6 Reasons To Consider Selling Your IT Services Business

And 4 Ways To Get The Highest Price

The Host Broker
CONNECTING BUYERS AND SELLERS

The MSP Broker
CONNECTING BUYERS AND SELLERS

Introduction

When considering why business owners sell their companies, we often think about an owner choosing to retire or a young owner cashing out on the success of their current business to move on to a new venture. There are many reasons why hosting, MSP, and other IT service providers may consider a sale.

In this ebook, we address six reasons why you may be considering selling your business and the tactics you should employ to obtain the highest price.

1. You Want To Cash Out And Retire

The reason for selling your business does not need to be complicated or require a long explanation. Sometimes, the answer is that you simply want to retire. You have spent many years building this business and it is finally time to cash out, so you can go on an extended vacation, spend more time with your family, or explore other opportunities.

What you should know:

Since your business may be a one-person operation or utilize a few employees or contractors, you may have signed contracts with freelancers or third-party providers. Consider how long these agreements will be in place, if they will transfer to the new owner, or if each outside support person should have their own conversation with a potential buyer.

During the sale of any business, customers can become nervous due to the uncertainty of future events. In cases where you are widely known to your customers (maybe they have your cell number) and they expect to communicate with you regularly or even from time to time, you will need to communicate to these customers about the pending sale. Provide the name of the new buyer, explain the additional value they bring to the acquisition and how a newly combined business will benefit them. Your endorsement of the company's purchase will put their mind at ease and lessen the number of email and phone inquiries you receive. Most importantly, it will decrease the churn rate – the rate at which anxious customers, uncertain of their future, decide to move their business to a competitor, thereby maintaining the value for the buyer. A significant increase in churn may also cause the buyer to ask for an adjustment in the purchase price if a substantial amount of revenue has been lost due to customer exit.

Although your intent is to retire, you may decide after a period of time that you miss the stimulation of running a business and agree to work for a company that is similar to the one you sold. Since it is common for the buyer to require you to sign a non-compete agreement as part of the sale, you should consider the implications of this possibility from the start.

2. You Want To Sell One Segment Of Your Business

Over time, the focus and direction of a company can change. You may have begun your business selling public cloud services to small businesses with 1 to 20 employees. But, over time, you have shifted your focus to dedicated, private cloud solutions for enterprises. Since small business clients often cost more to support, you may decide to sell the public cloud portion of your business and continue to support the private cloud customers.

What you should know:

Once you have decided that this is the appropriate solution for your business, the next step is to evaluate your customer base to determine the best timing for the sale. Consider when support contracts, software licenses, or third-party data center agreements will come up for renewal. The timing for each of these may help you determine when it will be most beneficial to sell a portion of your business. Enabling the buyer to negotiate new agreements or to provide them with sufficient time to migrate to their own data center or assign experienced employees to take over management responsibilities with sufficient time and resources, will enable you to close the sale without having to make new commitments or investments.

Selling one segment of your business will most likely generate a discussion about your company's brand name. If your organization contains multiple brands and you are selling one of those brands in its entirety, you may include the name in the sale and allow the buyer to use it for current and future customers. If only a portion of the brand's business is sold, you will continue to own and maintain that brand. However, the time allocated, and work required to transition customers to the buyer's brand may have implications on how many of those customers renew their service or transition to a competitor (churn).

Consider the pricing structure of both companies. If your customers are paying $20/month/user and the buyer is charging $5/month/user there will be a great deal of cannibalization of these customers. In such cases, ensuring that either the brands remain completely separate entities OR sufficient distinctions in service levels (ex. one brand offers 24/7 phone support while the other offers ticket support during business hours only) will be key.

If your customers purchase multiple services from you but only one of those services will be sold, what will your relationship be with the customers post-sale? For example, if you have a hosting and design/development/marketing business and want to sell only the hosting portion of the business, the buyer will require an explanation of what will happen to the design/development/marketing portion of the business. They will not want their future customers solicited by a 3rd party provider post close.

Clearly, this example will not enable you to sign a non-compete agreement for those services being retained however, you can expect to be asked to sign a non-solicitation agreement in which you must agree to not solicit the customers who were purchased from you.

3. You Want To Change Industries

You have most likely achieved your business success because you know your industry inside and out. You have probably worked in this industry in different capacities for decades and it may be time to do something new. Becoming involved in a new industry can often reinvigorate passions and excitement that remained dormant for many years.

