

# Should you retain a Business Broker on straight commission or on an hourly basis?



Almost all brokers are hired on a success fee or commission basis. If there is a successful sale of the company, then the broker is paid a percentage of the agreed upon selling price. Although that rate is negotiable, it typically starts in the 10-12% range and then scales down with each succeeding million to 8%, 6%, 4% etc. as the amount of the sale price increases. Is that a good deal for a seller? The answer is- that depends. But first things first here.

For the past twenty plus years I have been representing business owners and buyers, I am often asked why broker commissions are so much higher than, say, a house sale or

commercial property sale commission. The answer lies in three areas: 1) the percentage of successful sales of businesses; 2) the amount of expertise and depth of knowledge it requires to successfully complete a sale; and 3) the challenging tasks in perfecting a sale of a business.

**Re #1: the percentage of successful sales of businesses- Business brokerage professional organizations carefully track the percentage of businesses that come onto the market that ultimately sell.** Unlike real property listing, historically, less than 35% of all such listings ultimately sell. That means that a broker will



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often work months and can put in untold time, only to see that business never sells. Reasons for this are several. Sellers often price the business above the recommended amount and then either refuse to lower the price or do so at such a slow rate-often called chasing the market down-that the market still says no thank you. There are some sellers who change their minds about selling half way through the listing period-normally twelve months period-so the business comes off the market, with a previously agreed upon cancellation fee paid to broker. Additionally, there are such issues as a landlord not wanting to extend a lease to a new owner; the discovery of information about the financial status of the business that shows fraudulent intent or incompetency on the part of the seller; or a narrow band of available or logical buyers due to the business requiring specialized knowledge, extensive industry experience, or required licensing which is not easily obtained.

**Re #2: the number of areas of knowledge required are extensive- the amount of expertise and depth of knowledge it requires to successfully complete a sale the of a business** include: understanding of basics of accrual and cash accounting and understanding balance sheets; basics of tax laws and IRS filings and how they effect both companies, corporations, and individuals; basics of labor law with re to employees vs. independent contractors; basics of environmental laws and regulations; how businesses are valued which includes knowledge of comparable sales and appropriate multiples, discounted cash flow analysis, and the differences between ordinary net income and adjusted net income and EBITDA, and how value can be legitimately arrived at; knowledge of institutional financing, seller financing and combinations thereof-and where appropriate; knowledge of the use of business escrows, liens on businesses, and local,

county, state, and federal sign offs needed to perfect a sale; knowledge of value of and use of appropriate seller training and transition retention; knowledge of procedures to minimize the likelihood of post-closing legal issues. Finally, appropriate knowledge and skill set to work effectively with the legal and accounting team of the principals.

**Re #3: the very nature of the marketing and selling process- typically an extensive procedure to ensure buyer and seller are protected and seller receives highest value the market will bare, means most transitions take between two to four months from initial mutual ratification of a letter of interest or contract of sale, and the actual change of possession of that business.** This is necessary and unavoidable, but a skilled business broker will provide appropriate leadership and coordination throughout this process to make sure there is not wasted downtime, keeping in mind the old business brokerage adage- "Time kills deals." This requires an unusual skill set on the part of the broker as she must have just the right combination of persistence and patience, extensive knowledge of the items in #2-to say nothing of superior human relations skills.

Although I could be accused of having both a self-serving perspective and being somewhat biased, I believe an objective case can be made for the irreplaceable value a skilled and motivated business broker brings to the challenge of selling one's business. In fact, I have had numerous clients say in writing that they doubt the business would have been sold without my assistance.

With that in mind, I raise these questions. Is it to the seller's advantage to hire a broker on an hourly fee basis for compensation or strictly on a straight commission basis? In my opinion, the best decision lies in the answer to another

question-how likely is the business to sell? If you, the seller, are dedicated to the proposition that it is time to sell your company and move on, e.g., to retirement, then the likelihood of effecting a successful sale is high, as this kind of seller is willing to adapt to the market in pricing, if needed, and willing ultimately to accept what the market will pay. Moreover, they are not likely to change their minds about selling as there is more value in greater time to do other things in their lives, than there is in greater dollars in their pocket. Clearly, they want as much for their "baby" as the market will bare, but they are realistic enough and motivated enough to persevere in their goal of completing a sale regardless of the ultimate price. If this is an accurate description of you as a seller, you will likely save considerable selling costs if you employ a broker on an hourly basis.

Let's take as an example a small distribution company that has adjusted net income of 450k a year. That means a new owner, if she will run the company the same way the previous owner did, will generate about 450k in free cash flow annually. Let's say the original asking price for that business was 1.6 million and the final negotiated selling price was 1.475 million. That would typically generate a commission expense to the seller of 148k in round numbers.

Conversely, if the seller were to hire a broker strictly on an hour fee basis at, say, \$375 an hour, the total cost would more likely run between 35k-50k in total, resulting in over a 100k in selling expense savings for the business owner.

The catch here, of course, is that a sale must actually take place for these savings to be realized.

Here are some criteria to be evaluated and considered: 1) Seller motivation as discussed above; and 2) how transferable is the business.

This means the books must be clean and accurate. If the current location of the business facility is important or critical to the transfer of the business, then the landlord, ahead of the business being placed on the market, ideally has agreed to cooperate in the assignment and/or the extension of the current lease agreement. 3) The business requirement for skill level and knowledge is something a typical business buyer can master with the help of the current owner in a training and transition period-often two to six months. There may be industry buyers, as well, which will only increase the likelihood of a sale. A final consideration in transferability is how financeable is the business in qualifying for a bank loan. This somewhat depends on the strength of the buyer, but the historical cash flow of the company is critical here as well. I recommend any business be pre-qualified for a bank loan ahead of being place on the market.

Interestingly enough, many brokers will not work on an hourly basis unless they consider a likely sale a real long shot. Conversely, they will want to work on a success fee if they believe both the business as they know it, and the seller motivation, suggest the likelihood of a successful sale.

I am happy to consider working on an hourly basis, even when I judge the sale is more than likely to occur, which as previously shown can result in considerable financial advantage to the seller.

Feel free to contact me to discuss this and other relevant business sale considerations, you should be aware of.

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