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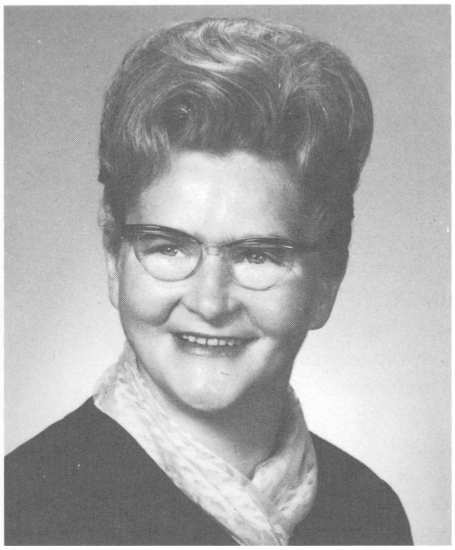

Small Business

THE SMALL BUSINESS — How Marketable is it?

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If the owners of all the small businesses in this country never died, became disabled, got, let's say, past "middle-age", or became just plain tired — they would be in great shape. But what happens if a sole proprietor, the partners in a going business or the owners of a close corporation want "out"? To say that finding a suitable and willing buyer is a hassle is an understatement.

The Unique Ingredient

One of the biggest problems is the fact that, aside from the usually large investment in capital it requires, it takes a very special person to take over the management of a small business — it takes that unique ingredient: entrepreneurship. While many people are capable of turning out good performances in supervisory or high-level management positions, being the boss of a small business requires more. It's hard work, long hours and the weight of the final decision.

In most cases, the business is entirely dependent on the skill, knowledge and often the personality of the "boss". Ideally, the new owner should be a carbon copy of the old one. Some people are lucky, they have a son or a daughter who is willing and eager to take over — others have to go to the outside.

Up from the Ranks

The next best thing, probably, is to hand pick a successor, do a lot of grooming and bringing along and then making it possible for the "Junior Boss" to acquire the business financially. It sounds good to go that way, but a lot of things can go wrong with this plan. The chosen successor may not have all the ambition he or she appeared to have at first and turn out to be unsuitable. He or she may predecease the owner, or somebody else may recognize the management potential of the young person and lure him or her away.

The problem becomes even more acute where unexpected death deprives the business of its sole owner, one of the major stockholders, or a member of the management team. While insurance can ease the financial blow, the life of the business may be at stake. How important is the "life" of the business? It's a matter of mathematics.

The Going Business — The Ultimate Pay-Off

Most sole proprietors, partners or officer-stockholders who are thinking about the sale of their businesses derive a steady and comfortable income from their businesses while at the same time the business grows, prospers and increases in value. It's like the goose that lays the golden eggs. The real value of the business lies in its continued ability to generate income — which comes back to the ability of the owner to make it successful or to keep it on its successful course. More often than not, the well-run, well-managed and prosperous small business is the end result of many years of great effort and many personal sacrifices.

There comes the point when the business is expected to provide a retirement income, security for a surviving spouse or where it will make the difference between comfort and poverty should the owner become disabled.

Sale or Dissolution?

There can be no question about the fact that liquidation should be a last resort. Too many times a forced sale means that inventories must be sold at less than cost, accounts receivable are hard to collect after a business has ceased to function in the normal course, and after all existing liabilities are paid off, the net proceeds on liquidation may be quite small.

Needless to repeat the old axiom that the right price is what a willing buyer will offer and a willing seller will accept. But it points up the fact that there can be no formula. The degree of effort and the amount of training or skill required of the potential buyer will greatly influence the price that can be obtained. A long history of steady earnings is certainly helpful in marketing a small business. Although there are cases where the prospective new owner will be absolutely certain that a business with mediocre earnings needs only his or her magic touch — this person is the great exception, the true entrepreneur who is spurred on by the challenge and who would probably be successful in just about any endeavor through sheer tenacity, frugality and hard work. But certainly there are not enough of that kind to go around.

It will be a hard search for the right combination of the man or woman who can run the business right and who at the same time has the capital required for the purchase.

