BEARDSLEY THEOBALDS
WE SELL BUSINESSES

THE EVOLUTION OF THE BUSINESS TRANSFER MARKET

In order to better understand the market as it is today it may be helpful to review its history.

The business transfer market is one which has only existed in anything like its current size during the past thirty to forty years. It is still developing. Until about a generation or so ago most people were either employed or worked for themselves until retirement. Businesses tended to stay within a family. The number that sold outside the family were relatively few.

From the 1960s and 1970s the market started to grow and a number of agents began to specialise in the sale of businesses. The 1980s saw enormous growth in the size of the market. The recession of the early 1980s proved to be a catalyst as many people forced out of employment decided to consider self-employment. As the decade progressed, property values rose and this encouraged many people as they realised that the equity value in their homes enabled them to buy a business. In the increasingly pressured world of employment, the idea of being one's own boss became very attractive to many. The disparity of property values between the South East and South West and the various problems associated with big city life made the South West seem very attractive. In the mid/late 1980s a high proportion of businesses sold in the South West were sold to buyers from the South East. The Midlands was another major source.

These buyers were largely buying homes and lifestyles and usually wanted to buy freehold. They needed a certain level of income but were not much concerned with the concept of "return on capital". They assumed that the values of properties and businesses would continue to rise. Even if the business was not very profitable, that did not necessarily matter because the real profit would come when the business was sold at a later date.

The businesses being considered were what may be described as traditional small businesses - shops, sub Post Offices, hotels, guest houses, pubs, restaurants, garages, care homes etc. Even as late as the 1980s many of these sectors had not felt the full brunt of competition from large multiple operators - or at least in large parts of the country this was so. However, there was a trend which continued in the 1990s - existing multiple retail operators opened more and larger outlets with a wider product range and moved into niche markets which previously were the preserve of the independent retailer. Pub operators, hotel and restaurant chains developed new formats and aggressively marketed themselves. The small repair garage often struggled against increasingly sophisticated competition. The care home sector suffered from the budget constraints of the public sector in the days of "Care in the Community". Town centres were affected by the development of "out of town" shopping centres.

All these trends were highly visible to the general public. Not surprisingly this had an effect on the business transfer market.

The other factor which had a significant effect during the 1990s was the reaction to the recession of the early part of that decade. The lending institutions started to take a wider view of lending propositions - looking at the prospects for the business, the abilities of prospective purchasers, insisting on business plans, taking a view of the price in a wider context, not just for lending purposes. They now expect the return on the investment to be sensible, the principle being that an appropriate profit must be earned each year. Inevitably, changes of attitudes by lenders filtered through to accountants and other advisors and eventually to purchasers. The market adjusts.

The total effect of these various factors has been considerable and will continue. It has helped to make the market more sophisticated. Prospective purchasers are more knowledgeable and selective. In many ways, they and their requirements are different from those of their predecessors. Inevitably, the range of businesses has altered little but their speed of sale and the prices achieved vary more widely and are more difficult to predict.

Today, it is possible to split a good proportion of prospective buyers into two broad groups - those seeking a lifestyle opportunity where the business is important but the prime objective is lifestyle rather than the return on investment. Many will want to buy freehold property and will mainly consider the traditional types of business.

The other buyer group is more focused on the need to maximise the business investment. These buyers are more likely to buy leasehold, preferring that their capital is in the business rather than in property. Partly for this reason and also due to the skills and business backgrounds of many of today's buyers, the less traditional type of business is frequently favoured by this group - distribution businesses, manufacturing, service businesses to the general public or the business community. These businesses are seen as more flexible with scope to allow the proprietor to be both pro-active and more easily reactive when market conditions change. Very often this type of business is bought by someone without the technical skills of the trade involved. Many buyers believe that they can bring new skills to the business, perhaps where the lack of these skills is considered to have held back the development of the business, typically in sales & marketing or financial management.

So, where is the market heading? Which are the factors that are likely to influence it and, most importantly for those currently active in the market today, what are the immediate prospects?

The general trends are reasonably clear because they are a continuation of current trends. The South West business transfer market is largely powered by two factors, one national and one regional. Few people today work for the same employer for the whole of their working lives and fragmented employment patterns often leave people in their forties or fifties trying to decide which path to take. For many, self-employment is considered. Purchasing an existing business is often the preferred option.

cont…

If a business is to be bought there is also freedom of location. At that point the South West comes into its own. As the U.K.'s No.1 holiday destination, not surprisingly, it appears to be a favourite region for buying a business. For those buying later in their working lives, it also makes sense to buy where they hope to spend their retirement. For many this is the South West. In fact, this is a small part of a wider picture of people moving west for the good life. During 2008 a national survey of 4,000 homeowners looking to move in the following 12 months found that one in seven had identified the South West as the region where they plan to live and the South West Regional Planning Guidance (published in 2008) called for 20,000 houses a year to be built in the South West for the following 20 years, partly to cope with expected migration into the region.