What you should know:

Switching industries is an easy and efficient way to leave your past behind and start something new. However, some buyers, less experienced in your business or industry, may look to you for financing or personal support. How much can you provide? If you are going to use the funds from the sale of the business to start a new venture, most or all of your funds will already be earmarked. And, if you start a new company shortly after the sale, you will not have time to assist the new owner in coming up to speed.

Non-compete or non-solicitation agreements will most likely not be of concern to you because you will be changing industries. However, if you choose to remain in the hosting or MSP industry in a different capacity, as an ISV for example, do not be surprised if the buyer wants to discuss your plans in more detail.

4. You Want To Transition From Being A Business Owner To Working For Someone Else Who Has Additional Resources and Capital

The attention and resources required to run a business on a daily basis can be daunting. It is something that can not be fully appreciated when you are simply an employee, working for someone else who is responsible for the finances and day to day management. You may decide that resource limitations are a distraction and do not allow you to focus on the aspects of your business for which you have a great deal of passion.

What you should know:

Since you most likely have deep industry expertise and product knowledge and have developed valuable relationships with customers and business leaders, this provides you with leverage in your negotiations. A buyer wants to be able to hit the ground running. They do not want to waste time replacing you with someone else who may not have the same level of expertise or inside knowledge on how the business is run. Keeping you on the executive management team but without the responsibilities of ownership solves the buyer's problem of finding experienced employees and gives you the security of a position in a company with which you are already familiar.

Remember, that you will now report to a new owner. In addition to determining if this is a good deal financially, you want to make certain that this will be a good cultural and personal fit for you. The rapport that you and the new buyer build will be critical to your future happiness and success in the new business.

If your plan is to sell your business and go to work for the buyer, it is important that you discuss the role you will play and what you and the new owner each bring to the table. The buyer will have the final say on how the newly combined company is run and the direction of the business moving forward. Will you be ok with that?

5. Your Spouse Wants You To Spend More Time with the Family

The time required to start and build a successful business can take over your life and get in the way of personal and family relationships. Balancing work and family can certainly be a challenge. You may need to step back from these business demands by selling your company and transitioning into a less demanding industry or taking on more predictable 9am-5pm responsibilities.

What you should know:

The sales agreement may include a stipulation that you remain on staff in an executive management capacity for a period of time – often between eight and eighteen months. Consider how much time you can spare. You may not be able to work for the new company full time for the next year. However, would 20 hours per week for the next eight months until the integration is complete be doable?

The buyer will most likely require you to sign a non-compete/non-solicitation agreement before the sale is complete. Although you may not currently have plans to start another business in the same industry, it is quite possible that in the future, you will want to return to a business in which you already have a great deal of experience and possibly "do things differently next time"! Consider the implications if you decide to start a new company like the one you sold.

6. You No Longer Want To Be A Business Owner But Rather A Minority Partner In Another Company

Although this is similar to number 4 above, in this scenario you will become a minority shareholder in an existing company or a newly created business venture. Consider what role you want to play. Where can you add value? After being your own boss, are you willing to work for someone else? How will you be compensated – with an agreed upon salary, equity, or a combination of both?

What you should know:

If you are interested in becoming a partner, it is most likely that both businesses will be of similar size, revenue and have a similar number of employees and customers. In this situation, it will be necessary to establish a reasonable and equitable valuation of both businesses. Although this will be challenging (likely the most challenging part) and may take more time to evolve, it is essential to building a true partnership.

Both you and the prospective buyer will be looking for a potential partner that brings something different to the relationship. One of your businesses may have the more technical expertise and the other may have a larger geographic reach. One may have more customers in a specific industry vertical and the other may have close business relationships with key vendor partners. These individual differences that each company brings to the table and the rapport you both have can be combined and leveraged to more quickly grow the combined organization.

Your willingness to join the buyer's company will enable you to continue working in a business and industry you love. It will provide the buyer with your extensive knowledge, expertise, business relationships and all of the other resources that come with you joining the new team without adding to the buyer's cost. There will be no need to hire additional management personnel.

Remember that in this relationship, you will no longer have majority control over the business. Being a minority partner means that the buyer (or majority partner) has the final say in how the business is run and the company's future plans. Consider if you will be able to work in this environment.