The Professional

Among the professionals probably the medical doctors and the related professions are the only ones who have gone into corporations in a big way. Accounting firms are slowly following suit with the legal profession trailing far behind. While the corporate form appears to make things a little easier, the fact that every stockholder must be a member of the profession still adds more problems to the difficulties encountered by commercial small businesses in locating qualified buyers. Much more so than the owner or owners of a business enterprise, the professional must plan ahead for the orderly transfer of the practice.

If a sole practitioner dies suddenly, the practice is not much to fall back on for the surviving spouse. Especially in the medical field, the accounts receivable are the single largest asset of the practice, and while patients are notoriously slow in paying their bills even while they are seeing the doctor on a continuing basis, collecting patients' accounts on behalf of a deceased sole practitioner is a monumental task and losses are extremely heavy.

The process of choosing and training an associate to eventually become the successor of a retiring professional can be a very frustrating experience. While it is still customary in the accounting and legal professions to have a new associate purchase a partnership interest or the stock in a professional corporation, the medical profession has for decades made it possible for young doctors to acquire a partnership interest or equity in a corporation at nominal, if any, capital outlay. Generally, the new associate's compensation is related to accounts collected while the income generated becomes part of the assets of the practice — which in turn becomes the capital contribution. Competition for young doctors — particularly in the highly specialized fields — is very strong, and naturally the ease with which a proprietary interest can be acquired, along with current compensation, influences the choice of the young professional to a very high degree. The opportunities available in the field also make it difficult to hold on to an associate after he or she has been trained and would be ready to take over the practice.

By making it harder to obtain partner or stockholder status, the other professions really are in a much better position to provide for retiring professionals or the surviving dependents of a deceased partner.

The Need for Planning

It cannot be overemphasized that marketing of a small business requires a great deal of advance planning. It does not really matter whether the business is conducted as a sole proprietorship, a partnership or a closely-held corporation, or whether it is engaged in a trade, manufacturing, selling or a profession. If — as is the case in 99 out of 100 small business entities — the success of the enterprise depends on the personal effort and contribution of one person or those of a very small number of people, finding the person or persons who are willing and able to carry on the business at the same or higher income levels is the singularly most difficult problem. Next in the order of difficulty is making sure these people are still around when the owners are ready to make the transfer.

In negotiations connected with the sale of a small business, the availability of the present owners for consulting services can be an important factor. It can make relations with customers and with the personnel a great deal easier and more pleasant to have the former owner around for a while.

Tax Considerations

The sale of a small business has many tax implications. The sellers have a hard decision to face: take the total proceeds in the year of sale and pay a hefty tax or take advantage of the installment sale privileges in the tax law which means trusting the buyers to be successful and able to meet their obligations in the future.

One lucky break is available in the case where the business is acquired by a larger organization through an exchange of the stock in the small business for the stock in the publicly held purchaser. Recognition of the gain, and the resulting tax, can be deferred until the stock received in the sale is disposed of. This can conveniently spread the tax consequences over years without too much risk of future losses.

Selling a small business as a corporation offers advantages over selling the assets of a sole proprietorship. Selling a partnership interest is more advantageous than selling operating assets. The stock in the corporation or the partnership interest are, of course, capital assets in the hands of the seller and the sale results in favored capital gains treatment. On the other hand, the sale of the operating assets of the business nearly always results in having a large part of the sales proceeds taxed as ordinary income.

Naturally, the buyer is usually interested in buying the operating assets, allocating the major portion of the purchase price to inventories or depreciable properties. A compromise is often possible through the medium of the bulk sale coupled with a 12-month or a one-month liquidation.

But — tax considerations may be the least of the worries of those entrepreneurs who find that they have started too late planning to make their small business marketable.

Faculty Position Available

The Indiana University (Bloomington-Indianapolis), Department of Accounting has vacancies at the assistant professor level for candidates with a primary interest in taxation or financial accounting. Outstanding candidates with primary interests in other areas of Accounting are also encouraged to apply. Faculty positions above the assistant rank are also possible for appropriately qualified individuals. Candidates for assistant professor should have the PhD or DBA degree completed and possess a dedication to teaching excellence as well as a strong interest in pursuing scholarly research. CPA or CMA desirable. JD is desirable in the area of taxation. Indiana University is an affirmative action and equal opportunity employer. The University welcomes applications from women and minority persons. Please send resumes to Professor Leon Hay, Chairman, Department of Accounting, Graduate School of Business, Indiana University, Bloomington, Indiana 47401.