Planning for Your Inevitable Business Exit

BY CRAIG O. ALLSOPP

There's been a lot of buzz lately about Baby Boomer business owners and the realization that one day people in their 50s will be cashing out and selling or transferring their ownership interests.

In fact, one recent report by a well-known consulting company concluded that 71 percent of the owners of small and mid-size businesses ($1 million in sales to $50 million in sales) are planning on leaving their companies in the next 10 years.

Whether that proves true or not is anyone's guess, but there is no doubt that demographics, a ticking clock and the law of supply and demand can easily create a "perfect storm" in the small to mid-size mergers and acquisitions market. In other words, a buyers' market with lots of companies available at lower valuations.

So how can an owner - who has spent a lifetime building up his or her business - avoid getting swamped by this potential tsunami?

For starters, experts say, you can gain more control by working with your advisors on a comprehensive Exit Plan that is tailored to your personal financial goals and lifestyle objectives. But while it may be good for you - like exercise - very few business owners really do it.

"Most owners spend more time planning a family vacation than they do planning the exit from their business," says Richard Jackim, a middle market investment banker who has written a book on the subject.

Simply put, an Exit Plan is a financial plan on steroids. It merges business planning, tax planning, estate planning, succession planning and investment planning to create a roadmap for a business owner to follow. The perfect time to start (exit planning) is three-to-five years before an exit event with an owner starting to focus on the following questions.

- When do you want to leave your business?
- How much income do you need to achieve your financial goals?
- Who do you want to take over the business?
- How much is the business worth?
- Are you taking steps to increase business value?
- Is there a continuity plan in place in case disaster strikes?
- Do you have advisors who understand the business sale/transfer process?

Three Exit Planning Options

John Brown, a former business lawyer whose new book is titled "Cash Out Move On," says there are three fundamental ways to exit a business. You can give it to your children. You can sell it to your key employees, or you can sell to or merge with a third-party. There are advantages and disadvantages to each exit option.

Transfer of Ownership to your Children -

If you are a typical business owner, there is a 50 percent chance that you want to realize the American Dream and transfer the business to your children. But there is a substantial possibility that you will end up transferring the business to someone else because of the difficulties associated with this type of transition.

Advantages

- Fulfills personal goals of keeping the business and family together.
- Allows you as the owner to control your departure date.
- Enables you to fix value rather than being told by an outside third-party how much they think the business is worth.

Disadvantages

- Potential family friction, discord and the feeling of unequal treatment among siblings.

Craig O. Allsopp is the co-founder of SEA and a Certified Business Intermediary. He is a former publishing company executive and CEO whose transaction experience includes licensing, joint ventures, debt and equity financings and M&A transactions. Craig is a member of the Business Enterprise Institute and frequently speaks and writes about business ownership and M&A strategies. He earned his Masters Degree at Pennsylvania State University. He can be reached at 802-332-6261 or coallsopp@seadvisorsllc.com

- You become banker of last resort, meaning that reaching your financial goals may be difficult without careful planning.
- You bear the risk - because of family ties - of transferring the business to someone who may literally run it into the ground.

Sale to Other Owners or Employees -

One of the great advantages of having other owners in your business is that they can be your means for retirement. This is especially true with smaller businesses - under $3 million in value - where the financial burden on the buyer is not as great.

Advantages

- You can structure the deal ahead of time to suit your specific needs and objectives.
- With proper planning, it is possible to cash out fully when you sell the controlling interest.
- You maintain a greater measure of control during the buyout.
- The buyer(s) is "pre-qualified" through on-the-job training.
- An internal sale preserves the "culture" of the business and protects employees who've helped build it.

Disadvantages

- You receive little or cash up front, thus you have greater risk as the buyout money comes from the future earnings of the business.
- If the business is worth more than $3 million, the employees may not be able to afford it.
- Employees may not have your entrepreneurial "mindset" and may find it difficult to meet the challenges of ownership.

Sale to a Third Party -

The private market suggests that about 20 percent - or two million - businesses are for sale at any given time. But in reality show only one in four of those companies under $5 million in sales ever sell. There are many reasons why ranging from unrealistic owner expectations to due diligence problems but even with a low closing rate about 350,000 owners cash out at some level each year.

Advantages

- If the business is properly prepared for sale, you can receive most - and sometimes all - of your payout in immediate cash.
- A sale makes it easier for you to treat your children equally without having to worry about who is going to run the business after you leave.
- If you are in a "hot" market you can receive substantially more cash than your CPA or valuation specialist anticipated.

> **"Most owners spend more time planning a family vacation than they do planning the exit from their business," says Richard Jackim, a middle market investment banker who has written a book on the subject.**

Disadvantages

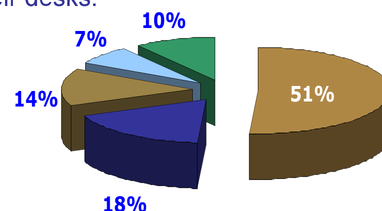
- The personality and culture of your business will change. You no longer have control.
- If you do not receive the bulk of the purchase price in cash, you will have carried investment risk. This can be good or bad depending on who you sell to and the growth prospects for your company.

Summing up, with proper planning, and an exit planning team that includes your transaction intermediary, your business lawyer, your accountant, your banker and your investment advisor, you can decide which exit path is best to maximize value and minimize risk. So in the words of John Brown, "you can leave your business in style." ■

Craig O. Allsopp is founding partner of Strategic Exit Advisors. For more information go to www.seadvisorsllc.com.

Business Owners' Dilemma

- Baby boomer owners are starting to retire.
  - 51% anticipate a sale to a third party.
  - 18% anticipate a transfer to the next generation.
  - 14% anticipate a management buyout.
  - 7% expect to sell to an ESOP.
  - 10% anticipate an IPO or will die at their desks.



Less than 25% have done any exit planning -
U.S. Small Business Administration

sea
strategic exit advisors, LLC
November 2007