use of retiring allowances and consulting fees, vendor take back financing and earnouts, non-competition covenants and similar matters can significantly affect each party’s view of a reasonable price. In particular, the “price” can fluctuate significantly depending on how the “price” is allocated between taxable capital gains or taxable income (to the vendor), or depreciable assets or future operating expenses (to the purchaser), and whether the seller holds any earnout risk or financing risk.

- There is more to a deal than price. Many other factors must be assessed in determining if a good deal has been reached. These include issues related to financing, tax planning, synergies and post-closing commitments. A buyer should be willing to go higher up the price range for the right intangibles. A seller should be willing to come down the price range for the same reasons.