



Exit gracefully — and prosperously *Cashing out at top dollar*

One way or another, every business will eventually sell or transfer hands. A formal plan covering all likely transfer scenarios — whether voluntary or involuntary — is essential to ensure smooth transfer.

Expect the unexpected

A well-planned exit strategy can help owners extract cash from their businesses, addressing a variety of transfer scenarios. These may include voluntary transfers such as retirement, gifts to family members, donations to charities, stock compensation plans for managers, or mergers or acquisitions. They may also include involuntary transfers such as death or disability, divorce, partner/shareholder disputes, bankruptcy or restructuring, or natural disaster.

Overworked owners tend to overlook the possibility of unexpected events. But operating a business without a contingency plan is like driving blindfolded: Things are fine as long as the road is straight and predictable. But when conditions change, the owner often runs into trouble.

Take the first step

The optimal exit strategy depends not only on the transfer scenario, but also on the owner's personal needs and objectives. Exit planning starts with some number crunching and soul searching.

Beyond the numbers, what else does an owner hope to achieve when he or she leaves the company? When prioritizing goals, it's important to be realistic. Many owners dream of having their children run the show after they leave. But in reality, their children may be incapable of managing the company — or uninterested in taking over the reins.

Weigh alternatives

Once goals are set, it's time to evaluate which alternatives meet the owner's short- and long-term needs. Some of the most common exit strategies for private businesses are:

Buy-sell agreements. When several individuals share ownership, a buy-sell agreement can provide liquidity upon retirement or an unexpected “triggering” event. In some cases, the company repurchases the departing owner's shares. In other cases, the remaining shareholders pitch in. Shareholder life and disability insurance policies can help fund company buybacks.

Comprehensive buy-sell agreements cover a broad array of triggering events — from death to imprisonment — and address valuation issues, such as valuation formulas, payment of appraisal fees, applicable valuation discounts and buyout terms.

Gifts and inheritances. For owners seeking to transfer ownership to relatives or a worthy charity, gifting interests in the business fits the bill. Proactive gifting schedules that span several years can dramatically reduce transfer taxes.

For instance, by transferring business interests to a family limited partnership (FLP), an entrepreneur can gift limited partner units to heirs at significant discounts from net asset value. FLPs also permit the donor — as a general partner — to retain control of the business.

Related-party sales. Rather than give away shares of the business, some business owners need cash and opt to sell the business. Numerous sale options exist. For instance, employee stock ownership plans (ESOPs) generate liquidity for the exiting owner while providing employees with a rare investment opportunity. Other potential buyers include suppliers, customers and competitors. They possess not only the requisite industry acumen to run the business, but also unique synergies that may warrant a premium price.

Mergers and acquisitions with unrelated buyers. Informed owners who can adapt to creative sales terms — including installment sales, seller financing and consulting contracts — often receive more than the asking price.

Public offerings. Public stock exchanges offer a means of raising capital and achieving liquidity. Going public also provides prestige and publicity. The downsides — steep registration fees and stringent reporting requirements — preclude small and midsize businesses from considering this option, however.

Clean up shop

Potential buyers will pay a premium for a business in “move-in” condition. Owners who continually position the company for sale maximize proceeds and expedite closing. Thus, preparing a business for sale is a matter of acknowledging weaknesses and emphasizing strengths. Three areas to target during a cleanup include:

- 1. Administrative chores.** Buyers don't want to inherit an owner's problems, including fraud risks. Owners should implement a strong system of internal controls that includes mandatory vacations, as well as job separation and duplication.

To ease transition to new management, owners should formally document job descriptions and update the organizational chart. It's also important to train and retain second-generation managers.

- 2. Finances.** Transparent financial reporting facilitates efficient business transfers. Buyers are often turned off by the need to recast income statements to eliminate aggressive tax deductions, nonrecurring income or personal expenses run through the business. Prepared sellers bring business plans and financial forecasts to the negotiation table.

Most buyers consider nonoperating assets a hassle — especially for C corporations. Before negotiating a sale, an owner should remove extraneous assets, such as idle equipment, vacation homes or investments, from the balance sheet.

- 3. Performance.** Buyers prefer a business that's running efficiently and effectively. Too often, owners become complacent after years of operating the business. To maximize proceeds, an owner should continually pursue growth opportunities and reinvest in equipment, technology, and research and development.

Start today

For most entrepreneurs, their companies represent the bulk of their personal wealth. Unlike pensions or retirement accounts, private business interests take significant time and effort to sell.

Most owners think about retirement and contingency planning, but few put their thoughts down in writing or distribute them through the appropriate channels. In the high-stakes game of exit planning, there's no time like the present.

Sidebar: Get professional help

Valuation professionals can estimate preliminary business values. This estimate is the cornerstone of any exit strategy. In addition, appraisers can quantify financial needs upon retirement, disability or untimely death. They can also discuss insurance options to fund estate tax obligations or company buyouts.

Valuators also come in handy when weighing exit strategy alternatives. They can appraise assets for gift and estate tax returns, provide insight into buy-sell provisions, evaluate the tax consequences of various exit strategies, consult on mergers and acquisitions, or prepare fairness opinions for high-profile transactions.