The future of the South West, the property market and the business transfer market all appear to be very bright. Although many more national and international companies are now represented in the South West, the region remains an area where small, independent businesses thrive. They serve a population which, by temperament and often by age and income, is more than averagely keen to support local businesses rather than large companies.

The strong flow of people moving into the region also seems to fit this pattern – and the numbers are impressive. The most recent report from the Office for National Statistics on 'regional' population changes (2007) shows that the South West experienced the largest annual regional growth in population at 1.1% which was nearly double the national rate. Additionally, a projection from the Office for National Statistics published at the end of November 2004 forecast almost a million extra incoming residents over the following 25 years. The 16% rise in population is the second highest in the country, just behind the South East. This is not entirely being caused by the magnet of the region's stunning scenery, unique environment and other attractions. There has been a sea change in recent years, particularly in the 4 more rural counties of Somerset, Dorset, Devon and Cornwall, towards a more modern and substantial business sector – and this is beginning to change perceptions elsewhere. The many Objective One projects in Cornwall which came on stream between 2000 and 2006 showcased by the Eden Project (many of these investments were long term in nature – the full impacts of which will not be felt for 15 years or more as they were focussed on new routes for the development of higher value economic activity including new business sectors), the impressive developments which have occurred and are continuing to occur on Plymouth's historic waterfront, the move of the Met Office to Exeter in Europe's largest high tech removal and the rapid development of Exeter airport and also the continuing expansion of Falmouth dockyard are just some of the more high profile changes but there are also a growing number of substantial developments in health, education, housing and commercial activities of all sorts. More and more people are becoming aware that there is a lot more to the South West than pasties, cider and clotted cream!

2006 turned out to be a year which was better than many forecasts. Economic growth was greater, house values rose much faster, consumer spending, business investment, the stock market and other factors beat the forecasters expectations. In the business transfer market for non-consumer businesses, the year was a repeat of 2005 with demand greatly exceeding supply. This produced many examples of businesses selling quickly, thus exacerbating the shortage, and sometimes at unexpectedly high prices following competitive bidding. The slightly higher rates of interest in the latter part of the year seemed to have little impact on the demand for businesses.

2007 was a year of two halves. The first half was much like 2006. The second half was when economic turmoil started with news of a credit crunch, a run on a bank and uncertainty about the banking system and credit availability – but consumer expenditure showed only slight signs of being under pressure by the end of the year. In the business transfer market there were some signs of more cautious attitudes and deals took longer to process.

2008 saw us enter the most turbulent economic situation we have seen for at least 15 years. In these circumstances all economic forecasts have to be treated with even more caution than usual. The fog of uncertainty had certainly not lifted by the end of 2009 when it was still not possible to forecast either the length or the depth of the economic downturn and its ultimate impact on various sectors such as the housing market, consumer expenditure or anything else. This, of course, included the business transfer market.

