

Selling Shares of Your Business

By BNET Editorial

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People sell shares of a company to raise funds or to eventually sell the company. Shares can be sold to angel investors, venture capitalists, individuals, and other businesses. These different types of buyers will have different motives for buying, expectations of the dividends they may receive, and intentions for selling the shares later.

What You Need to Know

What are shares?

Shares in a company represent a proportion of the ownership of that company. Initially, shares are exchanged for cash and that cash, called *equity capital* or *share capital*, is then available to the business. Shares can be sold by the owner of a company, who must follow regulations governing the sale.

Can a company sell shares at any time?

Companies set an initial authorized amount of share capital—the total number of shares the company is permitted to sell. The authorized share capital can be raised at any time by the shareholders, and the company can then sell the additional shares. Many companies include a “pre-emption” clause in their articles of incorporation requiring that any additional shares are first offered to existing shareholders before being offered to other potential new investors.

What are the different types of shares?

The main, voting shares are known as *ordinary shares* or *common stock*. Companies also often create *preference shares* or *preferred stock* in order to raise equity capital. In the event of a company being dissolved, the preferred shares are considered for repayment before the ordinary shares.

Preferred shares usually attract a fixed dividend (provided, of course, there is enough profit to cover the dividend). Sometimes these shares are cumulative—if the dividend is missed one year, it is carried forward until such time as there is sufficient profit to pay it. Dividends on common shares cannot be paid until the dividend on the preferred shares is paid.

Preferred shares are usually redeemable, meaning that the company can buy them back and cancel them if it so desires. Usually they are repaid at par (that is, for the amount for which they were

bought), but the repayment amount can be varied. The values for redemption are normally set out in the company's articles of incorporation.

What is internal rate of return?

The financial benefit of owning shares does not come solely from dividends, but also includes the return achieved when the shares are eventually sold. The total rate of return, from income and capital growth, on an annualized basis, is known as the internal rate of return.

What is private equity?

Private equity is simply the term used for finance from a venture capitalist, seed fund, or angel investor in exchange for a share of the business.

What is an exit route?

The term "exit route" is used to describe the way that an angel investor or venture capitalist exits from an investment. In general, there are just three routes: initial public offering, buy back of shares by the founders of the business, or a trade sale. In practice, early investors may also exit by selling shares to a bigger investor. For example, an angel investor might exit when a venture capitalist decides to invest and provides an exit route for the angel investor by buying his or her shares.

What is an IPO?

An initial public offering (IPO) is the term used if you sell shares to the public through a stock exchange, such as New York Stock Exchange (NYSE) or the American Stock Exchange (AMEX).

What to Do

If You Are Selling the Business...

In order to sell your business by selling most or all of its shares, you need to first make sure that all of your accounts and records are up-to-date and that you are prepared to spend time locating and working with prospective purchasers. If your objective is to sell your business, say, because you want

to retire, or want the money to start a new venture, then in most cases it will be best to use a business broker, who will help you advertise the business and seek prospective buyers. Also mention your intentions to local accountants and business support organizations, as they may well have clients who would be interested in buying.

You may want to stay active in the business, or buyers may wish you to stay, at least for a period of time. Some buyers may want to structure a deal over two or even three fiscal years, which will improve their cash flow and maintain a period of stability and continuity in the business, but may also help your tax position. Some buyers may want an earnout, whereby at least part of the price is dependent on future profit levels—so it is important to be realistic about future prospects when you talk to buyer prospects.

If You Want to Raise Equity for Investment...

If your objective is to raise money to reinvest in the business, first consider what makes the business attractive to an equity investor. Do you have proprietary intellectual capital? Potential for high returns? Is there an attractive exit route for investors? Perhaps most important of all, do you have the management team in place to make it all happen?

If the answer to these questions is yes, then you need to prepare a detailed business plan setting out the business's prospects for the next three to five years. This plan will become your presentation to prospective share purchasers. To find such people, discuss your interests with your advisors, local business organizations, and any other parties who may be able to connect you with angel investors and venture capitalists. Remember, though, that once you identify these prospects, in addition to conveying your business plan, you will need to demonstrate that you have the determination and commitment to make the plan succeed.

What to Avoid

You Exaggerate the Figures

Exaggerating past performance or future business prospects when you talk to share purchasers will come back to haunt you. At the same time, you can explain to purchasers the value of the “sweat equity” that you have put in the company.

You Don't Take Enough Time Preparing Your Proposals

Venture capitalists receive hundreds of business plans for every one in which they invest—so you need to work hard to capture their attention and persuade them that your business should be the one

to receive their investment. Your proposal must include a solid business case for investment, but it must also convey enough uniqueness and energy to capture attention.

You Expect Too Much Too Soon

When planning to sell shares in your business, be realistic about the potential interest among investors, and plan accordingly for how long it will take you to identify investors and develop successful relationships with them.

Where to Learn More

Books:

Alterowitz, Ralph and Jon Zonderman. *Financing Your Business Made Easy*. Entrepreneur Press, 2006.

Crosier, Louis P. *Selling Your Business: The Transition from Entrepreneur to Investor*. Wiley, 2004.

Kotler, Philip, Hermawan Kartajaya, and S. David Young. *Attracting Investors: A Marketing Approach to Finding Funds for Your Business*. Wiley, 2004.

Web Sites:

American Stock Exchange: www.amex.com

Association for Financial Professionals: www.afponline.org

National Venture Capital Association: www.nvca.org

New York Stock Exchange: www.nyse.com

U.S. Small Business Administration: www.sba.gov

U.S. Department of Commerce: www.commerce.gov