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7. Once You Have Decided To Sell, Position Your Business To Secure The Highest Valuation

Confirm Your Financial Data is Complete and Current: Review your financial records with a fine-tooth comb, ensuring that data is provided for each line of business and source of income. For example, if you sell non-recurring revenue services such as professional services, domains, hardware or software, SSL certificates or others, each should be given their own line item. Subscription-based business services such as VPS, cloud computing, dedicated servers, managed WordPress, virtual desktops, etc. should each receive their own line item under recurring revenue services. If your company includes multiple brands, ideally each brand should also have its own set of financial statements – especially if you plan to sell off only some brands. Your initial goal may be to sell the entire business to one buyer but, after various discussions, you may decide this is not easily feasible and that it would make more sense to sell individual brands or lines of service to different buyers.

Retain Multiple Years of Financial Statements: The last three years of financial statements should be complete and readily available. Combined with financial records for the current year, you will ideally be able to demonstrate steady growth over time (or at least show that your revenue has been flat). Having said this, declining revenue is common however be prepared that this will impact the ultimate valuation and you should ideally have a rationale to support this decline (we lost a few large customers etc.).

Itemize Individual Products: If you provide both managed IT and hosting services for example, be sure to separate out the revenue for each individual component – help desk support, hosted Microsoft Exchange Server, hosted email archiving, dedicated servers, and private cloud – by type and itemize expenses associated with each revenue source.. Also, remember to note whether each service produces recurring or non-recurring revenue.

Full Customer Disclosure: A potential buyer will be interested in seeing detailed spreadsheets on your customers and you may be asked to slice and dice the data in a number of different ways. Without providing any identifying information like company or contact names, you should be able to produce information such as when they became a customer, which products/services they have purchased and how much they pay for each service, how frequently they are billed, when the next bill will be due, payment method (company check, credit card, or another method) and whether they have a contract including the expiry date. Remember to also have data on the number of net new customers you bring on board each month and what your monthly churn rate is. In addition to this business-focused data, you will most certainly be asked to provide data on bandwidth usage over time, the number of active users, and if any custom engineering work is required to support them.

Catalog Your Assets: Create a list of all the capital equipment and other assets which will be included in the sale. So that nothing will be overlooked, think about each department individually and all the assets that are associated with them. For the marketing department, it might include multiple website domains and trademarks. For sales, it might include toll-free phone numbers. For IT, it might include spare server hardware, software licenses, or other equipment.

Understand the True Value of Your Proprietary Technology: Proprietary technology can be a benefit or a hindrance depending on your situation. Developing a proprietary accounting or operations solution, for example, which enables you to uniquely analyze data, decrease customer expenses by 45%, and be integrated with other industry-wide reporting tools, may be so beneficial to the buyer that it is considered a significant asset. However, if your billing system or customer control panel is a stand-alone tool which is maintained by a single employee and could be unusable if that employee leaves or has other limitations on its usefulness outside of your company, any real value might be negligible at best. In this case, common applications like cPanel or WHMCS would be seen as providing greater value to the buyer. Evaluate each of your technology resources individually to determine if they do indeed add value to the sale or if you would like to retain ownership for possible future use.

Be Firm but Flexible: It is important to know what you want out of this sale and to try and secure the best deal you can. However, this not a zero-sum game. Being flexible and co-operative in discussions on staffing, equipment, the timeframe to close, the final purchase agreement and other matters could mean the difference between a shorter and straightforward sales process or one that is lengthy and contentious – or never comes to fruition at all. A back-and-forth, give-and-take method of negotiation will serve you well.

Reveal the Skeletons in the Closet: Whether large problems or small oversights, always be upfront and honest about issues that could affect the outcome of the sale. Having you introduce these issues up front rather than the potential buyer uncovering them later, provides the buyer with insight into your honesty and how you have successfully resolved challenges along the way. In a real-life example, an affiliate/partner of the seller had not been paid for several months. Post-close, this partner approached the new owner requesting their commission. Because they were not told about this partner nor the money owed before the sale was completed, the new owner was not pleased nor interested in paying for expenses that predated his ownership This was a contentious issue for several months until resolved.

Consider Your Future Path: Take time to evaluate your future goals and the new role you would like to take on once your company is sold. Remember that you may be asked to sign a non-compete agreement as part of the sale. This is very common and would require you to remain out of the respective industry / space/line of business for some time – usually 2 to 5 years.