The first half of 2010 did not give rise to a much clearer picture but by the end of the summer/early autumn of that year things certainly appeared to be improving. Although some gloom still existed, there were several positives which gave rise to optimism. Interest rates continued (and looked set to continue during the short term at least, despite inflation stubbornly continuing to be above the government's 2% threshold) at an all-time low for borrowers and by that time the economy was in the midst of experiencing its fourth consecutive quarter of growth and in many respects we appeared to have left the recession well and truly behind us. However, as winter approached and with thoughts on the impact of the rise in V.A.T. (which was then due to be imposed in January 2011) in mind, together with the effects on the economy which the coalition government's 'austerity' measures were expected to bring to bear in 2011 (and thereafter), it appeared that we were possibly heading for more choppy waters. Those thoughts were exacerbated in January 2011 when we were informed that the final quarter of 2010 saw a contraction of 0.5% in GDP, but fortunately the following quarter saw a return to growth. However, by the end of 2011 things were again beginning to look bleak and in early 2012 we learned that the final quarter of 2011 had seen GDP contract again (by 0.4%) and this gave rise to people questioning whether this was the precursor to a double-dip recession! Three months later we were informed that, following a contraction of 0.3% in GDP during the first quarter of 2012, our economy was indeed (technically at least) again in recession! A further contraction in the following quarter further compounded the situation but reported growth of 1.0% in the third quarter at least gave us some respite, although nobody was even pretending that this signalled cause for optimism! On the contrary, towards the end of October, among the mixed messages then being received, there was a very definite underlying tone of economic weakness remaining both at home and abroad. However, despite the level of uncertainty and the continuing travails within the E.U., the U.S.A. and elsewhere, the business transfer market had become more buoyant and there was good reason to consider that this would continue during the remainder of 2012 and beyond. This sentiment was very definitely confirmed early in 2013 when we discovered that the fourth quarter of 2012 saw the economy shrink by 0.3% and, despite growth of 0.2% for 2012 as a whole, the economy remained 3.2% smaller than its peak in the first quarter of 2008 and had grown by just 3.4% since the low in the second quarter of 2009! However, by the end of 2013 – despite the initial impact of the government's austerity measures and the fact that unemployment levels were still high, at least as far as full time employment was concerned (noting that many out of work people were being forced to consider/accept part-time employment) and with significant problems continuing to confront the Eurozone – prospects for the UK economy were beginning to look a lot brighter! By the end of the first quarter of 2014 we had witnessed five consecutive quarters of growth and the annualised rate of growth for the twelve months to 31st March 2014 was 3.1% – the strongest growth recorded since 2007, giving Britain the best performing economy among the G10 nations – and this had given rise to improved confidence, increased household and business spending and a forecast for even higher growth rates for 2014 and beyond. Nonetheless, by May 2014 and despite a continued fall in the unemployment rate – to 6.9% (approximately 2.24 million) of the economically active population –many unemployed people plus a sizeable percentage of those in employment (and whose pay had not kept pace with rising inflation in recent years) were looking to improve their lot. Consequently, it came as no surprise to see a rise in the number of businesses being sold – the reasons for which are explained below.

cont….

In spite of the optimism in early 2014 and although the jobless total continued to fall, by the autumn it had become clear that the annual rate of growth was slowing and predictions in the region of 2.6% for the 12 months to 31st December 2014 were generally voiced and accepted. This deceleration had been and was still being caused by various events worldwide – including unrest in the middle east and in eastern Ukraine, the Ebola outbreak, uncertainty over the future of oil/energy prices, a damping down of China's economic growth, etc. – and some pundits were beginning to wonder if we were heading for a full scale recession worldwide! Despite this cause for concern and the fact that political tensions and other factors continued to fray the nerves and impact markets, the U.K. emerged in the spring of 2015 having eventually achieved a 2.8% rate of growth in 2014 and with aspirations to achieve at least 2.5% in 2015 – the GDP growth forecast announced by the chancellor in his Budget on 18th March. By that time the inflation forecast for 2015 was just 0.2% (and actually fell to 0% by the end of March) and numbers of people in employment were continuing to rise, registered jobless numbers were still falling and wage increases were, at long last, becoming fairly common practice again. In April employees on average found themselves again earning as much, in real terms, as they did prior to the recession but, to put it another way, it took them over 8 years to get back to the standard of living they had enjoyed in 2007!

The remainder of 2015 saw the economy experience a mixture of positive and negative outcomes with some sectors performing better than others, employment levels continuing to rise and inflation falling to near zero, whilst growth was apparently stabilising around 2.6%. However, despite significant and varied ongoing global problems – political and economic – including the stark fall in crude oil prices and the continuing turmoil in the Middle East – the U.K.'s prospects for 2016 were considered to be quite reasonable. This was certainly true by comparison with the Eurozone and many other major economies and was underpinned by the fact that at this time the U.K. had the second fastest growth in the G7 after the United States. Moreover, the U.K. economy was by then 6.1% larger than it was at its pre-financial crisis peak!

Since the autumn of 2013 the demand for businesses from prospective purchasers has increased quite considerably. Consequently, the rate at which businesses are now selling is much greater than has been the case during the preceding five years or so. A rise in unemployment (which was experienced almost throughout the recession) usually paves the way to increased demand for businesses. However, although unemployment has fallen appreciably since we emerged from what proved to be a very long recessionary period, (and the rate of U.K. unemployment fell even further to just 4.7% by March 2017 – the joint lowest level since 1975!) it appears that the number of people seeking full-time employment may not reduce significantly over the next 12 months. Those in employment, (31.85m - and at a record high in March 2017) and who had experienced factors such as wage freezes or small wage increases coupled with inflation during the recession, had seen their disposable income come under ever increasing pressure until towards the second half of 2014 and many therefore considered the idea of buying a business as the best way to improve their financial circumstances. In addition, given the very poor rates of return on savings, a lot of people who were previously able to live off the interest on their capital can no longer do so and they are being attracted towards investing in businesses (ones which are or could be operated for them under management and sometimes offering opportunities for employment for their own family – a win/win situation for such people) for the higher rewards on offer. Investments in such as stocks and shares and pension funds have taken a hammering in recent years and although there has been considerable recovery the situation remains volatile. Consequently, a lot of people are seeking alternative investment vehicles and some of these people are looking to acquire businesses over which they can have at least some degree of control! Whatever the squalls that surround us, it certainly feels that the business transfer corner of the economy is quite positive. People do want to buy and sell.

Interestingly, following the EU referendum vote (the result of which, of course, completely shocked many of the pundits and voters alike), and as perverse as it may seem to be, there was initially an appreciable increase in the number of owners considering selling their businesses. However, since towards the end of 2017 there has been a general reduction in the number of businesses coming onto the market. It is generally understood that business owners, who in principal would like to sell, have been demonstrating a reluctance to commit to taking the necessary decision to do so. They have been citing all sorts of reasons for this, including the current state of the economy (national and global) and the uncertainties surrounding Brexit, but the underlying rationale appears to be based on the premise that it's easier for them to defer the matter rather than make a decision which they do not have to at this point in time! This may be somewhat understandable, but to simply defer making a decision to sell may in time prove to have been entirely the wrong course of action. This assertion is made because there has for some time been good demand for businesses but relatively few available, especially in certain sectors. Paradoxically, this situation, of course, has served to improve the prospects for serious sellers, both in terms of sale timescales and prices achieved. However, if all of those business owners who have been delaying offering their businesses for sale until such as a significant improvement in the economy and clarity as far as Brexit is concerned occurs, they may have quite a long wait! Moreover, for those who want to sell in order to retire or for health reasons etc. and would like to be free from work and improve the quality of their lives, a deferment obviously runs counter to such underlying desires. However, the main cause for concern among these business owners should be the danger that when they deem that circumstances have improved sufficiently to encourage them to make their move it is likely that this could produce a situation whereby a lot of businesses will be offered for sale at the same time. Consequently, supply could well outstrip demand at that time and this may well result in lower prices and longer sale timeframes for most vendors. Would-be sellers would therefore be well advised to reflect on the prospect of such a scenario which perhaps may cause them to consider selling their businesses sooner rather than later! N.B. Since the December 2019 General Election, resulting in a massive Conservative Party majority – and what many believe that this promises to herald – we have witnessed an appreciable improvement in confidence across the market and a significant increase in prospective seller enquiries. So, perhaps we will see rather more businesses being offered for sale in 2020 than has been the case in recent years!

At the same time, an increase in the numbers of prospective buyers entering the market place has also been experienced since late 2016 and, although economic uncertainties may have made people nervous and cautious (especially following the triggering of Article 50 and negotiations regarding the UK's exit from the EU continue to take us on a very demanding and arduous journey – which by 31st October 2019 had become all too apparent!) – they nevertheless do not alter the desire of people to own their own business; indeed there are many factors currently serving to heighten this desire!

Commercial finance for the right applicants is not significantly more difficult to arrange for the purchase of quality going-concern businesses than was the case prior to the recession and, of course, interest rates for borrowers are now very considerably lower than was previously the case, but some lenders have adopted a much more selective approach. In fact, given that deposit percentages for commercial finance are little different than was previously the case and with interest rates only a fraction above an all-time low (and apparently, as at November 2019, are forecast to reduce by 0.25% and possibly to lower than this early next year), borrowers are now in a position where they can, if they wish, clear their loans much more quickly than they were able to previously – say 5 to 7 years as opposed to 10 years. Therefore, one might be tempted to ask "Has there been a better time to buy a business?". The main reasons for the resurgence in prospective buyers entering the business transfer market can be summed up as follows:-

- increased prospective buyer confidence (boosted by very attractive low level interest rates for borrowers)
- a requirement to improve household income (given the lack of wages growth in recent years – only towards the end of 2019 did Average Weekly Pay surpass its August 2007 peak of £513, measured in 2019 prices)
- a need to obtain significantly better returns on savings
- a desire to be one's own boss and be in charge of one's destiny
- a need for change in peoples' lives

and, quite simply, and very importantly

- a vast improvement in the availability of funds to enable people to finance business acquisitions. Yes, the banks are 'open for business'.

Not all banks, and certainly not just the better known high street banks, are as 'open for business' as others on the lending front and borrowers certainly need to shop around. It certainly pays to know what the lending market has to offer because some banks (and building societies) are more interested in lending against certain business types and in particular circumstances than others. As always, it's 'horses for courses'.