Review Partner Contracts: Do not forget to evaluate each of the contracts you previously signed with vendors such as data centers, leasing companies, or others. They may include stipulations that the contract cannot be assumed or that the contract must be renegotiated. Also, take this into consideration when negotiating new contracts while you are in the process of shopping your business for sale. Do not get locked into long-term agreements if you believe the company will be sold before the new contract has expired. Ideally, a month to month arrangement with vendors is best in the eyes of a new buyer despite the fact that this can be a more costly arrangement for you as the seller.

Be Prepared for Comprehensive Due Diligence: We have already discussed many of the reports and data you will be asked to provide. Different pieces of information will be requested by potential purchasers at various stages in the due diligence process. As you get closer to signing a sales agreement, final requests for billing system reports, current bank statements and tax returns will be made. Conference calls where you seemingly answer the same questions over and over to different suitors are also inevitable. This can be a long and arduous process, especially if you are speaking to a few potential buyers at the same time.

Ensure Your Minute Book is Complete: A minute book is literally a book or binder of records that are important to your business. It may include articles of incorporation, company bylaws, minutes of shareholder and board of directors' meetings, stock certificates, and other legal documents. While maintaining an up to date minute book is important, the accuracy and completeness of your minute book is particularly important if you are interested in executing a stock sale. Most sales, however, are asset-based. As a result, do not be surprised if the buyer's intent is to register a new company name similar to yours to reduce the possibility of the current customers being alerted to the sale early-on in the process. This could be as subtle as registering the new company as Vista Technologies, Inc. as opposed to the current company name which is Vista Technology, Inc.

Continue To Do Business: Selling a business takes a great deal of time and effort. Your tendency may be to focus more on the sale of the business rather than running the business as you have up until now. Continuing to successfully market and sell your products and services will maintain your company's position and influence in the market and may even increase its standing and value with potential buyers.

Choosing to sell your hosting, MSP or other IT services business is just the first step in a long road ahead. It may be somewhat of a time-consuming process, but it does not have to be difficult or painful. Understanding your true motivation for selling, the implications of your decision, and the tactics you should employ from the start will help pave the way for a smooth transition and help you achieve your ultimate business and personal goals.

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8. Confidentiality Within Your Organization Is Just As Important As Outside Your Organization

Confidentiality is a critical component of your company's sale. A confidentiality agreement is usually signed between you and the potential suitor. What is often overlooked is that confidentiality is equally important within your company as it is with external participants.

At the beginning of this journey, you may be the only person within your organization who knows about the plans for the sale. As the process develops, you will most likely involve select members of your management team who are responsible for specific operations or financial data. As the sale nears completion, you may inform a key member of your marketing team, enabling them to prepare a public-facing press release, employee communications, customer communications and any other materials needed to announce the company's sale. It is critical that these members of your internal team sign a confidentiality agreement as well. A seemingly innocent conversation will spread like wildfire and may cause key personnel to leave the company, negatively affect the value of the business, prompt current customers to leave due to uncertainty over future integration and/or cause potential customers to hold off on their purchases hoping the new owner will provide discounted pricing or other incentives for new customers to come on board.

9. Don’t Go Down This Road Alone

Selling your business can easily become a full-time job. Remember that your primary responsibility is to your employees and your customers. Maintaining consistent sales growth and making sure that your company’s financials are trending in the right direction required for a sale. In addition, as an “insider” in this sales process, you lack an “outsider’s” perspective which can be extremely helpful.

An independent advocate or advisor with expertise in IT services and M&A processes can provide you with unbiased insight and recommendations. They can also take over the responsibilities of gathering and preparing the required paperwork, vet offers, evaluate potential market opportunities, and make sure that you are prepared at every point along this journey. Most importantly though, they can also expose your business to multiple parties ensuring the best “fit” which of course includes the valuation but also aspects related to competency, rapport, culture (relevant if employees will remain) and the ability to provide support to the customers in a similar or better way relative to what they experienced before.

10. Negotiate With Buyers As They Present Themselves

If you are trying to juggle both your company's day to day operations and the sale of the business on your own, it is tempting to negotiate with one buyer at a time. By implementing this process, not only will the sale take significantly longer to complete but it overlooks one key element – the value of competition. Negotiating with buyers as they present themselves increases the competition among potential purchasers and positions your business as one that is in demand and attractive to multiple organizations. This can raise your perceived value and increase the offers you receive.

As discussed above, it is beneficial to hire an independent M&A advisor that can seek out opportunities, field inquiries, prepare documents and provide you with invaluable insights into present market conditions, your company's worth, and how to best position it to achieve maximum value.