A mixture of Government backed lending schemes and individual lender initiatives has led to a complete change in the landscape as far as the availability of funds is concerned for the purchase of businesses in the SME sector and it is not uncommon for acquisitions to consist of a financial package that might include a combination of Asset Finance, Invoice Discounting, Government's Enterprise Finance Guarantee Scheme as well as a conventional secured long term loan against a freehold asset. Banks are once again becoming more pro-active and competitive in their approach to commercial lending (and about time I hear you say) and funds are now much more widely available. Deals are being arranged with many at around 3% over Bank Base Rate (BBR) and some with no arrangement fees applying! Lenders are increasingly looking to members of the National Association for Commercial Finance Brokers (NACFB) for good quality introductions. One such brokerage – Mendip Business Finance (where we have been recommending Graham Jones for the past 5 years) – has recently produced the following newsletter which encapsulates some of what we are now experiencing :-

Latest News on Business Funding

As we head into the next decade the lessons learned from the financial crisis and precautionary measures taken have changed the landscape. Appetite for new lending by High Street Banks can best be described as variable and sourcing the lender that best suits your business can be a difficult process without up to date knowledge of which sectors are currently in or out of favour. That does not mean to say that any given business is regarded as a higher risk, it can simply be down to that particular Bank becoming overly exposed on its lending book to one type of business. To remedy this "imbalance" the Bank may consequently apply a more stringent lending policy by requiring a larger deposit and/or reduce the number of repayment years. By contrast there are "specialist" lenders out there who only operate in very few business sectors where they are most comfortable and can draw from many years' experience.

That said, our experience as Brokers is that lenders are increasingly keen to do business with us and have set up local networks of New Business Development Managers recognising that we add significant value to new cases by assembling every last bit of information required from the very outset and move the process forward far quicker than individuals can achieve on their own.

For these reasons it now makes sense, more than ever before, to engage with a Commercial Finance Broker who will guide you through this financial maze and find the right match for you.

***Mendip Business Finance** has specialist knowledge in raising finance under the Government's "Enterprise Finance Guarantee Scheme" which provides participating lenders with the comfort of security when this is the missing ingredient in an otherwise acceptable proposition. Talk to us or e-mail for more information.*

Certain fundamentals never change, this includes a thorough understanding of the lenders borrowing criteria and the need to pay careful attention to providing them with a well thought out and fully documented proposal including a business plan and financial projections both of which we help to prepare. "Getting it right first time" is a key element in gaining the confidence of any commercial lender from the very outset as this clearly presents the applicant in the best possible light.

*Graham Jones ACIB CeMAP of **Mendip Business Finance** has decades of experience working closely with lenders, accountants, solicitors and business transfer agents and has consequently built up an enviable reputation within the finance sector. Before becoming a commercial finance broker he worked in the banking sector as a professionally qualified senior business manager dealing directly with a wide cross section of business owners on a daily basis. If you are considering a business purchase then you would be well advised to consult a professional first so that you are fully in the picture. Simply call or e-mail Graham Jones for a free consultation.*

If you want to investigate just how much you could borrow (and how much this will cost) to help you to purchase a business, give Graham Jones at Mendip Business Finance a call on 01761 241144.

Meanwhile, mergers and acquisitions are also expected to be a major feature during 2020 (despite upheaval in global markets and the continuing, but now somewhat lesser uncertainty surrounding Brexit) as risk appetite among leading companies reaches a 12 year high! In addition, recent research from such as the manufacturers' organisation EEF and small business bank Aldermore suggest a vast improvement in confidence compared with previous years, with firms anticipating a further increase in exports to emerging markets. In fact, the manufacturing sector is expected to continue to expand in 2020 at a rate which will maintain U.K. producers' position as being among the fastest growing in Europe. Even more important, from a UK economy perspective, the dominant services sector (which accounts for circa 80% of total UK economic output) has now re-emerged as the driving force for growth.

Consequently, small businesses and medium size and large companies right across the board as well as individuals, including prospective buyers, are now feeling slightly more confident and ready to embrace future prospects and opportunities and so are likely to take appropriate action during the year ahead. The knock-on effect of all this activity should prove significant indeed.

With increasing numbers of people now buying businesses and with this trend looking set to continue throughout 2020, possibly the only thing which can slow the pace is the availability of quality businesses for them to buy! However, this should not be a problem given the multitude of business owners who have delayed offering their businesses for sale during what they perceived to be relatively poor market conditions (mainly due to the economic stagnation the U.K. has suffered since the result of the EU Referendum was announced), as they have since started to take the plunge. So, perhaps everyone is agreed – it's time for us all to come out from hiding and get on with things!